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Economics Guide

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Galaxy



Featured Book Review

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Things Aren't Quite What They Seem

How to Think and Explore the World Like a Renegade Economist

by Chris Lauer

Exploring the interconnected nature of reality through hard data might offer many surprises, but real stories about real people give us solid points to ponder about ourselves. Combining these two methods of observation — data and stories — into a single view of our lives answers numerous questions while providing us with a better perspective on our world and helping us understand what we see when we open our eyes a little wider.

Freakonomics helps us unearth the subtle facts that converge to create larger concepts, events and phenomena in our lives, as well as the personal stories that create them. It also shows us how we can use the tools of the economist, such as “regression analysis” and the LexisNexis database, to shape these elements into a more coherent perspective on the society in which we live.

Discovering the Details

In *Freakonomics*, renowned economist Steven D. Levitt and journalist Stephen J. Dubner ask many valid questions about the world around us, and go about “stripping a layer or two from the surface of modern life and seeing what is happening underneath.” As an economist who finds great pleasure in discovering the details that have been missed by others, Levitt seeks out the answers found in the data, as well as the patterns in that data, which can only be revealed when the proper questions are asked (outside of the realm of moral posturing and conventional wisdom).

For example, why did the average price paid for term life insurance fall dramatically in the late 1990s? The authors point out that the Internet allowed customers to instantaneously find the cheapest policy, saving them \$1 billion per year. What did

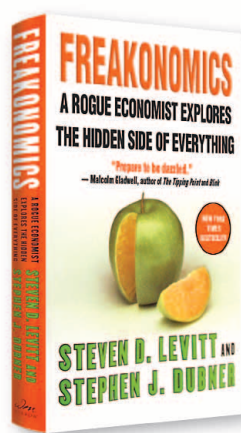
crack cocaine have in common with nylon stockings? They explain that both things made a previously expensive product available to the masses. How much do parents really matter? The authors conclude that parents matter a great deal in some ways, and not at all in others, and provide the specific details and studies that help us understand many of those ways.

The authors explain that *Freakonomics* is based on the following five fundamentals:

1. Incentives form the cornerstone of modern life.
2. Conventional wisdom is usually faulty.
3. Dramatic effects can often be traced to distant, subtle causes.
4. The people who call themselves experts use the advantage of their information to serve their own personal interests.
5. We can reduce the complexity of our world by understanding what we should measure and how we can measure it.

Freakonomics has become a runaway bestseller due to many factors. On a superficial level, *Freakonomics* is the most compelling name a book on economics has ever had. The word *freak*

added to the word *economics* is a clever play on words — an enticing moniker that is both fun to repeat and instantly recognizable as a concept worthy of closer inspection. To further the intrigue, the book also bears an appealing graphic of an apple that upon deeper inspection reveals the pulpy interior of an orange under its green, shiny skin — a perfect image to represent the secret worlds lurking beneath the book's surface. This one-two combo punch of title and graphic makes it the best-looking business tome



FREAKONOMICS
by Steven D. Levitt
and Stephen J. Dubner

Published by
William Morrow.
Copyright © 2005,
242 pages, \$25.95.

“Moving up to the next level of storytelling and comprehension, the book expands the nitty-gritty details that help us comprehend more than the story of an economist on the cutting edge: We get facts and concepts that can help us live our lives, as well as understand more about the systems surrounding us.”

to hit the bookstores in years, perhaps ever. The bright orange spine and title also scream out for additional attention.

A Simple Guideline

But the inside of *Freakonomics* is what keeps the book at or near the top of many bestseller lists. Although it offers none of the usual seven strategies, five steps, six ways, and 10 things that often grace the pages of the usual business book, it does provide a simple guideline that blazes a trail through its contents. This unifying element unleashes its intent, and guides readers into its conclusions that are strong enough to invite reflection long after the book has been shelved. That guideline is made up of short excerpts from a magazine article that was written long before *Freakonomics* was a book.

Initially, journalist Stephen J. Dubner, wrote an extensive piece about the brilliant young economist Steven D. Levitt in the Aug. 3, 2003, edition of *The New York Times Magazine*. Dubner detailed the controversies surrounding Levitt's work as an economist who is willing to put himself on the front lines of political debate. At the time, Levitt and a colleague were turning heads by questioning the connection between the *Roe v. Wade* abortion decision and the recent decline in the nation's crime rate. Dubner also painted a personal profile of the economist that colored him as a lovable, absent-minded professor whose nerdy style, youth, and unique take on the world of economics set him apart from his contemporaries.

Conventional Wisdom Meets Statistical Analysis

Each chapter in *Freakonomics* begins with a snippet from that fateful piece in *The New York Times Magazine*. These excerpts provide a starting point from which the stories within the book take shape. Not only do we see the glossy prose of a masterful journalist turn the obsessions of a young economist into subject matter that is relevant to the average person, but we also get the deeper

inside scoop that was left out of the original article due to space restrictions.

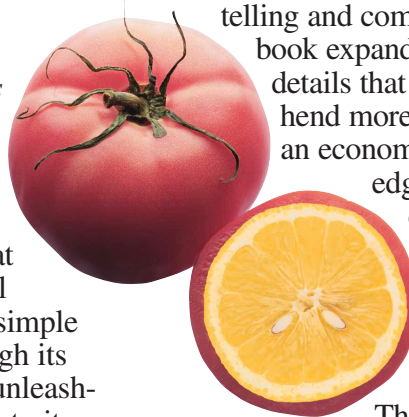
Moving up to the next level of storytelling and comprehension, the book expands the nitty-gritty details that help us comprehend more than the story of an economist on the cutting edge: We get facts and concepts that can help us live our lives, as well as understand more about the systems surrounding us.

These details are not just trivia for entertainment's sake. Thanks to Levitt's masterful ability to crunch the numbers past conventional wisdom down to a foundation of statistical facts, we learn that swimming pools are far more dangerous to children than the guns in their homes, that the management infrastructure of some crack-dealing gangs often resembles that of McDonald's, and that an honor system for buying bagels works at least 87 percent of the time.

Controversy

Many of the points made in *Freakonomics* are controversial. These include claims that many sumo wrestlers cheat, the elderly and Hispanics are consistently discriminated against on *The Weakest Link* game show, and commissions motivate real-estate agents to sell homes at lower, not higher, prices. But Levitt's controversial conclusion that legalized abortion has had a dramatic effect on reducing crime in the United States (and elsewhere) made national headlines when former Secretary of Education Bill Bennett said on his Sept. 28, 2005, "Morning in America" radio show: "It's true that if you wanted to reduce crime ... you could abort every black baby in this country, and your crime rate would go down." The comments ignited a media firestorm of condemnation and defense. Bennett explained that he was simply extrapolating an idea that was written in *Freakonomics*.

But on the authors' Web log two days



later, Levitt took issue with Bennett's twist on his work. Levitt writes that he and John Donohue, the co-writer on their academic paper that brought to light the abortion-crime connection, did not focus on race in their work. Levitt writes, "I mean it when I say that, from a purely fact-based and statistical perspective, race is not in any way central to our arguments about abortion and crime."

Freakonomics is a book that offers more than advice and tips: It provides deeper understanding of many professions and fundamental concepts by challenging faulty conventional wisdom at every turn. The people who can benefit from its statistical analysis include parents who may be doing too little or too much for their children, social activists looking for an edge, anyone interested in education reform, schoolteachers who want to learn how their cheating colleagues get caught, and fans of inner-city crime dramas who want to learn how real gangsters make their money. *Freakonomics* offers all readers the hidden facts buried within the stories they live and see dramatized every day, along with the numbers and statistics that can help them draw sense from the chaos.

Klansmen and Real-Estate Agents

For inquisitive people in the habit of asking random questions, Levitt is a mentor. He has asked some of the most outlandish questions ever conceived and found illumination in their answers. For example, when Levitt poses the question, "How is the Ku Klux Klan like a group of real-estate agents?" he isn't just throwing two concepts together to see how they clash. He is actually drawing the reader deep into the economist's world of hidden incentives and the power of exclusive information. By deciphering the codes used by both Ku Klux Klansmen and real-estate agents, the authors demonstrate how the right information in the right minds can both enlighten and empower.

At the onset of World War II, anti-bigotry activist Stetson Kennedy decoded the language of the Ku Klux Klan and helped to get its code words

inserted into the *Adventures of Superman* radio show. This converted the Klan's private communications into ammunition for mockery. By portraying Klansmen as Superman's foes who used a silly coded language to communicate with each other, Kennedy demystified the Klan's real secret code when it was broadcast to millions of listeners nationwide. The authors explain that removing the Klan's informational advantage reduced its ability to gather new members, deflating its power. Similarly, the authors offer readers the code words that real-estate agents use to sell their own homes, uncovering and sharing the information asymmetry they use to their own advantage.

Perfect Parents

In a compelling chapter called, "What Makes a Perfect Parent?" the authors delve into the connections between a child's personal circumstances and his or her performance at school, as well as our perceptions of those connections. Breaking down the data from a study undertaken by the U.S. Department of Education called the Early Childhood Longitudinal Study (ECLS), which measured the academic progress of more than 20,000 grammar-school children from across the country, Levitt uses the economist's tools to find out more about the art of parenting.

Levitt found eight factors that showed a strong correlation with the students' test scores, and eight factors that had no correlation. The factors that did affect test scores were no surprise, including the fact that the child has highly educated parents, the child's parents have high socioeconomic status, the child has many books at home, and the child's parents are involved in the PTA. But the eight factors that had no correlation to the children's test scores were the biggest surprises of all.

According to Levitt's analysis of the

"Freakonomics offers all readers the hidden facts buried within the stories they live and see dramatized every day, along with the numbers and statistics that can help them draw sense from the chaos."



ECLS data, the fact that a child's family is intact had no correlation with his or her test scores. It also did not matter that the child's parents recently moved to a better neighborhood, nor did it matter if the child's mother did not work between the child's birth and kindergarten. Even more surprising, Levitt found that regularly taking your child to museums and reading to him or her nearly every day also had no effect on test scores. Likewise, frequently watching television had no negative effect on the child's test scores. What can parents learn from Levitt's insights? Basically, the conventional wisdom about the detrimental results of watching television is wrong. And, despite the best of intentions, the cultural cramming performed by doting parents will not bring up their child's test scores. Levitt explains that parents who are successful, well-educated and healthy usually have children who test well in school, but most child-rearing techniques are highly overrated.

The Heart of the Matter

Although *Freakonomics* has no traditional narrative running from beginning to end, it leaves readers with the overall feeling that they have stumbled on a treasure-trove of many concepts and facts that were once beyond their grasp. By justifying the use of strange questions to get at the heart of the matter, the authors expand their readers' minds by showing them how economists turn collections of facts into unusual theories, and then prove them by subjecting them to critical analysis. The authors admit that their book has no "unifying theme," but it does have a unifying element: the thought patterns of its economist protagonist, Steven Levitt. With Stephen Dubner's empathetic portrayal of Levitt's personal quirks (unfashionable eyewear, unkempt hair, etc.) and personal tragedy (the sudden loss of a young son), we can easily put ourselves in his shoes as a human, and just as easily find ourselves in his inquisitive, truth-seeking head. ■

Chris Lauer is senior editor for Soundview. He can be reached at clauer@summary.com.

Inside the Bestsellers: What Makes *Freakonomics* So Special?

Ever since its release on May 1, 2005, *Freakonomics* has been making waves on the nonfiction hardcover bestseller lists of the *New York Times*, Amazon, *Publisher's Weekly*, *BusinessWeek*, and many other media outlets. Although great books weave in and out of our perceptions on a daily basis, the unique books that make it to the bestseller charts are a privileged few.

About 200,000 books were published in 2005. Of those books, only a tiny percentage (about 0.2 percent) made it to the bestseller lists. According to Daisy Maryles from *Publisher's Weekly*, only 442 new adult trade titles made it onto *PW's* four weekly lists last year. In addition, she explains, 45 percent of those stayed on a list for less than one month.

Statistics such as these demonstrate the relevance of *Freakonomics's* success. Maryles points out that the combined stays of Malcolm Gladwell's *Blink*, Thomas L. Friedman's *The World Is Flat*, and *Freakonomics* on the 2005 charts took up almost 15 percent of the available weekly nonfiction hardcover positions on the bestseller charts: a distinguished reign indeed.

Freakonomics spent 35 weeks on *Publisher's Weekly's* hardcover nonfiction bestseller list, the fifth most popular book of the year on that list, topped only by two books that had a head start by being released before 2005. The only other 2005 books that stayed on the hardcover nonfiction bestseller list for a longer period of time are *Blink* and *The World Is Flat*, which were both published before *Freakonomics*.

The co-author: Steven D. Levitt teaches economics at the University of Chicago. He recently received the John Bates Clark Medal, awarded every two years to the best American economist under the age of 40.

The co-author: Stephen J. Dubner lives in New York City. He writes for the *New York Times* and *The New Yorker*, and is the national bestselling author of *Turbulent Souls* and *Confessions of a Hero-Worshiper*.

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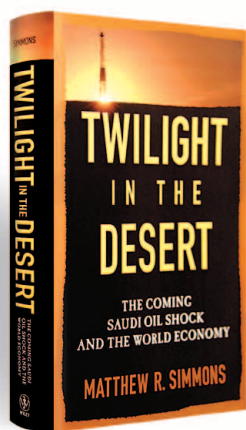
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FILE: ECONOMICS



By Matthew R. Simmons

The Coming Saudi Oil Shock and the World Economy

TWILIGHT IN THE DESERT

THE SUMMARY IN BRIEF

Saudi Arabia is the most important oil-producing nation in history. The secretive Saudi government repeatedly assures the world that its oilfields are healthy beyond reproach and that they can maintain and even increase output at will to meet skyrocketing global demand.

But what if they can't?

This summary looks behind the curtain to reveal a Saudi oil and production industry that could soon approach a serious, irreversible decline. Veteran oil industry analyst Matthew Simmons draws on his 30 years of insider experience and more than 200 independently produced reports about Saudi petroleum resources and production operations. What he uncovers is a story about Saudi Arabia's troubled oil industry, not to mention its political and societal instability, that differs sharply from the globally accepted Saudi version.

It's a story that is provocative and disturbing, based on undeniable facts, but until now never told in its entirety. This summary examines numerous aspects of Saudi Arabia and its looming oil crisis. It also reveals the history of other major oilfields to determine that Saudi Arabia is, in fact, overproducing its primary resources and couldn't possibly ramp up production for long.

How long can critical Saudi Arabian oil pipelines be kept open? This summary addresses the information needed to answer that question with keen examination into Saudi Arabia's plentiful, low-cost oil resource.

In addition, this summary will show you:

- ✓ *The truth behind the 70-year history of modern Saudi Arabia.*
- ✓ *Why the geological phenomena that created Saudi oil invincibility now threaten to bring it to an end, far sooner than the world has been led to believe.*
- ✓ *A field-by-field assessment of 12 key Saudi oil fields, and how verified shortfalls in their production and potential stand sharply at odds with unverifiable Saudi rhetoric.*
- ✓ *How Saudi Arabia's Aramco invokes "fuzzy logic" to manage the future of Saudi oil.*

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TWILIGHT IN THE DESERT

by Matthew R. Simmons

— THE COMPLETE SUMMARY

PART ONE: FROM BEDOUIN TO BOURGEOISIE

The Birth of a Nation

Of all the many nations that emerged during the 20th century, none moved so rapidly from obscurity to glaring prominence as Saudi Arabia. Dominated by the Ottoman Turks and warring tribal chiefs in the 1890s, the Arabian Peninsula was in political disarray, and the Saud family, traditional rulers of the area around Riyadh from the mid-1400s, was in exile in Kuwait.

The present nation came into being only in 1932, when Abdul Aziz ibn Saud proclaimed the kingdom of Saudi Arabia after reclaiming the traditional family homeland and battling rival tribes for 25 years to gain control of most of the peninsula. He ruled a largely rural people who followed centuries-old traditional ways as farmers and nomadic herders.

The Saudi Arabian Oil Industry

Saudi Arabia has always been an extremely reliable proprietor of the world's most critical oil supply. The kingdom has maintained a very close relationship with the United States, and, as the largest producer in the Organization of Petroleum Exporting Countries (OPEC), has worked to maintain fair oil prices and safe, reliable oil supplies.

What we know about the kingdom's oil is what Saudi Aramco (the kingdom's wholly owned integrated oil company), the Petroleum Ministry and the royal family want us to know. The "known facts" are few and simple. In late 2004, "proven oil reserves" totaled 259.4 billion barrels, plus another 2.5 billion barrels in the Saudi-Kuwait neutral zone. If these numbers are real, Saudi Arabia's oil will last another 90 years at the current production rates of 8 to 9 million barrels per day. ■

The History of Major Saudi Arabian Oil Discoveries

The first significant Middle East oil discovery was made in Iran in 1908, where small amounts of oil had been found in the 1880s. Fires fueled by oil seepages and gas bubbles at the surface in various parts of the Middle East

had been noted for several millennia. The Eternal Fires burning when Nebuchadnezzar was king, as described in the Bible, were no doubt fueled by petroleum.

The first oilfield of great size found on the Arabian Shield was Iraq's Kirkuk, discovered in 1927 near the Eternal Fires of King Nebuchadnezzar's time. The Kirkuk discovery kicked off an aggressive search for oil throughout the Middle East for almost five decades, accounting for 50 to 70 percent of Iraq's oil production for most of that time.

Prospecting for Oil

The first discussions about prospecting for oil in Saudi Arabia took place in 1923 when a New Zealander, Major Frank Holmes, visited King Abdul Aziz and insisted that there had to be oil on the Arabian Peninsula. He came to the Middle East as a quartermaster in the British army in World War I. He heard occasional rumors of oil seepages in the Persian Gulf, and after the war he established various syndicates to find oil in the region.

Holmes not only obtained the first oil concession in Saudi Arabia's Eastern Province, he also secured the concession in the area of Kuwait where the super-giant Burgan oilfield was ultimately found. Holmes continu-

(continued on page 3)

The author: Matthew R. Simmons is chairman and CEO of Simmons & Company International, a Houston-based investment bank that specializes in the energy industry. Simmons serves on the boards of Brown-Forman Corp. and The Atlantic Council of the United States. He is also a member of the National Petroleum Council and the Council on Foreign Relations. He has an MBA from Harvard University.

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The History of Major Saudi Arabian Oil Discoveries

(continued from page 2)

ously borrowed money from Abdul Aziz, whose coffers were meager at best.

On May 29, 1933, Standard Oil of California (SOCAL) and the Kingdom of Saudi Arabia signed a seemingly unremarkable oil concession. This 1933 concession gave SOCAL the exclusive rights to prospect for and produce oil in the entire Eastern Province. The 1933 decision of Saudi Arabia and SOCAL to sign the concession forever changed the nature of the kingdom that Abdul Aziz founded. This planted the seed that grew to create the most important oil producer on earth.

Further Discoveries and Production Growth

On March 3, 1938, after six wells were drilled with discouraging results, the seventh oil well drilled on the Damman Dome blew out and was producing almost 1,600 barrels per day. Within a few more days, the well was producing close to 4,000 barrels a day.

As SOCAL geared up its Saudi Arabian oil campaign, it soon brought in Texaco as a partner to help fund the expensive Damman drilling and also to gain Texaco's marketing facilities for the crude oil they hoped to discover. The name of the operating company was changed from California Arabian Standard Oil Co. (CASCO) to Arabian American Oil Company, or Aramco, in January 1944.

For almost 60 years, Saudi Arabia's "Big Seven" oilfields (Ghawar, Safaniya, Abqaiq, Berri, Marjan, Zuluf and Abu Sa'fah) produced almost all of the enormous volume of oil that made Saudi Arabia so important to global supply. And in reality, a high percentage of this oil production came from just the five largest, with the two largest, Ghawar and Safaniya, producing 75 percent of all Saudi Arabia's oil. These fields allowed the kingdom to become one of the three largest producers in the world by 1970, ranking just behind the USSR at its peak and the United States, which gleaned its oil production from some 500,000 individual oil wells. ■

Saudi Arabia's Road to Oil Market Dominance

During the golden age of oil discovery in Saudi Arabia — 1941 through 1965 — the kingdom's oil production was still limited. Relative to the oil production of the United States, Saudi Arabian output was incidental. This situation was not destined to last, however.

Global oil demand was experiencing its greatest

growth ever seen as the 1970s began. In 1960, global oil demand was only 20 million barrels a day. Ten years later, global demand was approaching 50 million barrels a day.

Saudi Arabia Replaces the United States as King of Oil

In the 1970s, Saudi oil production soared as U.S. oil production dropped. The decline of U.S. oil production enabled Saudi Arabia to take advantage of its resource potential. With its oil output soaring and prices rising, Saudi Arabia enjoyed a revenue windfall.

The money that Saudi Arabia generated from this surging oil production was as astonishing as the rise in the volume of oil it produced, even though oil prices at the start of the 1970s were still only \$1 to \$2 a barrel. Since the population of Saudi Arabia was still small, the kingdom became a font of enormous wealth virtually overnight.

Damaging Effects of Overproducing Oilfields

The history of the petroleum industry is rife with examples of how easy it has been to accidentally overproduce an oilfield. Overproducing brings on rapid gas cap formation and premature water encroachment. Overproduction leaves far more oil in the ground upon depletion than steady production at lower rates. Experienced petroleum geologists and petroleum engineers will attest that overproducing is a real risk to any oilfield, regardless of its size.

Saudi Arabia, through its long-standing desire to be a responsible and reliable provider of oil, probably inadvertently caused long-term, if not irreparable, damage to its great reservoirs by trying to keep pace with soaring global demand. It was a noble undertaking to become the world's swing oil producer; but this title role, despite its prestige, was achieved only at a steep, long-term cost to the sustainability of its Big Five fields.

By the late 1990s, almost all OPEC producers, other than Saudi Arabia, were starting to bump against their peak sustainable production rates. Oil production in every Middle East OPEC country was still coming from only a handful of giant oilfields. Few fields of any significant size had been discovered in the entire Middle East in the preceding three decades.

As the 21st century began, the bulk of OPEC's oil production still came from a small number of slowly aging mature fields. But these great fields had produced so much oil for so long that even the current Aramco managers began to assume their prolific output might be immune to the normal aging problems affecting all other oilfields. ■

The Veil of Secrecy Over Saudi Reserves and Production

By the mid-1970s, Saudi Arabia's giant and super-giant oilfields were already showing the first signs of normal aging and, perhaps, of damage caused by raising production so rapidly in response to soaring world demand. But Saudi Aramco continued to increase its oil output as needed in response to either increasing demand or shortages caused by one crisis or another. Ironically, in trying to meet its responsibilities as a swing producer, Saudi Arabia probably violated the principles of good stewardship of its great oilfields.

In other respects, it is clear that Saudi Arabia abrogated certain responsibilities, although it was by no means the only important oil producer to do so. By veiling its oil operations in secrecy and refusing to provide credi-

ble data to support its claims about reserves, production rates and costs, Saudi Arabia served its customers, the consuming nations, poorly. Energy planners the world over were forced to base their calculations on assumptions rather than verifiable information, a circumstance that has undoubtedly had harmful consequences for all energy stakeholders, producers and consumers alike. This secrecy concealed the true condition and extent of aging of Saudi Arabia's principal fields.

As Saudi Arabia's oilfields aged, the multitude of problems grew. Saudi oil operations in 2005 are far more complex, sophisticated and costly than they were prior to the mid-1970s. Thus, the kingdom entered the 21st century and the 72nd year of its national history with issues of several sorts — technical, economic and political — that may interrupt or reduce its oil exports. These issues have no obvious positive resolutions. ■

PART TWO: THE EBBING OF THE SAUDI OIL BOUNTY

Saudi Aramco

Virtually all of Saudi Arabia's oil and gas is under the control of the kingdom's wholly owned integrated oil company, Saudi Aramco, one of the world's most sophisticated petroleum organizations. Aramco produces more oil each day than any oil-producing country, and twice as much oil as the next largest individual oil corporation in the world. Aramco is now one of the most active and adept users of state-of-the-art oilfield technology.

The history of oil exploration in Saudi Arabia has followed a pattern seen in many other key oil basins of the world. This pattern was described by old-timers at the French Petroleum Institute (IFP) as "The King, Queen, and Lords of an oil basin." Based on a lengthy review of all known oilfields, the IFP study revealed that any petroleum basin, regardless of its extent, contains oilfields of various sizes that can be ranked in a predictable hierarchy:

- A King — a field larger than any other in the basin.
- A Queen — one to three fields that range from one-half to one-fifth the size of the King.
- A handful of Earls or Lords — five to 10 fields, all significantly smaller than the Queens.
- A large number of commoners or peasants — small oil and gas fields and reservoirs above and below the royalty formations.

As a general rule, the largest fields in a basin have been discovered and developed first, with the smaller ones coming along later as exploration and production (E&P) work across the entire basin matures. The IFP study concluded that it takes between three and eight years to find a Queen in a previously unexplored hydro-

carbon basin. Only rarely is the King found first. After a handful of years, the King shows up, and it then takes a decade or two to round up all the remaining royalty. ■

Oil Is Not Just Another Commodity

As is evidenced by the data disclosed by the GAO Report in 1978 and the more detailed April 1979 Senate Staff Report, Aramco experts believed that a realistic, albeit possibly conservative, estimate of its total proven oil reserves was 110 billion barrels.

Saudi Arabia raised its proven reserves estimates from the 100-billion-barrel level to more than 150 billion barrels at the end of 1979. The proven reserves then jumped to more than 250 billion barrels in 1988 — in the absence of any large new discoveries. The 250-billion figure then crept steadily upward, despite the fact that Saudi Arabia produced almost 3 billion barrels of oil each year. These reported reserves numbers raise legitimate questions:

- What criteria did Saudi Aramco use to increase the estimate of proven reserves by a factor of 2.5 times in less than a decade?
- What is the source of the estimates' validity?
- How is it possible that proven reserves effectively remained constant for the last 17 years, while Saudi Arabia produced another 46.5 billion barrels of oil?

Despite decades of technical advances, the process of estimating proven reserves still lacks precise accuracy and is subject to errors and significant revisions. The reserves estimation process may also be biased by

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Oil Is Not Just Another Commodity

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financial and career interests or by political concerns. When such imperatives bias the estimation process, the numbers are even less likely to reflect reality.

Keeping Up the Pressure

Saudi Aramco operates one of the world's most complex and extensive water injection systems. This system has one overarching objective — to maintain adequate pressure in the producing reservoirs. Injected water maintains high reservoir pressure by replacing fluids extracted from the reservoir as oil is produced.

The most common water/oil problems happen when the “perforation” — the point where oil actually enters a

producing wellbore — gets too close to the oil/water contact. As an oilfield is produced, the oil/water contact steadily rises as the oil column shrinks. This also leads to wellbores getting too close to the water. Since water generally flows more readily than oil toward the wellbore, it tends to displace oil production.

Corrosion is a further issue that is both a result of the presence of water and a cause for additional water intrusion. In almost all Middle Eastern oilfields that have water drive, corrosion in the water injection systems has become a constant problem. Leaks accidentally release hydrocarbon fluids into zones where they cannot be retrieved. The difficulty of managing these water problems has risen exponentially as the giant Middle Eastern oilfields age. ■

PART THREE: GIANTS AT THE TIPPING POINT

Ghawar, the King of Oilfields

Ghawar is the greatest oil-bearing structure the world has ever known. Its superlative qualities cannot be overstated. It is unlikely that any new oilfield will ever rival its bounteous production.

Technical work launched in the early 1990s — computer modeling, new seismic data gathering and analysis and re-examination of well cores and well logs going back 40 years — revealed a picture of Ghawar that was not pretty.

In a paper delivered at the 2001 Annual Technical Conference in New Orleans, four senior Aramco experts admitted the technical difficulty of properly managing Ghawar's oil drainage and depletion. According to these authors, the best way to manage Ghawar's endgame was still an open question, even though the field had been in

production for 50 years. The paper candidly described how the great field's most productive areas were now extremely mature and showing the common symptoms of their age — declining pressure, increased water production and higher gas fractions, which all play a significant role in the recovery of oil. ■

The Second-Tier Oilfields

When the current production phase ends at Ghawar, it will be virtually impossible to replace its declining output even by aggressively developing a series of much smaller fields already in the kingdom's inventory. Ghawar is the king of Saudi oilfields. There is no “crown prince” waiting to assume the throne. It is the same in an oil basin as it is in chess: Once the king has fallen, the game is over.

If all the lesser giant oilfields were still enjoying prime reservoir conditions, a jolt from Ghawar would not be such a serious event. Unfortunately, the Saudi Aramco teams responsible for maintaining a steady flow of oil from the other great Saudi oilfields (i.e., the “queens” and the “lords”) face the same technical challenges encountered at Ghawar. These problems are typical of the difficulties that affect all mature oilfields. They vary, but the overall list of issues is the same:

- **Falling reservoir pressure**
- **The emergence of a secondary gas gap**
- **Rampant corrosion**
- **Erratic water behavior**
- **Growing water cuts**
- **Lower productivity in the parts of each field remaining to be drilled.** ■

Coming Up Empty in New Exploration

Saudi Arabia achieved a remarkable string of exploration successes from 1940 through 1968. Then the successes dried up. For the next three decades, Saudi Aramco employed the best exploration technologies available anywhere to bulk up its portfolio of world-class oilfields. Unlike exploration in many other regions, however, Saudi Arabia's efforts produced only very meager payoffs.

Unless some great series of exploration miracles occurs soon, the only certainty about Saudi Arabia's oil future is that once its five or six great oilfields go into steep decline, there is nothing remotely resembling them to take their place.

The Best of the Rest

The half-century of miraculous oil production in Saudi Arabia has been anchored by the largest oilfield the world has ever known, Ghawar. This field is supported strongly by three other super-giant fields: Safaniya, Abqaiq and Berri. In 1979, when Saudi Arabia's oil output was nearing its all-time peak, these four fields accounted for 8.5 million barrels a day of a 9.8-million-barrel sustainable peak output. All three of these sustaining oilfields are well past their production peaks and possibly nearing steep production declines. They might be reinvigorated for some period of time through aggressive drilling and stimulation strategies, but this would be the equivalent of performing a tune-up on a 30-year-old Buick: It will make the car run better for a short while, but top speed will be 60 miles per hour instead of 95, and every hard acceleration will take a toll.

What about the other fields that have supplemented production from the super-giants over the years? Can they make up for declining production from Saudi Arabia's Big Four oilfields? The answer would seem to be "no," but with a minor qualification. The more recently developed Shaybah field may have further upside potential, but it has already shown that it will not replicate Abqaiq or Berri. No other new discoveries are queued up for development.

The Lesser Offshore Fields

Saudi Arabia has a total of 13 offshore oilfields in the Persian Gulf. They all lie in shallow water off the northern coast of the Eastern Province, between the western shore of the Gulf and the boundary dividing Kuwait, Saudi Arabia and Iran. The Safaniya field is the largest. Two others have achieved giant status — Zuluf and

Marjan. The smaller fields, such as Manifa, Ribyan, Hamur, Maharah and so forth, have either never been produced or only produced sporadically.

A recent Society of Petroleum Engineers (SPE) paper reported that this entire northern offshore area contains a total of 1,045 producing oil wells. If the report is accurate, 52 percent of these wells are now experiencing water cut problems. As the number of wet wells grows, the complexity of downhole water management practices will rise. ■

Turning to Natural Gas

From the time Saudi Arabia began producing oil in 1938 through the 1960s, the kingdom saw little value in its natural gas. Saudi Arabia's internal domestic energy needs were still small, and the cost to export gas was prohibitive. Only a fraction of the associated gas was used for domestic purposes. All that has changed: Over the last 40 years, gas has become the critical feedstock and fuel for Saudi industry and domestic utilities.

While the oil challenge is mostly a *monetary* threat for the kingdom, Saudi Arabia's need for a substantial increase in natural gas supply is fundamental, a more compelling concern for the kingdom than flattening or even declining oil production. The kingdom's natural gas needs are all about creating more kilowatts and more potable water. Without abundant additions to natural gas supplies, it will be extraordinarily difficult, and perhaps impossible, for Saudi Arabia to fill these urgent *social* needs.

For Saudi Arabia to function securely and comfortably in 2010 and beyond, it must find and develop *massive* amounts of natural gas. ■

PART FOUR: TWILIGHT IN THE DESERT

Saudi Oil Reserves Claims in Doubt

The SPE technical papers dealing with Saudi Arabia's giant oilfields make it clear that each of these rapidly maturing fields poses serious challenges for Aramco. None seems immune to pending production declines, including even the Shaybah oilfield, though it has been in production for only five years. These production challenges would seem to bear directly on the most fundamental elements of Saudi Arabia's petroleum supremacy — its vast oil reserves — inviting these questions:

- Are there *sufficient reasons* to believe that Saudi Arabia really has the 260-plus billion barrels of proven oil reserves that it claims?
- Could this claim merely reflect the *competitive need*

of an otherwise minor nation to remain at the top of the OPEC reserves pecking order?

- Or does it represent an *optimistic best guess* at how many barrels might ultimately be produced?
- Even granting the sincerity of Saudi Arabia's reserves claims, do the difficulties in the mainstay fields imply that some (or much) of this oil *may not be recoverable*?

Future Oil Production Estimates Are Unreliable

The task of assessing proven reserves in any oil reservoir is elaborate, difficult and problematic, relying as it must on data gathered by remote sensing and many assumptions. The fluid volumes being estimated are never visible or physically present, and the whole process is plagued by numerous variables that cannot be controlled.

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Saudi Oil Reserves Claims in Doubt

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The bottom line on Saudi Arabia's proven oil reserves is that the real number is hidden in obscurity. Like all proven reserve estimates, the final number will only be known with certainty when the last producing oil well has been capped. Until detailed production data is disclosed and proven reserves are identified for each key field, no estimate has any substantive reliability. ■

Facing the Inevitable

The most striking aspect of the technical challenges now facing all the important Saudi Arabian oilfields is the difficulty Saudi Aramco is having merely to keep each field's oil output flat. Unless the kingdom soon discovers a new generation of giant oil and gas fields, it now seems almost impossible that Saudi Arabia could grow its production by any significant amount.

If it is unrealistic for Saudi Arabia to substantially grow its daily oil output on a long-term sustained basis, a more urgent question arises: How easy would it be for Saudi Arabia simply to maintain flat production of 7 to 8 million barrels a day? And when Saudi Arabian production finally begins to decline, how rapidly could output actually drop? These are now the most important energy questions in the world. Unfortunately, they cannot be answered easily. ■

Reading Between the Lines of the Latest News From Aramco

The 2003 and 2004 SPE papers continue to provide detailed information about the condition and status of Saudi Arabian oilfields. These most recent technical reports both add to the volume of evidence and provide more specific detail about the severity of the problems now affecting the once trouble-free giant oilfields. *Without question these challenges are mounting, not receding.*

Saudi Aramco authors presented 12 papers at the SPE Annual Technical Conference and Exhibition held in October 2003 in Denver, Colo. Several of these papers deal with various aspects of the overriding issue — how to sustain production from Saudi Arabia's giant oilfields for the long term. As with prior Saudi-authored reports, no single paper addresses the overriding issue directly. But taken together, they continue to highlight the intense technical struggle that Saudi Aramco is now engaged in to keep the Oil Miracle alive.

Aramco Invokes 'Fuzzy Logic' to Manage Saudi Oil

At some point, the steady, high reservoir pressures that keep typical Saudi Arabian oil wells flowing at such prodigious rates will fade. A growing number of the most productive sections of Saudi Arabia's greatest fields have now been depleted. The massive water injection programs that began decades ago will finally sweep all the easily mobilized oil into producing wellbores. This endgame will play out in all the mainstay giant and super-giant oilfields.

Once these events arrive, all of the reservoirs that made Saudi Arabia the world's "Oil Superpower" will still have a great deal of oil left. What will have disappeared is their driving energy, the "fizz" in the soda bottle's water. When the reservoir pressure drops below "bubble point" in each key field, the gas dissolved in the oil will immediately begin to emerge from the oil solution and create a gas cap at the top of the reservoir. As this gas separates from the oil and reservoir pressure continues to fall, the flow of oil and water into the wellbores decreases progressively.

Regardless of an oilfield's size, when its reservoir pressures breach bubble point, they tend to quickly head to their dew point. Once dew point pressure is reached, oil ceases to freely flow out of the wellbore. At dew point, there is no reservoir pressure left to keep oil, water and natural gas separated, and the enormous volumes of oil left behind in the reservoir start to commingle with the underlying water at the bottom. At this point, it is no longer easy to create high oil flows in Saudi Arabia. It is a scenario that will soon become reality as Aramco invokes "fuzzy logic" in an attempt to ward off the inevitable decline. In some respects, it has already begun.

'Fuzzy Logic' Versus Crisp Logic

Crisp logic deals with statements that are clearly true or false. Crisp logic answers questions within the black-and-white range of an issue or problem. There is no ambiguity. But in the middle area, the picture blurs and crispness gives way to fuzziness.

It is the maturity facing each of Saudi Arabia's oilfields that requires the use of fuzzy logic to determine how these resources can best be managed over their remaining lives. As these fields grow steadily more mature, predicting their future performance becomes increasingly more difficult. It is no longer clear to the production managers and reservoir engineers just what should be done to achieve a certain objective. Perhaps it is not even clear what the objectives should be. They are forced to deal with complex probabilities and seek

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Aramco Invokes ‘Fuzzy Logic’

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assistance from experts who have dealt with similar situations elsewhere.

The question of when and how rapidly Saudi production will decline sits at the top of the list of issues to be turned from fuzzy to crisp. With that issue and others brought into sharper focus, we can then begin to map an energy future on a more realistic basis than we are able to do now, a future that will almost certainly involve decreasing oil supplies. ■

In Search of Crisper Truths Among Saudi Claims

The first 2005 edition of *The Economist* carried a story about how the world’s largest and most powerful oil firm has finally revealed some of its secrets. The story reports that Aramco’s technical experts “now openly discuss field data previously held secret.”

The story quotes Dr. Nansen Salari, Aramco’s head of reservoir management, as stating, “We’ve released more data in 2004 than we did in the previous 50 years. On a field-by-field basis, we now release more than investor-owned companies.” The story gives credit for this new openness to Abdullah Jumah, Aramco’s CEO. But it noted also that when Jumah was asked about the need to bring in outside auditors to verify their comforting claims, “A glint of steel appears in his eyes: ‘Why should we? We have never failed to deliver a single barrel of oil promised to anyone, anywhere!’” Unfortunately, the story did not report, even by way of example, any of the new data that it claimed Aramco had released.

As Saudi Arabian oilfields age and the world’s need

for oil steadily rises, the probability increases month by month, year by year, that we are approaching an oil-curtailling twilight in the desert kingdom that has provided the greatest single contribution to the world’s oil supply at the least expensive cost.

When this desert twilight arrives, the world faces an energy future, and in turn an economic future, far different from the one that all current forecasts and human expectations assume. The need to begin creating an energy blueprint for a world that has passed peak oil output is so urgent that the citizens of all nations, in unison, need to demand energy data reform. The time to trust but verify is now, before twilight arrives and darkness begins to set in. ■

Aftermath

History has shown that out of great crises comes man’s greatest ingenuity. We will soon witness twilight in the desert for Saudi Arabia’s oil production.

But it need not create twilight for the global economy. If the problem is diagnosed in time and if we begin to take the proper steps to transcend into a new age beyond dependence on oil, this single event could begin a journey into a world that becomes even more prosperous for an even greater part of the global population than the affluent enclaves that a minority of us living in North America, Europe and Japan have enjoyed in the Great Age of Cheap Oil.

The twilight of Saudi Arabia’s oil miracle, if properly understood and managed, could become the dawn of a more enlightened and sustainable global society. It could lead to the dawn of prosperous and democratic new societies throughout the entire Middle East, Nigeria, Libya, Algeria and Venezuela. It could be the triggering event to change the energy habits of the United States and other oil-dependent Western nations. And finally, it could unleash the dawning of a scientific revolution as the world’s brightest minds work to invent new energy forms that create even greater security and prosperity than we enjoyed through the bounty of affordable and dependable oil. ■



If you liked *Twilight in the Desert*, you’ll also like:

1. [*A Thousand Barrels a Second*](#) by Peter Tertzakian. According to Tertzakian, the future of energy is a mix of increasing dependence on alternative fuels and conservation.
2. [*Black Gold*](#) by George Orwell. Investment suggestions that will allow you to profit from current and future conditions in the oil industry.
3. [*Internal Combustion*](#) by Edwin Black. The story of how corporations and governments conspired to ensure the world’s addiction to oil and derailed alternatives in the process.
4. [*The Coming Economic Collapse*](#) by Stephen Leeb, Ph.D. Leeb shows how hard times in the energy sector can be a boon for smart investors.
5. [*Black Gold Stranglehold*](#) by Jerome R. Corsi, Ph.D. and Craig R. Smith. Analysis of the belief that oil is not a fossil fuel, but a bio-product continuously produced below Earth’s surface.

The Post-Peak Era

Once Saudi Arabian oil production peaks, we will face a number of issues, many of which are interdependent. These include:

- ✓ The long-term price and affordability of oil.
- ✓ Extending conventional oil supplies.
- ✓ Allocation of available supplies.
- ✓ Modification of consumption patterns.
- ✓ Sources of investment in conventional oil production and alternative energy forms.
- ✓ The need for accurate oil resource data.
- ✓ The environment and emissions controls.
- ✓ Development of alternative forms of energy.

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Featured Book Review

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The Big Impact of Small Forces How 75 Trends Are Shaping American Society

Review by Stephen Wolter

In the opening pages of *Microtrends: The Small Forces Behind Tomorrow's Big Changes*, author Mark J. Penn declares to the reader that he is a trend-spotter, a member of a lineage that includes the likes of Alvin Toffler and John Naisbitt, who respectively wrote two of the best-known books of prognostication of the late-twentieth century: *The Third Wave* (1980) and *Megatrends* (1982). Penn credits those writers as being among the earliest thinkers to consider the societal changes taking place as the United States and the world transitioned from an industry-based economy to one that was information-based. And Penn also acknowledges that Toffler and Naisbitt were correct in their predictions regarding the early-era Information Age.

But Penn is quick to distance himself from fellow trend-spotters Toffler and Naisbitt in one crucial area, namely, the size of the trends in question. Both Toffler and Naisbitt considered the large, sweeping changes transforming society as a result of an emerging information economy. From the title of Penn's book, it is obvious what kind of changes concern him. While his predecessors in the trend-watching business examined the dawning of the Information Age, Penn writes that the Information Age changed the way trends should be examined.

Today, those big, sweeping changes are out, and for Penn, it's the small, hard-to-find changes that are significant — the *microtrends*. Penn defines a microtrend as “an intense identity group, that is growing, which has needs and wants unmet by the current crop of companies, marketers, policymakers and others who would influence society's behavior.” But does that mean these trends will have less of an impact on society than the megatrends that

preceded them a quarter-century ago? Not according to Penn, who sees a world changed in startling and powerful ways by the microtrends taking shape today.

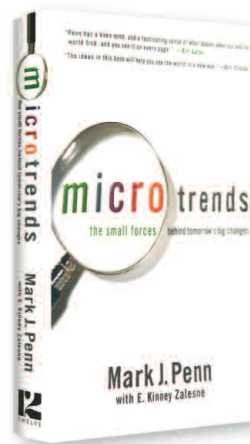
Naisbitt's *Megatrends* examined 10 major trends that he believed, in the early 1980s, were changing the face of how we lived. Considering that Penn is concerned with the micro, it's not surprising that he manages to include 75 society-changing trends in his book, from Social Geeks to Bourgeois and Bankrupt.

The Era of Unlimited Choice

Penn's introduction describes an America in which individual choice has never been greater — an “explosion of choice” as he puts it. The Starbucks economy has conquered the Ford economy, and by that Penn means the Ford Motor Company of the early 1900s, when everyone could own a car in the color of their choice, as long as that color was black. From potato chips to toothpaste to coffee, the variety of choice available to consumers today has surpassed any previous moment in history. The black car has given way to an endless menu of combinations at the coffee bar.

Penn writes that the secret behind Starbucks' success is found not just in a good cup of coffee, but also with the concept of choice: the more choices people have, the greater their satisfaction. Substitute the Starbucks name with that of another company, product or technology that provides a person with as many choices as possible, and you're going to have a primary ingredient for success.

Think of the iPod, Penn writes. Its amazing popularity



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by Mark J. Penn with
E. Kinney Zalesne
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“According to Penn, as little as 1 percent of the population can attach themselves to a microtrend, and if that number seems too low to have a significant impact, consider that 1 percent of the American population represents 3 million people.”

doesn't hinge on the fact that it makes music portable; the Walkman provided the freedom of portability in the early 1980s. Instead, the secret to the iPod's success is that it allows users to *create* their own personal music library, which just happens to be portable.

Personalization and choice may be terrific for consumers, but Penn sees unlimited choice as a nightmare for trend-spotting. More choices mean more and more groups and subgroups attaching themselves to specific needs and wants. A greater number of groups means greater analysis is needed by anyone who follows trends. The one-size-fits-all mentality has pretty much expired, and marketers or political-campaign advisors who try and lump large population groups into either/or categories are doomed to fail when it comes to prediction. Think micro, Penn advises.

If choice is a key element in determining present-day trends, then an equally important factor is that these trends are often counterintuitive to the observer. Penn writes that microtrends can be hidden from the public and the media, not only because of the relatively small groups that attach themselves to specific trends, but because trends are counterintuitive by nature.

One example Penn uses to illustrate the counterintuitive dilemma is when the media focuses its coverage on large organized religions, to the exclusion of newer, smaller sects that currently have faster growth rates in membership. Another example of a trend being counterintuitive involves terrorism. Poverty is often cited as a root cause of terrorism, but wealthy, educated terrorists are often the driving force behind terror attacks.

Penn also sees contradictions everywhere when he studies trends: Americans are eating more healthy meals than ever before, even as obesity rates rise. We have a growing elderly population, but advertisers direct their marketing campaigns toward the country's youth. With their counterintuitive and contradictory natures, and the numerous disparate groups that help define them, Penn believes that many of today's important trends can easily get lost in the shadows.

Looking for Trends: the Birth of the ‘Soccer Mom’

No one can deny the computer's impact on society in the last 25 years. When John Naisbitt described the computer as an instrument that would smash down barriers erected by an industrial-based economy, he was describing a trend, one that grabs hold of an extraordinary number of people.

But just how many people does it require for a trend to exist? According to Penn, as little as 1 percent of the population can attach themselves to a microtrend, and if that number seems too low to have a significant impact, consider that 1 percent of the American population represents 3 million people. Whatever their size, Penn stresses that microtrends are largely ignored. But what business or political party can afford to ignore a group of people with a *minimum* membership of 3 million?

To illustrate the importance of the groups linked to trends, Penn describes his role in identifying a previously overlooked group that was part of a microtrend back in 1996, when he was working as a pollster for President Bill Clinton's reelection campaign. At the time, conventional wisdom held that, for the most part, male voters determined how a household voted.

According to Penn, in 1996 most male voters had already made up their minds about which presidential candidate they were supporting by the start of the campaign. This left a new group of voters that could conceivably be won over — the suburban mom, whose responsibilities included both work and raising a family. The newly christened “Soccer Moms” became critical swing voters.

More than a decade later, political candidates eagerly seek the vote of the Soccer Moms, although as Penn points out, trends move fast. The kids of those Soccer Moms are now in college, and many of the moms are divorced. Today, other issues — such as personal financial security — are as important to the former Soccer Moms as raising their children was a decade ago.

Looking back on what happened in 1996, Penn finds the story of the Soccer Moms a perfect example for identifying a new microtrend. Finding what the trend is and who's following it isn't necessarily simple, and the old conventional wisdom rarely helps. “We need the equivalent of magnifying glasses and microscopes, which in sociological terms are polls, surveys and statistics,” he writes. When it comes to trend-spotting, he has little use for the advice of “follow your gut.” Numbers hold the key to discovering trends in his view, and for every one of the 75 trends Penn describes, he comes armed with statistics to back up his conclusions.

Penn's statistics and ample research indicate that America is not moving in two or three big directions,

but rather, it's headed in hundreds of small directions. Penn writes that there is no one America anymore, not even two or three Americas. Instead there are hundreds; hundreds of niches comprised of people sharing common interests. And these niches are forming and evolving at an incredibly rapid rate.

A Trend for Everyone

The bulk of Penn's book is comprised of relatively brief analyses, four or five pages in length, of each of the 75 microtrends. The trends are grouped into 15 broad categories and are presented in such a straightforward manner that the book almost resembles a one-volume encyclopedia.

Other than the device of grouping by large categories, there is virtually no overlap between one trend and another. A reader could easily dip into the text at any point in the book, read about the trends that interest him or her and skip those that don't — without losing any of *Microtrends*' underlying message.

The 15 broad categories are worth noting here, and are arranged in the book as follows: Love, Sex and Relationships; Work Life; Race and Religion; Health and Wellness; Family Life; Politics; Teens; Food, Drink and Diet; Lifestyle; Money and Class; Looks and Fashion; Technology; Leisure and Entertainment; Education; and International Trends. It's not much of a stretch to say that Penn provides just about something for everyone.

Whether he's writing about office romances, college dropouts, retiree workers, or the nonprofit sector, every topic that Penn discusses is smart and concise. He tosses in a graph here and there, which is largely unnecessary, but the real strength in Penn's writing is his precise definition and history of each trend, coupled with an explanation of a trend's potential effect on society.

For example, in the chapter concerning the microtrend of workplace relationships (aptly titled "Office Romancers"), Penn provides statistics indicating a rise in romantic liaisons in the workplace, long-term and short-term explanations of why these numbers are trending upward, and what this means for the future. For the record, between 2003 and 2006, there was a 13 percent increase in office romances.

The reasons for this are due to a steadily closing gap between the sexes in the work force (long-term explanation) and a rise in the number of working singles (short-term explanation). What this trend means to employers includes the following issues: creating revised HR policies as well as dealing with the fact that romantically linked colleagues may share similar interests about their work, which could be a good thing. In any case, each of Penn's descriptions of a microtrend in the book follows this basic pattern of analysis.

Comparing the impact of a microtrend like office

romances to a megatrend such as the rise of the information-based economy might seem on the order of putting an Ivy League football team on the same field as the Pittsburgh Steelers. Simply stated, they just don't match up. But Penn makes convincing arguments as to why his microtrends are worthy of consideration, and how they really will affect society in powerful ways.

Will office romances lead to more married couples working in the same profession, in turn creating more positions for double-entry candidates? As Penn notes, universities have been working to encourage double-entry jobs for decades, so what's to prevent it from spreading to the business sector?

Or consider the microtrend of older Americans staying in the work force longer — what Penn dubs as the "working retired." One huge implication of this is the potential savings in Social Security benefits. As Penn puts it, there won't be 10 current workers for every retiree. The number will be less because the retirees will be working too. Could a bunch of retirees who aren't really retired save the country billions of dollars? If so, that's a trend worth paying attention to.

The strength of Penn's arguments lies in the numbers he uses to back them up. In his bibliography at the end of the book, Penn provides source notes on every one of his 75 microtrends. "Numbers will almost always take you where you want to go if you know how to read them," he writes, which is exactly the sort of thing you would expect a professional pollster to say. Then again, how many businesses operate solely on the gut instinct that Penn disdains, when there are hard numbers from which conclusions can be drawn?

It's hard to fault him for holding up a set of statistics in order to prove a point. Granted, statistics can be cherry-picked with prejudice in support of any idea, even nutty ones. But Penn's sources are solid and he does a conscientious job of documenting them for the reader, even the reader who doesn't usually peruse bibliographies. The critics that Penn will surely encounter would

"Penn's statistics and ample research indicate that America is not moving in two or three big directions, but rather, it's headed in hundreds of small directions. Penn writes that there is no one America anymore, not even two or three Americas. Instead there are hundreds."

do well to provide some strong data of their own when presenting the inevitable counterarguments.

The Splintered Society

Penn describes the central thesis of his book like this: “Society is changing in ways that few are really appreciating or understanding.” He has a problem when trend-spotters focus only on major trends, thereby missing the idea that trends no longer have to reach a “tipping point” to have a vast impact on society.

The notion of America splintering into hundreds of tiny groups that can potentially affect large numbers of the population may be disquieting to some, but it isn’t to Penn. He believes that in general all this splintering will be good news, for both our country and the world. Addressing the issue that America is no longer “one America,” Penn wonders if a single, unified America has really ever existed, or if that is just wishful thinking by those who mythologize history.

Considering everything from the numerous ethnic groups who settled this country, to a civil war fought over the issue of slavery, to polarizing social issues of today such as abortion and gun control, the concept of one America does seem to rely more on imagination than historical fact.

Penn doesn’t believe that the path ahead will necessarily be easy. Despite what politicians promise, there are no simple national solutions that will appeal to relatively large majorities. There will be more actions based on 51-percent coalitions, because as he puts it, increased personal choices tend to pull individuals in opposite directions. But Penn sees the opportunity rising from all that choice.

Predicting the future is a rather haphazard undertaking, and something of a thankless task. One could fill the shelves of a small library with the moldering volumes about the “not-too-distant” future. Sometimes we have trouble separating the serious-minded from the charlatans when it comes to forecasting because the serious-minded can be just as wrong as the phonies.

But you have to believe that Penn is one of those indi-

viduals genuinely concerned and curious about the shape of things to come. As to which of his microtrends will make a big impact on society, and which might be tossed into the dustbin with silly forecasts, it’s still anybody’s guess, even with all that data backing him up.

“The future rarely turns out as predicted,” he writes in the book’s conclusion. Yes, even Penn is hedging his bets, if only a little bit. ■

Five Fascinating Microtrends

Penn offers his readers 75 different microtrends filed under 15 specific groups. Here are five of some of the most fascinating he has to offer — they may surprise you:

- **Extreme Commuters.** Those dedicated individuals who travel at least 90 minutes one way (for a roundtrip total of 180 minutes, or *three hours*) to get to work.

- **Do It Yourself (DIY) Doctors.** As people become more involved in their personal health, Web sites like WebMD allow for potential self-diagnosing while over-the-counter drug sales soar. No more going to your general practitioner and paying a hefty co-pay when you have the sniffles.

- **High School Moguls.** Because of Web sites such as eBay, entrepreneurship for teenagers is easier and more profitable than babysitting.

- **Caffeine Crazies.** According to Penn, No-Doz (often used by college students to stay awake longer) has 100 mg of caffeine per pill, whereas some energy drinks have three times that amount in one serving.

- **New Luddites.** These aren’t just the people who lack computers or access to the Internet because of age, geography or income. These are the people who simply put their collective feet down and say “No” to technology.

The authors: Mark J. Penn has been called “the most powerful man in Washington you’ve never heard of” by *The Washington Post* and is widely considered one of the most perceptive pollsters in U.S. politics. He is the CEO of Burson-Marsteller and currently the chief advisor to Senator Hillary Clinton’s presidential campaign. Penn also

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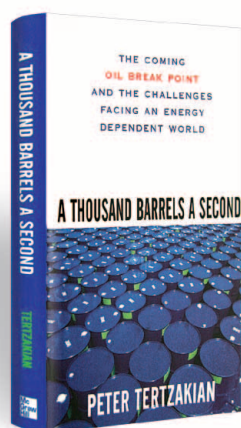
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By Peter Tertzakian

The Coming Oil Break Point and the Challenges Facing an Energy Dependent World

A THOUSAND BARRELS A SECOND

THE SUMMARY IN BRIEF

In *A Thousand Barrels a Second*, Chief Energy Economist of ARC Financial Peter Tertzakian delivers a provocative look at the future of oil and offers fresh insight into what it will take to rebalance our energy needs, while seizing new opportunities in a post-crude-oil world. He also offers a brief history of worldwide energy policy as well as explanations of past “break points,” such as when the world shifted away from whale oil toward rock oil, and how the invention of electricity became linked to the notions of scientific and social progress. This summary also looks at the kinds of energy policies that would be best for the United States in the years ahead.

In his approach, Tertzakian concedes that the issues, conflicts and worldwide implications of oil supplies that are dwindling — at the astonishing rate of 1,000 barrels per second or 85 million barrels per day — are confusing, even to the experts.

Tertzakian offers a strong case for his belief that the world is approaching another energy break point. Despite the many challenges he outlines, however, in the end his message is positive. He establishes that there are new energy options available to us, many of which will be surprising and unexpected.

In this summary, you will learn:

- ✓ *About the history of energy development and the meaning of “break points.”*
- ✓ *That the oil crisis isn’t so much about running out of oil, but running out of the oil that’s easiest to process.*
- ✓ *Why there are no “magic bullets” that will solve the energy crisis.*
- ✓ *That the solutions to the energy crisis involve some public sacrifice and a mix of resources involving coal, gas, natural gas and perhaps even nuclear power.*

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A THOUSAND BARRELS A SECOND

By Peter Tertzakian

— THE COMPLETE SUMMARY

The Coming Oil Break Point

Big changes in the world of energy are coming at you faster than you think. Beginning now, and over the course of the next five to 10 years, unstable energy prices are going to affect how you live and what you drive, not to mention the economy, the environment and the complexity of the geopolitical chess match being played out for the world's precious energy resources. We're on the verge of a tipping point on oil.

We are in the midst of volatility, right on the cusp of a break point that will change the way governments, corporations and individuals exploit and consume primary energy resources, especially crude oil. The vulnerabilities that hurricanes Katrina and Rita exposed in the United States' energy lifeline in 2005 highlight the increasingly untenable balance between the way we are supplied oil and the way we consume its marvelous products: day-to-day necessities like gasoline, heating oil and jet fuel. Future potential calamities — natural or political — will continue to exacerbate the pressure points of an intertwined global problem.

Warning Signs

Whether Katrina or Rita are the events that actually accelerate a response to those challenges, and put into motion the serious structural and lifestyle changes that are necessary, remains to be seen. But circumstances will force us to come to grips with our problems and rally to a new balance in our energy use.

Even a cursory glance at the growing number of news articles over the past 12 months reveals the warning signs of change. As the price of crude oil has reached new highs at \$70 per barrel, this has already hurt profits and created uncertainty about the future for many industries.

Nor is the news about other primary energy commodities any better, as natural gas, coal and uranium prices have at least doubled since 2002. The reason for this dramatic change is simple: Worldwide, demand for energy is growing at a never-before-seen pace, just as supplies of inexpensive, light, sweet crude are finally tightening and getting more difficult to find. The impact is only beginning to be felt. As the pressure builds, we will soon wake up to the realization that the age of

cheap, easy-to-obtain energy is rapidly coming to an end.

Questions Everywhere

The questions that business leaders, politicians and concerned citizens have are simple but profound:

- How high will the price of oil go?
- Why are these changes happening?
- Are we running out of resources?
- Where are the solutions going to come from?

Providing answers involves many dynamic variables, including the economy, the weather, technological advances, environmental issues, social factors, policy strategies and geopolitics. Most of these factors have long been taken for granted because energy has been available without undue pain or worry for many years.

But even now, a new lexicon of issues has become fodder for popular debate:

- Is China's growing thirst for oil sustainable?
- Have we entered a new multi-polar world in which energy is the primary source of global tension?
- Is oil from Iraq a panacea for growing U.S. gasoline consumption?
- Will nuclear power and coal save the day — again?
- Will you really be driving a fuel-cell vehicle in the next decade, and will it even matter?

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The author: Peter Tertzakian is the Chief Energy Economist of ARC Financial Corp., one of the world's leading energy investment firms. Tertzakian's background in geophysics, economics and finance, combined with his entrepreneurial spirit, helped him rise from the trenches of oil-exploration fieldwork to become an internationally recognized, top-ranked expert in energy matters. Tertzakian publishes *ARC Energy Charts*, a weekly synopsis of world energy trends.

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The Coming Oil Break Point

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- Which government policies work and which do not?
- What sort of global landscape will emerge from the turmoil?

A Light at the End of the Tunnel

In the end, there is a positive message to be found: There are energy options available to us, many of which will be surprising and unexpected. Understanding these possibilities will inspire confidence and optimism in our ability to navigate the future.

Will the fuel cell become the steam engine of tomorrow? What will the next Edison be discovering in his or her laboratory? Where will the General Electric or Standard Oil of tomorrow emerge? Will the struggle for oil between the United States and China define the next generation of geopolitics the way the struggle between the United States and Britain defined the early 20th century?

Someday, historians will mark the first two decades of the 21st century as the dawn of a new energy era. ■

Lighting the Last Whale Lamp

The daily news about oil is arbitrary, contradictory and confusing. We're told many different things, often based on misconceptions and half truths. For instance, we've all heard that OPEC can produce more oil and bring down the price, or that drilling in the Arctic National Wildlife Refuge (ANWR) will alleviate U.S. dependency on Middle East oil.

Other pundits claim that a new Manhattan Project can wean us off oil altogether, while many consumers have come to believe that hybrid cars and fuel cells are the answer or that conserving electricity will have a direct impact on oil consumption. None of these magic bullets are practical now or will make a difference any time soon.

In fact, our problems aren't going to go away for a decade or more. North American addiction to cheap energy is too strong, and the technological standards of the last century too entrenched, for any new or different approach to be easily or painlessly (let alone quickly) adopted. Moreover, because of its rapidly growing demand for imported oil, the United States is becoming increasingly exposed to global risk. Our birthright of abundant, reliable energy is coming to an end.

Why is this happening? How will we find a way forward to a cheaper, cleaner, more secure energy future? The answers are complex, but they're also fascinating. Throughout history, because of our evolving energy needs, we've gone through cyclical periods of protracted

demand increases, volatile tension and pressure in our supply chains, followed by a break point that ultimately provokes great innovation and change in the structure of the world's energy sources. We call this the "energy cycle."

During high-pressure eras such as today in which a break point is imminent, we'll go to any lengths to secure the energy we need — scavenging, hoarding and even engaging in war for resources that spike in price. The balance returns only when consumption patterns change, and new energy resources or processes are discovered and restructured into the economy. Getting back to a point of balance is never easy, but it can be made less painful if we understand the dynamics and evolution of the energy cycle.

Lighting the World

We've been through such transitions before. The story of energy is an often dramatic and turbulent tale of world events and social evolution driven by the economics of supply and demand, the buildup of pressure on valued resources, and the "magic bullets" of ingenious innovation. Today, the world is lit and powered by a mix of fuels, including coal, uranium, crude oil, natural gas and renewables like wind and solar power. But just 150 years ago, whale oil was the world's primary illuminating fuel.

If you think that our search for crude oil has been intense in recent decades, imagine a time when men chased whales across the oceans to meet the world's growing energy thirst. Indeed, from its rise in the mid-1700s to its peak in the mid-1800s and through its sudden and rapid decline in 1870, the whale hunt was more than a mere fishery; it was an ever more desperate search for the oil that lit up our world.

Ironically, at the peak of its worldwide demand, the days of whale as a premium fuel were nearly over. In 1849, Abraham Gesner, a Canadian geologist, distilled bituminous tar to produce coal oil. Gesner called the substance kerosene as a way of easing its adoption to those already familiar with the suffix in camphene. Kerosene was a wonderful new illuminate, as clean burning as whale oil and much cheaper, though not as nice smelling.

Eight years later, with the invention of the kerosene burner by Michael Dietz in 1857, kerosene became the most sought after illuminate on the market.

The Last Whale Lamp

The new fuel, kerosene, was cheap enough to be afforded by nearly everyone. The conversion from whale oil to this new petroleum-based fuel marked the beginning of a sense that cheap, clean energy is our

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Lighting the Last Whale Lamp

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birthright, something we can take for granted. Kerosene's use as an illuminate was actually short-lived due to the introduction of the electric light bulb. But because of other timely innovations, namely diesel engines for ships and gasoline engines for automobiles, the crude oil from which kerosene was extracted became the most sought after substance on the planet. In the 140 years since the U.S. whale fishery began its demise, our thirst for crude oil has gotten ever stronger, even as we supplemented our energy needs with coal, natural gas, hydroelectricity and nuclear power.

Since the dawn of the modern era, our hunt for fuel has been a frantic one, catalyzed by the insatiable needs of our energy-hungry world. If the psychologist Abraham Maslow could append his theory of the Hierarchy of Needs, he would do well to include energy, along with such basics as food, water and shelter as a primary need that must be fulfilled before other, higher needs get our attention.

Energy is the underlying force that has shaped our history and built our modern world, even as it makes our society work. To see to that need, we have chased whales across the ocean, drilled into the depths of the earth, fought wars and fought them again, changed the course of rivers and split the atom.

With amazing ingenuity, we have created the means of converting fuel into the energy we need to light and

power our lives. Today, as the global supply of light, sweet crude tightens and the demand for it continues to grow, our world is under great pressure, not unlike it was in the last days of the sperm-whale fishery. ■

Not a Wheel Turns

The entrenchment of crude oil parallels how extensively the personal computer has penetrated society, business and government, and been embraced as a new essential by individual consumers. Such platform products don't come around often, but when they do, visionary entrepreneurs like John D. Rockefeller and Bill Gates can become titans of the new industry, and opportunities are rich for investors.

One of the more prescient early historians of the oil industry was an American investor named Reid Sayers McBeth. In his 1919 book, *Oil: The New Monarch of Motion*, McBeth observed the great changes taking place in America and wrote that, "Petroleum today holds the front of the stage in a greater degree than ever before. As a wealth creator it never has been so fruitful as at present."

The reason for McBeth's bullishness was simple: He saw that average consumers were starting to buy gasoline-needy cars. Noting that ships, airplanes and nearly everything industrial was becoming increasingly dependent on oil products, he stated that, "Not a wheel turns which is not dependent on petroleum."

In macroeconomic terms, McBeth sensed that every corner of the economy was being fueled by petroleum. Naturally, the reverse of this observation was also true: Petroleum demand was being fueled by the growing economy.

Pressure Buildup, Break Point, Rebalance

Global tension, anger at oil companies, drastic government action, frustrated consumers, steep and volatile prices, economy uncertainty and no relief in sight are all very familiar. From the OPEC Embargo in 1973 until the early 1980s, the pressure surrounding energy was unrelenting.

Although energy sources can often coexist seamlessly, at the end of some energy supply chains there is very little room for substitution. The vehicle you drive is a good example. It needs gasoline. You can't shovel coal into your fuel tank any more than you can put in a uranium fuel rod or strap on a windmill. Other fuels like diesel can be used in vehicles, but then you need a different engine.

When do we know that things have reached a break point for fuel? A break point occurs when a primary fuel or an associated supply chain becomes substantially

The 33 Percent Advantage

In the late 19th century, John Arbuthnot Fisher, First Sea Lord of the Royal British Navy, felt that the navy had to convert from coal to oil in order to power its fleet. He quantified the benefits of an oil-powered navy as having a 33 percent advantage over a conventional coal-powered navy. However, while large reserves of high-quality coal could be found in Wales, converting to oil meant that Britain would become dependent on importing its most strategic fuel, putting it into direct competition with other nations struggling for their own access.

The vulnerability of committing to an extended supply chain made it difficult for many people to see the advantages of oil. Nonetheless, over the years the change was gradually made, with the Rockefeller family's Standard Oil coming to the forefront in the United States and Royal Dutch/Shell and British Petroleum (BP) growing in Great Britain.

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Not a Wheel Turns

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disadvantaged relative to other energy supply sources in a nation's energy mix, or relative to the emergence of a completely new supply chain. Upon reaching a break point, governments, industries and individuals take proactive measures to mitigate the imbalance caused by the break point, and rebalancing ensues. ■

To the Ends of the Earth

So what is happening today? Listening to the pundits, you're bound to get confused. The alarms have sounded; the prices are up. Everyone acknowledges that we're confronting energy challenges that we've never faced before.

The problem is that we're not talking about the same thing. Whether you think the end of the world is near or today's concerns will go away on their own depends on what kind of expert you are listening to at the time.

There are a host of experts on both the supply side and on the demand side — and there is a raging debate between them. Some think we're running out of oil; others say we've got plenty left.

Some think that world demand — especially from China — is going to push the pressure needle into the danger zone; others say that all those engines firing at the same time will cool down soon and leave us idling comfortably. Throw in the voices of those who are advocating various positions on conservation, global warming, geopolitics, government policy and the wonders or limitations of new technological advances — and you are left with a blurry picture of what is really happening now and how that will affect your life in the next five to 15 years.

Without a comprehensive understanding of the various forces affecting us today, we can't understand why the pressure in our energy cycle is rising and what that means for the near future. So let's clear some things up. We're not running out of oil, but the oil we need is getting harder to find. Neither China, India nor the United States is going to swallow the world's resources whole, but even a global economic slowdown is not going to turn back the clock on how much oil is consumed every year.

There are no magic bullets in the form of radical technological innovations to rescue us, and yet technology in some form or another will still help save the day. It all seems contradictory, confusing and complicated, and for the most part it is. But from these basic ideas, we can begin to get a handle on what's going on and how to bring energy's big picture into focus. ■

The Technology Ticket

"Technology is this nation's ticket to greater energy independence," President George Bush declared in an April 2005 speech promoting his energy plan. Referring to gasoline costs that were unacceptably high, he went on to tell the expectant crowd, "This problem didn't develop overnight."

President Bush was right in his assessment of the situation. Neither the United States nor the world's energy problems developed overnight; they evolved in conjunction with economic growth and dependency. On the one hand, our problems are evidence of the extent to which a society has grown through crude oil.

On the other hand, they are a kind of reckoning for the choices we have made along the way that increased our dependence on a wonderful resource. When we imagine the power of technology to change the world, we often think in terms of stunning speed: a bolt of lightning from the sky, a magic bullet quickly neutralizing all that ails us. But the amount of time from experiment to application is almost always much, much longer than we realize, and in the case of energy technology that often means decades.

The Last Carbon Standing

Once compelling standards are set, they are remarkably intransigent. This fact alone makes the period from 1800 to 1920 the most influential in our modern energy era. Despite all the scientific progress we have achieved in the interim, in our search for energy alternatives we remain largely fixed in our approaches and limited in our options because of the winning technologies that were adopted in those early, formative days. Think, for example, how difficult it would be to successfully mass-market and sell a 60-watt light bulb that didn't fit Edison's simple screw-based lamp socket, or an electric product in North America that didn't run off the two-prong 110-volt wall plug.

And so, too, should innovators and pundits in the world of energy consider that introducing an alternative is about replacing an entrenched set of compelling standards up and down a complex supply chain. Gasoline, for example, is not merely a fuel, it is the Microsoft Windows operating system of the transportation world, and much harder to displace.

It is in this light that Edison's skills as an innovator can be best appreciated. In fact, his relentless determination to win support for the electric light bulb was absolutely necessary to overcome the deeply entrenched standards of the existing supply chains — for example, kerosene, coal gas, candles and even the last vestiges of whale oil. Imagine switching a whole world to a new

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The Technology Ticket

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source of illumination. Anyone who longs to create such change today will need all of the skills of Edison and then some.

Nevertheless, there are those today who believe that new alternatives to oil will come to the rescue any time now. Even the venerable Alan Greenspan sells a version of this story with his public retelling about how “oil displaced coal despite still vast untapped reserves of coal, and coal displaced wood without denuding our forest land.” On the surface, such beliefs are not wrong, but it’s dangerous to think it will all just work out and a solution will emerge before we run out of a primary fuel like oil.

With time at a premium, how long should we expect to wait for the next great energy substitution? Historically, substitutions in the energy world take a long time and there’s no reason to think the next substitution is going to happen overnight. While it’s likely that we may not run out of oil before a substitute is found, it will be decades or more into the future before any new solutions make a difference.

The Most Abundant Element in the Universe

Many are betting that hydrogen will be the wonder fuel of the future. The first and simplest atom on the periodic table of the elements, hydrogen is an odorless, colorless gas. A more high-tech solution is to use something called a fuel cell: a device akin to an atomic cheese grater that strips electrons off hydrogen atoms to generate electricity. Though it’s not a combustion process, oxygen from the air is essential to the fuel cell’s operation. Heat and water are produced as by-products.

That sounds like a dream process: hydrogen and air being fed into a device with no moving parts; water, electricity and heat come out. Why aren’t we rushing to use this process? We’re trying to. Governments around the world are funding hydrogen and fuel-cell research. Giant automakers like Toyota and GM are pioneers and have devoted hundreds of engineers to make a practical and economical vehicle that runs on a fuel-cell “engine.” It all sounds great, but there is a core issue that needs to be resolved: Where will the hydrogen come from?

Despite clean and simple operation, fuel-cell vehicles today do not have an overall utility advantage over piston-fired cars, trucks and SUVs. That’s not to say they won’t get there eventually, but best-case scenarios appear to be 10 to 20 years from now. Think back to the last major substitution in transportation, the diesel locomotive over the steam locomotive, and recall the

Looking Back for Answers

How will the world deal with the coming break point? The past can provide us some answers. In the mid-1980s, the world came out of a difficult and painful 13-year break point and rebalancing period. In many ways, we were all better off as a result.

By 1986, U.S. oil consumption was far less sensitive to economic activity as compared to the years leading up to 1973: Only half as much oil was needed to fuel each new dollar of GDP growth. The world had expanded its portfolio of primary fuels in its energy mix to include more nuclear power and natural gas. In countries like the United Kingdom and Japan, oil consumption flattened even while economic growth continued.

Today, each nation is unique in terms of its energy mix and dependency. Some nations, like Brazil, are rich in natural energy resources; others, like Japan, have next to none. Some are in geographically secure positions like the United Kingdom; others, like China, are less secure. For these reasons, each nation will experience the break point, rallying cry and rebalancing in different ways.

Nevertheless, the rebalancing challenge we now face is more complicated than it was in the 1970s. Oil has become more difficult and expensive to find, develop and bring to market. Geopolitical issues still antagonize. Environmental and social pressures are more acute. “Magic bullet” cures are not handily available to diversify our energy mix and ease the burden of our oil dependency, nor will this period of global turmoil we’re entering end quickly.

compelling utility of diesel over coal/steam. If railroads didn’t switch to diesel, they went bankrupt. Will anyone go bankrupt if they don’t buy a fuel-cell vehicle? As a consumer choice, it’s going to have to be really compelling — or legislated.

And then we come back to the issue of hydrogen. Set aside the nontrivial problem of having to establish a nationwide network of new fueling stations while mothballing gas stations: Where is the hydrogen going to come from practically?

Is Nuclear the Answer?

In 2005, President Bush pushed for more nuclear power plants to be built, in part because the electricity can be used to electrolyze water and produce hydrogen fuel for fuel-cell vehicles in the future. If that’s the intent, then more power plants are certainly required. In fact, to completely substitute the oil-to-gasoline supply chain with one that goes from uranium to hydrogen —

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The Technology Ticket

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in other words, to completely switch over 230 million cars from gasoline to hydrogen — would require about 350 nuclear power plants.

Obviously, to ease our current oil-demand problems we don't need to go to the extreme of replacing the entire fleet of gasoline vehicles with hydrogen. Partial solutions are possible, though even so, the magnitude of displacing the oil-based supply chains with hydrogen is staggering and would take decades to implement.

No Magic Bullets

Technology can still do a lot to improve the efficiency of society's energy map, whether by constructing new pathways or improving old ones. We as a society can decrease hydrocarbon consumption significantly without compromising economic productivity. This "alternative" notion is the true and potentially radical idea that new energy technology companies need to pursue. We need to be honest with ourselves.

A magic technology bullet, similar to ones that have "saved the day" so many times in the Energy Evolution cycle, will not be in our hands any time soon and certainly not in time to prevent the upcoming oil break point. Ultimately, we must be determined to make all these existing supply chains more efficient, while also making them cleaner and learning how to lower our demand for them. It's a big repaving effort on all our energy highways and side streets, and just like road construction, it won't come cheaply.

If that recipe of solutions doesn't sound very new, radical or sexy, you should recognize that it's rare in the history of technology that the early adopter gets the worm. More often than not, companies, nations and individuals who benefit from technological transitions are the ones who learn to take full advantage of the opportunities that are currently available. Technology is the ticket, but you may be surprised where the ride is going. ■

The Next Great Rebalancing Act

We are approaching another moment in the evolutionary cycle of energy supply and demand where the status quo will be shaken. A break point is coming before the end of the decade. This will force nations to alter the structure of their energy supplies and fuel consumption, especially oil. In the interim, governments, corporations and individuals need to make choices that minimize the economic damage that can result from the pressure buildup in society's vital energy supply chains.

Light, sweet crude oil is quickly becoming "disadvantaged" as a fuel. Rising energy prices are reducing peo-

ple's disposable income, eroding corporate profitability and making a broad range of previously marginal substitutes like bitumen attractive. But break points are not just about numbers.

Security of supply and concentration risk for this most strategic of energy commodities is at the fore of political and economic issues. Independent oil companies and their state-owned foreign rivals are embarking upon another great scramble for the world's remaining oil concessions. And like the final years of the whaling industry, the scramble is happening at the ends of the Earth, in some of the harshest geographies and climates, the deepest oceans and the murkiest political regions.

Evolutionary Phases of Break Point and Rebalancing

Some experts believe that energy break points are resolved when economies slow down. True, economic downturns do allow energy demand to take a breather and provide suppliers with the time needed to catch up. But economic cyclicity is different from fundamental rebalancing. Normal cyclical forces are generally not strong enough to resolve the severe imbalance associated with a disadvantaged fuel in the energy mix. External measures are required to initiate real evolutionary change.

There are four evolutionary phases that a society experiences during pressure buildup and rebalancing:

- **Complaining and paying up**
- **Conserving and being more efficient**
- **Adopting alternative energy sources**
- **Making societal, business and lifestyle changes.**

Bear in mind that these dynamics occur only in broad chronological sequence and that there is plenty of overlap. For example, meaningful conservation and efficiency most often requires business and lifestyle change. And, of course, complaining and paying up is pervasive.

Making Societal, Business and Lifestyle Changes

Alternatives will slowly emerge; new supply chains will gather strength as old ones die out; people and corporations will adopt more efficient hardware, appliances and vehicles. However, these rebalancing trends are measured in decades. To speed things up, we need to make lifestyle changes that involve consuming less energy. If we don't make those choices consciously, other choices will be imposed on us by economics, government or both.

Governments that have had a vision to curb demand have imposed lifestyle changes as tough medicine in the past. In 1978, Japan was the second-largest importer of oil in the world because it had no oil or natural gas resources. This made it extremely sensitive to the spike in oil prices in the 1970s. With resolve, the Japanese government put into action the report of its Advisory

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The Next Great Rebalancing Act

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Committee on Energy, which aimed to reduce its 75 percent dependence on oil to 63 percent in the mid-1980s and to 50 percent by 1990.

After having set these goals and benchmarks, Japan proceeded to meet them. Today, Japanese citizens drive cars, but they pay a high tax for gasoline and at toll booths and must undergo strict annual inspections. These choices seem restrictive and even technologically backward to North Americans, but they are culturally tolerated in Japan and have done much to moderate energy use.

Imposing lifestyle change by legislation on high consumer fuel taxes or outright limits on consumption is tough medicine. But to really offset demand we need to see lifestyle changes today at the level that was accomplished in Japan and many European countries over the past three decades. ■

A Golden Age of Opportunity

After the break point occurs, the emphasis changes. Consumption growth for the disadvantaged fuel levels off as nations, companies and individuals try to rid themselves of the dependency. The value of the energy resource asset peaks and starts declining.

The emphasis shifts to rebalancing solutions and other substitute resources. Things are still changing and there is still money to be made. But investors must look ahead, and put their money in rock oil, not whale oil. They should search for opportunity in the way people conserve. Consider the following investment areas:

● Substitute Resources and Supply Chains —

Liquefied natural gas, coal, uranium and renewable energy sources will all gather value as light, sweet crude oil becomes progressively harder to find. Nonconventional sources of petroleum products like oil sands and shales will also remain at the fore. This often happens well before the disadvantaged fuel, in this case oil, hits a break point.

● Balancing Infrastructure and Services —

Building infrastructure to facilitate bringing new primary fuels to market requires massive investment in infrastructure. Investing activity in liquefied natural gas infrastructure and Canadian oil sands highlights this point. Look for companies that are building equipment, hardware and specialty devices that facilitate rebalancing toward alternative energy supply chains.

● **Demand Management** — When fuel prices go up, consumers complain. Then they start minding how much they consume. Keeping tabs on conservation and counting dollars becomes important. The digital revolu-

tion is spawning the means to do so.

Information-gathering devices to monitor energy consumption, energy efficiency and dollar consumption are going to become increasingly important in all sorts of day-to-day appliances. From corporations to individuals, we'll all be much more aware of how much the work we extract from our various fuel sources is costing us.

● **Process Innovation** — We know that rebalancing is not just about switching to alternative fuels and conserving resources. It's also about finding process innovations that improve the efficiency of the countless number of products in use that are currently dependent upon our primary fuel supply chains. Technology is a major enabler of energy efficiency, and companies that are pioneering ways to become more energy efficient have an increasing value proposition as pressure builds and a break point is reached.

Further, the energy policies of many countries are offering grants and subsidies amounting to billions of dollars for companies to find process solutions. Product innovation is giving way to process innovation, and investing opportunities will be increasing in this area.

The Way Forward

By the end of the summer of 2005, oil had topped \$65 a barrel. And when the aftereffects of hurricanes Rita and Katrina disrupted refinery operations and distribution in the Gulf of Mexico, our nation witnessed a sobering example of how vulnerable we are to operate with so little spare capacity.

These conditions also served to remind us how fortunate we have been to be able to take energy for granted. It means that we live in stable and prosperous times. But those days are over for the moment. High and volatile prices are now the norm in this chapter of our energy evolution. We should not forget, however, that the turmoil and uncertainty surrounding energy throughout history have always led to a brighter future. ■



If you liked *A Thousand Barrels a Second*, you'll also like:

1. ***Black Gold* by George Orwell.** Learn how falling production and rising demand for oil have enabled companies and investment banks to cash in.
2. ***Twilight in the Desert* by Matthew R. Simmons.** Simmons offers a detailed description of the relationship between Saudi Arabia and the United States, and this country's long-standing dependence on Saudi oil.
3. ***The Coming Economic Collapse* by Stephen Leeb, Ph.D.** Leeb shows how hard times can be a boon for smart investors, especially in regards to oil prices and potential investments.
4. ***Commodities Rising* by Jeffrey M. Christian.** Filled with in-depth insights and anecdotes from Christian's 30 years in the commodity markets, this is a resource for investors or traders.
5. ***Beyond Oil* by Kenneth S. Deffeyes.** The author bases his book on the work of M. King Hubbert, who mathematically determined that the world's oil supply would peak in 2000 and then drop steadily thereafter.

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The Services Shift

Seizing the Ultimate Offshore Opportunity

THE SUMMARY IN BRIEF

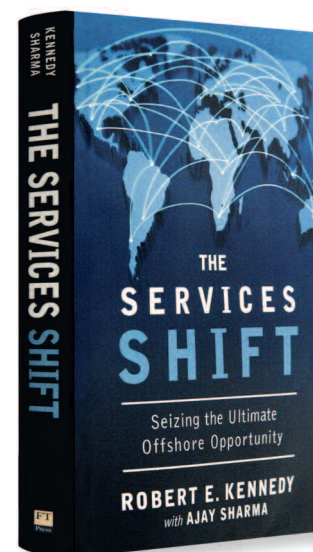
By now, most businesspeople, pundits and politicians in the United States and other developed nations have come to grips with the phenomenon of manufacturing jobs moving offshore. The process is variously referred to as “outsourcing” or “offshoring.” But a far bigger wave of change is approaching the shores of those same developed nations: the globalization of services.

In *The Services Shift*, two leading researchers show how services offshoring works in both industries and individual companies, and they show how to define and implement realistic services-sourcing goals for your organization. You’ll learn who’s involved in services offshoring, understand leading business models and discover the main geographical centers.

The Services Shift previews the enormous wave of services offshoring that is now building — and helps you understand what it will mean for you, your company and the world. It also tours today’s emerging centers of services offshoring, revealing what can be offshored and introducing powerful strategies and tactics for businesses that want to purchase services offshore.

IN THIS SUMMARY, YOU WILL LEARN:

- How to embrace the new revolution in services offshoring.
- Where services offshoring is happening today, what’s coming next and how to profit from key trends.
- How to prepare for the massive financial and political implications of services offshoring.
- How to define the right global-sourcing strategies for your service business.
- How to thrive in the world of services offshoring, where everything from HR management to emergency medicine can be provided from half a world away.



by Robert E. Kennedy
with Ajay Sharma

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THE COMPLETE SUMMARY: THE SERVICES SHIFT

by Robert E. Kennedy with Ajay Sharma

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The Services Shift: Seizing the Ultimate Offshore Opportunity by Robert E. Kennedy with Ajay Sharma.

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For additional information on the authors, go to <http://www.summary.com>.

Introduction

If you're an active manager in the first decade of the 21st century, you already know about the phenomenon of globalization in the manufacturing sector. By any measure, it's enormous.

In 2006, the U.S. trade-to-GDP ratio was 28.0 percent, compared with 11.1 percent in 1970 and 20.4 percent in 1990. In 2006, U.S. companies committed \$60 billion to new manufacturing foreign direct investment (FDI): a jump of 66 percent over the previous year.

The reasons behind this phenomenon are well documented, and they are widely — often hotly — discussed. They include the low cost of labor overseas, fewer regulatory restrictions, proximity to emerging markets (facilitating sales in those markets), the ability to focus home country resources on product development and marketing, the commoditization of manufacturing technology, the rise of supplier clusters in different countries, and so on.

But there's a parallel phenomenon occurring today — another kind of offshoring — that may soon overtake its manufacturing-based cousin in scale and scope: *the globalization of services*.

This is “the services shift.”

Outsourcing and Offshoring

Outsourcing means moving a particular task outside an organization's boundaries. When a company decides to eliminate its in-house food service department and hire an outside contractor to run its cafeteria, it is “outsourcing” that function. For lots of “non-core” practical activities — such as staffing the cafeteria and cleaning the headquarters building — outsourcing means buying

the service fairly close to home.

But many other activities aren't necessarily rooted in geography. In theory, at least, you *could* outsource these tasks to a contractor anywhere in the world. When a task moves across a geographic boundary, we call this “offshoring.”

Offshoring, as the name implies, means moving a function and its associated jobs to another part of the world. Offshoring comprises a wide range of relationships between the “parent” company and remote service providers. Sometimes those providers stay within the corporate boundary, but operate at a geographic distance. Sometimes they are outside the corporate boundaries (they are “outsourced offshorers”). Here, we focus mainly on the offshoring phenomenon, although certainly domestic outsourcing is another important kind of “services shift.”

Fundamental Reorganization

The globalization of services is not simply a story about jobs being moved offshore. It's about a *fundamental reorganization of work*, in which different tasks are being carried out by different individuals in different locations. As new global sourcing options become available, forward-looking managers are actively evaluating tasks, processes and functions inside their firms — from back-office support to leading-edge research — to determine the most cost-effective *and* highest quality location to carry out these activities. In other words, it's not just about finding a low-cost location. It's about gaining access to the best combination of talent, resources and local markets.

Tomorrow's managers will have to become more flexible, more versatile and more broad-gauge. You



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need to understand the offshoring options that are available to you, because — without a doubt — your strongest competitors will certainly understand and exploit them. ●

Globalization of Services: What, Why and When

The global economy is in the midst of a vast transformation. Globalization can be measured in many ways — in terms of government policies, actual trade and investment flows, and so on — and nearly every measure shows that economic linkages among countries have become more extensive. Three measures illustrate this change.

The first measure is a country's "openness" to international trade and investment. In 1994, and later in 2000, seven factors were used to calculate a "policy openness" index in 192 countries. These factors included average tariff rates, regulatory restrictions on FDI, the presence or absence of a two-tiered foreign exchange system and others.

Research results show that the share of the global population living in open economies remained fairly steady from the early 1960s through the mid-1980s. Then, starting around 1986 and accelerating in the early 1990s, dozens of countries implemented programs of economic liberalization that deregulated domestic markets and lowered barriers to trade and investment.

The Bottom Line

What's the bottom line for managers today? The global economy has undergone substantial changes in the past 20 years. It is likely to change *even more* over the next 50 years. The engines of growth in the new global economy are increasingly located in developing countries. How managers seize these opportunities and manage the challenges these trends create will determine the success or failure of their companies and careers.

The Compelling Case for the Services Shift

Today's business environment is one of increasing competitive intensity, on a global scale, creating staggering new challenges for managers.

It's an environment characterized by *increased volatility* and *greater uncertainty*. The average product life cycle is shrinking, meaning that companies need to bring more products to market, and do it faster. Consumers are becoming more demanding, insisting on more value at lower price points. There is a growing need to continually come up with something *new* (product or service or

You and Your Vendor

Transformational outsourcing requires a very close partnership and assumes the most complex kind of relationship between the service provider and the service recipient. You and your vendor will have to interact intensively, invest in each other extensively, renegotiate the contract(s) continuously and trust each other intimately. You have to be prepared to engage in a long-term relationship, most likely based on gain-sharing, equity-sharing or a joint-venture model.

market) or something *better* (efficiencies, product features, customization, personalization, etc.).

Meanwhile, new technologies and business models are lowering barriers to entry, introducing disruptive changes and creating asymmetric competition. Competitive intensity has increased as technological innovation has accelerated.

Meanwhile, the speed, efficiency and global nature of financial markets generate a steady drumbeat of demand for greater shareholder value, trimmer balance sheets and stronger bottom lines.

Better, Cheaper and Faster

In short, companies are compelled to deliver along multiple and seemingly contradictory dimensions. They have to be better *and* cheaper *and* faster — all at the same time!

Here's where the phenomenon that we refer to as the "services shift" can, and should, come into play.

Most of these forces compel companies to look offshore for solutions to at least some of their problems. From a defensive standpoint, they need to lower their costs to compete — and offshoring certainly offers that prospect. But offshoring also allows companies to be proactive in shaping their futures: by improving the quality of products and services, developing new offerings and — over the long term — creating toeholds in the economies and markets that will be most important years and decades down the road. ●

The Economics and Drivers of Offshoring

When we begin contemplating moving some aspect of our enterprise offshore, it's important to focus more closely on the process of value creation.

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One way to think about how firms create and capture value is by using a framework originally developed by Harvard Professor Michael Porter. The value chain approach was first presented in Porter's 1985 book, *Competitive Advantage*.

Porter's central insight was that a firm is actually a system of interconnected activities, with both physical and informational linkages. A firm's competitive position in the marketplace results from superior or inferior performance in specific activities. With this perspective as a starting point, activity-level performance can be explored analytically and strategies can be formulated to improve the firm's position.

The Value Chain

Primary activities are the steps that directly impact the product/service that customers care about. In a manufacturing firm, these include inbound logistics, operations, outbound logistics (distribution), marketing and sales, and service. Support activities are those that provide the background necessary for the effective and efficient operation of the firm but do not impact the main product/service directly. Support activities typically include human resources, information technology and accounting.

Value chain analysis posits that competitive advantage occurs at the activity (or functional) level. The analysis and strategy formulation process consists of three distinct steps:

- Breaking down the firm's key functions into primary and support activities.
- Assessing the potential for adding value in each activity.
- Formulating strategies that focus on key activities that enable companies to sustain a competitive advantage.

Superior Performance

The value chain framework provides several insights. First, *competitive advantage results from superior performance in specific activities*. In most industries, one or a few activities are "core" — that is, they are the keys to competitive advantage. The value-chain approach argues that managers should *focus their efforts on improving performance in core activities*, meanwhile making sure that other, non-core activities are performed at an acceptable level. These non-core activities are good candidates for outsourcing, particularly if there are outside firms that specialize in these non-core activities (for example, ADP in payroll processing, EDS in running data centers and Hewitt Associates in managing human resources processes).

A second insight is that *there are two generic sources of competitive advantage: low cost and differentiation*. Firms can win in the marketplace either by offering standard products at the lowest cost or by distinguishing their products in such

a way that customers are willing to pay a premium for them. Again, cost strategies and differentiation take place at the activity level.

Digging Deeper

Companies don't have to perform all the activities that ultimately are required to create value for their customers. Firms can partner with other companies (very often, established vendors) and *outsource* some of these activities to them.

Firms are no longer constrained to perform all value-creating activities within the borders of their home countries. Some of these activities can be located *offshore* (outside the national borders of the firm's home country) in places where they can be carried out most effectively. Phrased slightly differently, for many service companies, *new sources of value are likely to be found outside the boundaries of the firm and the nation*.

Firms that decide to pursue those new sources of value generally face two key decisions. The first is the "make or buy" decision: Do you perform the activity within the firm or do you outsource it to another firm? The second relates to the geographic location: Should the activity be located "locally" (that is, within the same country) or remotely (abroad)?

Five Key Drivers of Services Globalization

What's driving services globalization today? We can point to five such "drivers":

Driver #1: An ongoing global market liberalization. In only 13 years, the percentage of people around the world living in "open" economies rose dramatically, from 23 percent in 1985 to 78 percent in 1998.

Driver #2: The digitization of business processes. The explosion in outsourcing and offshoring is in large part the result of the digitization of a wide range of business processes, including payroll, procurement, customer support and many others.

Driver #3: The low cost and high speed of computing and telecom. It's worth reminding ourselves that no modern technological advance has ever been embraced as quickly.

Driver #4: Growing capabilities around the globe. The 2005 MBA rankings by the Economist Intelligence Unit identified a Spanish school as the world's top MBA program, and 10 out of the top 25 MBA programs in that particular ranking were located outside the United States.

Driver #5: The rise of a global business culture. Since the mid-1990s, schoolchildren in China have been required to learn English starting in primary school. The

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British Council estimates that by 2015, 3 billion people — in other words, almost half of the world's total population — will speak more or less fluent English.

Re-evaluating Boundaries

The five drivers exert a powerful influence on global business, and they are only going to increase in importance.

For service companies, the drivers of globalization — especially technology and economic liberalization — have led to serious re-evaluation of the boundaries of the firm.

Is the globalization of services simply a fad, or is it likely to be a permanent and growing phenomenon? The answer to that question grows directly out of the five drivers. Of those five, only the first (ongoing global market liberalization) can be considered “reversible” in any significant way. Yes, it's conceivable that one or more of the recently liberalized economies — put under some sort of serious social or political strain — could slip back into the kind of static, centralized economic model that characterized their past. This is conceivable, but unlikely, because liberalization creates its own momentum.

The other four drivers exist more or less outside the realm of public policy and legislative fiat. The first two are technology-focused, and history suggests that once a technology genie is let out of the bottle, it can't be stuffed back in.

The second two are people-focused, and once people have acquired skills and a new (self-interested) way of looking at the world, they are unlikely to be led back into the old, unproductive ways of doing things.

In short, the globalization of services is here to stay and is only likely to accelerate in the future. ●

Making It Real

As you start your sourcing journey, it is important to define your goals and expectations. This may sound self-evident, but establishing a clear definition of what you hope to achieve through offshoring may be more elusive than you might think.

Three Offshoring Goals

There are three distinctive (but interrelated) goals you may choose to pursue through offshoring: efficiency, enhancement and transformation.

- **Efficiency.** The goal of efficiency-focused sourcing is to maintain existing service quality, availability and consistency while cutting costs, commonly through labor arbitrage (that is, buying your labor more cheaply elsewhere).

- **Enhancement.** By moving to a better technology platform, re-engineering existing business processes or otherwise embracing ways to do things better, you can improve your operational performance and outcomes. Here, your primary focus is not on cost reduction, but on process improvement — which often leads to reduced costs, along with higher quality, increased availability and other good outcomes.

- **Transformation.** This is aimed at achieving rapid, sustainable step-change in enterprise-level performance, often through bundling technology, consulting and outsourcing. The point is to dramatically improve the competitiveness of the organization by creating new value and new revenues, outmaneuvering the competition and changing the very basis on which your corporation operates.

Effective Outsourcing/Offshoring

Here is an eight-step process for effective outsourcing/offshoring:

1. **Identify the tasks.** Consider whether the tasks are routine and repetitive in nature — and are thereby *efficiency* focused — or whether they require knowledge and skills and are thus *effectiveness* focused.

2. **Map the process(es).** Visually display exactly what happens across the collection of activities that together create value.

3. **Decode the relevant technology and infrastructure.** As you consider outsourcing or offshoring your business processes, you need to confirm that your underlying information technology applications and infrastructure can support this strategy.

4. **Identify and mitigate risks.** These risks include geographic and location risks; migration risks; business operations risk; customer, employee and capabilities risks; and the risk of “holdup” by a vendor under the guise of a renegotiation due to “unforeseen circumstances.”

5. **Select a vendor.** Assess vendors thoroughly on the “Three C's” of outsourcing: capabilities, culture and commitment. Most companies in search of an outsourcing vendor follow these four steps: Create a vendor selection team, short-list appropriate service providers and reach out to them, evaluate these potential providers, and negotiate the contract.

6. **Select a geography.** While India has long been the leader in IT and IT-enabled services, the phenomenon is no longer India-centric. China, Southeast Asia, Central and Eastern Europe, and Latin America have emerged as attractive destinations for global service delivery.

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7. Migrate your operations. The *migration* of tasks — along with knowledge, systems and capabilities — is the phase when tasks that are currently being run in-house/onshore are handed over to an external vendor or moved offshore.

8. Integrate your operations. Even as processes move outside a firm's boundaries, companies need to ensure control of overall cost, risk and quality. This can be achieved by ensuring continued operations integration. ●

The Supply Side

Offshoring follows the fundamental rules of economics and incorporates most of the lessons learned in the fast-growing universe of global trade. These include the following:

- **The need to strike appropriate balances.** Firms must balance cost savings against the investment required to achieve those savings. At the same time, they must weigh the risks inherent in offshoring (including loss of control, exposure to macroeconomic risks, public perception, the distribution of sensitive data and intellectual property, and so on) against the likely benefits.

- **The need to achieve scale.** For many basic operations, the key is to gain sufficient scale in order to minimize costs. Large firms can achieve this internally. Small firms generally go to outside vendors, which gain scale by aggregating across many customers.

- **The need to build and control an expertise.** Some businesses involve specific skills — for example, in fields such as radiology, genomics research and so on. This creates the need to gain access to specific people, who by and large tend to have bargaining power and mobility. In some cases, multinational corporations — for example, large pharmaceutical firms — can successfully hire and retain these people. In others, the talent bands together and acts as a group (for example, paralegals and radiologists) that offers its services as independent vendors.

- **The need to create or embrace appropriate business structures.** Higher perceived risks (to business processes, intellectual property, outsiders or data) make it more likely that a particular process or task will be kept in-house.

Types of Vendors

Many types of vendors and corporations are delivering global IT and IT-enabled services from offshore. These organizations employ a variety of business models for providing offshore services, which can be grouped into four categories:

- **Captives of multinationals.** “Captives” are wholly owned subsidiaries of multinationals, and this business model is used by many prominent companies today, including American Express, Microsoft, Oracle and Motorola.

- **Offshore IT vendors.** Offshore-based IT service providers, such as TCS, Infosys, Wipro, Satyam and Mphasis, have grown aggressively and matured substantially in recent years.

- **Multinational outsourcing firms.** Leading multinational service firms (such as IBM, HP and EDS in data systems; Convergys and Sitel in call centers; and Accenture and Siemens in business services consulting) now have a sizeable offshore presence.

- **Offshore BPO-specific firms.** Along with the increase in volume and value being delivered from offshore, there has been an expansion in the types of activities being offered, resulting in more and more processes in a greater number of industries being serviced from offshore. This has led to increased fragmentation and specialization, and the emergence of different types of offshore BPO-specific firms.

As you consider your offshoring options, think about how location, task and organization can be made to intersect to your advantage. At the same time, scrutinize the likely transaction costs associated with your options. ●

Shifting Skill Sets

While the services shift creates many new possibilities to create value in your organization, it also requires the development of new and different skill sets in your management team. Simply put, instead of directly managing people and outcomes, the global sourcing manager generally exerts influence indirectly, through negotiations, mutually agreed-upon goals and the intelligent design of incentive systems for vendors.

These new functions require global managers to draw on a very different toolkit. Some of these skills are obvious — for example, analytical skills, IT solutions and structured root-cause analysis all play an important role in managing offshore operations. But some of the changes are less obvious. The global operations manager has to step up his or her game on both the analytical and the soft-skills ends of the spectrum.

What This Means for Your Company

This shift in management roles has broad implications for your company, assuming you seek to capitalize on the opportunities offered by global sourcing. First, you will need to seek new skill sets in middle-manage-

ment positions, with an emphasis on both analytical and soft skills. Second, you will need to revisit and reconceptualize basic organizational issues. Finally, you will have to communicate a new working culture to your employees. Gone are the days of “9 to 5, Monday through Friday.”

Today’s managers need to keep their passports in their desk drawer and their immunizations up to date. They need to be ready to catch an overseas flight at the drop of a hat. They need to keep their BlackBerrys and cell phones charged up and on at all times — almost literally.

Transformation

Going forward, the easy gains from labor arbitrage will be available to most firms. Once that happens, the source of advantage will shift to accessing talent and tapping into global resources to facilitate transformation.

That transformation has to extend to individuals and individual jobs. Among middle managers, it seems, the success rate is somewhat higher — but in the process of succeeding, their work lives change dramatically. They live in the world of service level agreements (SLAs), intercontinental travel and root-cause analysis.

What about senior management? Senior managers may be in the best possible position to take advantage of organizational transitions. If you chart the right course and invest wisely in your people — and, yes, disinvest when necessary — you are likely to see productivity increase as costs decrease. You are likely to know *more* about your organization — thanks to improved reporting — even as your resources become more dispersed geographically. And perhaps most rewarding of all, you’re likely to get the benefit of great business ideas bubbling up from the virtual trenches. ●

The Services Shift: Policy Implications

In most countries today, services account for the largest share of economic activity. In the United States, for example, services account for 67 percent of both GDP and employment if we exclude government from our definition of “service.” These are staggering figures from almost any perspective. And because the manufacturing sector itself has a steadily growing component of services — such as R&D, design, logistics, marketing and servicing — even these huge percentages tend to understate the importance of services.

So the policy implications that grow out of the

Four Challenges for Developing Economies

Developing economies face multiple challenges as they seek to attract and grow global services industries. These can be considered in four “buckets”:

- **Infrastructure.** This plays a critical role in a country’s competitive position.
- **Human capital.** General education levels are critically important.
- **The regulatory environment.** Tax policy is a particularly important component of the regulatory environment.
- **Social repercussions.** Multinationals can crowd out existing domestic firms.

expanding globalization of services are both far ranging and complex. In recent decades, many restrictions to trade in manufacturing have been removed via trade agreements and the World Trade Organization process. The demand for a corresponding liberalization in the services sector has become more and more insistent — and is already well under way.

Globalization

Globalization has come to the services sector. In the long run, and taken in the aggregate, it is a vital element of growing productivity and living standards. Over time, many clever approaches have been proposed to mitigate or stop trade flows, but history shows that countries that embrace trade prosper, and those that don’t, don’t.

But trade in services differs in some important ways from what we have traditionally seen in manufacturing and/or natural resources. It affects huge new areas of the economy. Many of the tasks and processes that move are not “low end,” but rather affect people “like us.” As the old economist’s joke puts it, “A recession is when your neighbor loses his job. A depression is when you lose yours.”

The good news is that the policies that made sense to deal with globalization in manufacturing largely apply to the services shift. Think long term, invest in accumulation, allow reallocation and promote innovation. And most of all, *don’t throw sand in the wheels of commerce*. It’s expensive and it doesn’t work. Instead, look for the lubricant. ●

Looking Ahead

Here are seven predictions about the future of the services shift:

- 1. Global sourcing will continue to grow — rapidly.** There is still plenty of room for growth in global sourcing.
- 2. The key word will be “global.”** Expect global sourcing to become steadily more global.
- 3. Global services sources will keep moving “up the food chain.”** Today, we see firms such as ITTIAM (chip design in India), Microsoft (graphics research in China) and Pfizer (genomics research in India) moving some of their most sophisticated jobs to low-income countries.
- 4. Talent will become more important than cost.** A recent survey of civil engineers in the United States revealed that about 20 percent of CE firms had experience with offshoring. Among those firms, 47 percent had ventured overseas in search of lower labor costs — but another 40 percent went to procure more capacity or specialized talent.
- 5. The scale will decline dramatically.** “Scale” here is the scale of the projects that are likely to be serviced globally in the coming years. Suppliers will come up with increasingly specific competencies that will service increasingly specialized market segments.
- 6. Global sourcing will become increasingly personal.** We are almost certain to see a dramatic rise in personal services: tutoring, concierge services, schedule management and so on.
- 7. We will see more two-way travel.** Almost certainly, we will see customers traveling to the suppliers for some outsourced services. The economics of medical tourism can be compelling. The knee replacement that might cost \$40,000 in the United States costs \$18,000 in Singapore and \$8,500 in India. With insurance companies and global hotel chains working together to promote medical tourism, the industry is almost certain to grow exponentially — from \$60 billion in 2006 to \$100 billion by 2012, according to McKinsey.

Complex Landscape

For most companies, making the services shift isn't easy. Even assuming that infrastructure-related issues don't cause problems for you — and in more and more parts of the world, the technological and physical infrastructure is coming up to world standards — you will almost certainly find that cross-cultural challenges persist. Among 200 U.S. business executives polled in a recent Accenture survey, for example, two-thirds said that their companies had experi-

enced problems offshoring because of cultural differences.

In addition to more countries and more firms, there are more and more types of firms participating in the global sourcing landscape. The broad-line providers are all rapidly growing their geographic footprint.

There are also hundreds, possibly thousands, of new specialty firms, offering everything from personal concierge services to sophisticated data analysis and research services. These generally small, focused vendors tend to deliver higher-value services, and they account for a growing share of the sector.

A more complex landscape is the natural result of the sector's maturing. As a customer, you face more and more options to meet your global sourcing needs. Yes, greater complexity creates confusion in the short run, but it also gives you the potential to create and harvest greater value through your operations in the longer term.

A Game You May Have to Play

If the services shift is so difficult, why are companies doing it? There are many reasons, but in the end, companies are doing it because they have to.

The business environment is constantly changing, and forward-looking firms are always searching for and seizing new options. The past decade has seen the sequential removal of various barriers to globalization in the service sector. These include economic liberalization, technological innovation, improvements in education in low-income countries and the emergence (some might say triumph) of an American-style global business culture.

Some pundits and polemicists would prefer to ignore these new options and insist that “responsible” firms not pursue them. But this is simply head-in-the-sand logic. Think of the British Army marching in formation (in bright red jackets) during the Revolutionary War, being picked off by the ragtag American colonists. Those who cling to the past — those who rush into battle with the wrong weapons or the wrong strategy — will be ground down. Eventually, they will lose the war. ●

RECOMMENDED READING LIST

If you liked *The Services Shift*, you'll also like:

- 1. *Intelligent M&A* by Scott Moeller and Chris Brady.** Moeller and Brady set forth a solid strategy for thriving in the high-stakes, high-stress environment of mergers and acquisitions.
- 2. *The New Age of Innovation* by C.K. Prahalad and M.S. Krishnan.** This successful title presents a better method for business processes to smoothly connect consumers and resources.
- 3. *Wikinomics* by Don Tapscott and Anthony D. Williams.** The authors address how the Internet's social network offers new, decentralized ways to produce content, goods, services and profit.

· Book 6 of 32 ·

3303 Makrowikinomics

Don Tapscott and Anthony D. Williams



Macrowikinomics

Rebooting Business and the World

THE SUMMARY IN BRIEF

In their 2007 bestseller *Wikinomics*, strategy experts Don Tapscott and Anthony Williams showed the world how mass collaboration was changing the way businesses communicate, create value and compete in the new global marketplace. Now, in the wake of the financial crisis, the principles of wikinomics have become more powerful than ever.

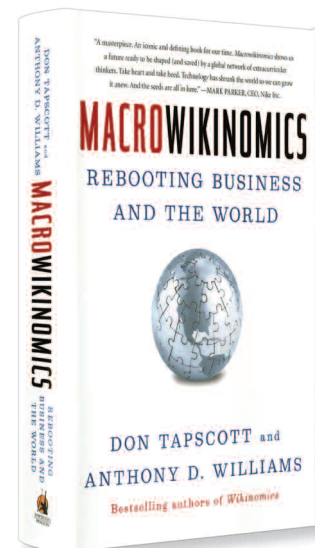
Many of the institutions that have served us well for decades or centuries seem stuck in the past and unable to move forward. And yet, in every corner of the globe, a powerful new model of economic and social innovation is sweeping across all sectors — one where people with drive, passion and expertise take advantage of new Web-based tools to get more involved in making the world more prosperous, just and sustainable.

In many fields — from finance to health care, science to education, the media to the environment — we have reached a historic turning point: Cling to the old industrial era paradigms or use collaborative innovation to revolutionize not only the way we work, but how we live, learn, create, govern and care for one another.

Macrowikinomics provides vivid new examples of organizations that are successfully embracing the principles of wikinomics to change the world.

IN THIS SUMMARY, YOU WILL LEARN:

- How to translate the latest developments in collaborative innovation and open systems.
- How to rethink and rebuild many industries and sectors of society with a new, open, networked model.
- How to reboot our business, education, media and government institutions.
- A map for the transformational voyage organizations must take.



by Don Tapscott and
Anthony D. Williams

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THE COMPLETE SUMMARY: MACROWIKINOMICS

by Don Tapscott and Anthony D. Williams

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For additional information on the authors, go to <http://www.summary.com>.

From Wikinomics to Macrowikinomics

As a mode of production the industrial economy was infinitely superior to what came before it (the agrarian craft society), dramatically advancing wealth, prosperity and the standard of living for many. But this was a centralized, one-way, one-size-fits-all mass model controlled by the powerful owners of production and society.

Now, because of the new Web, the old industrial models are all being turned on their heads. There is now a new engine of innovation and wealth creation and a powerful new force that radically drops collaboration costs and, as such, enables communities to collaborate on shared concerns, endeavors and challenges. We can rethink and rebuild many industries and sectors of society on a profoundly new, open, networked model. Indeed, for the first time in history, people everywhere can participate fully in achieving this new future.

Rebooting the World

In *Wikinomics* (Portfolio 2006), this new force was called “mass collaboration” and it was reaching a tipping point where social networking was becoming a new mode of social production that would forever change the way products and services are designed, manufactured and marketed on a global basis. But, in the years since the idea was penned, it’s clear that wikinomics has gone beyond a business or technology trend to become a more encompassing societal shift. It’s a bit like going from micro- to macroeconomics. In which case, wikinomics, defined as the art and science of mass collaboration in business, becomes macrowikinomics: the applica-

tion of wikinomics and its core principles to society and all of its institutions.

Just as millions have contributed to Wikipedia — and thousands still make ongoing contributions to large-scale collaborations like Linux and the human genome project — there is now a historic opportunity to marshal human skill, ingenuity and intelligence on a mass scale to re-evaluate and reposition many of our institutions for the coming decades and for future generations. After all, the potential for new models of collaboration does not end with the production of software, media, entertainment and culture. Why not open-source government, education, science, the production of energy and even health care? These are not idle fantasies, but real opportunities that the new world of macrowikinomics makes possible.

Five Principles for the Age of Networked Intelligence

Organizations can succeed and even thrive in this new environment by embracing the five principles of wikinomics: collaboration, openness, sharing, integrity and interdependence. These are not only key business principles; they are principles for achieving a world that is secure, prosperous, just and sustainable.

1. Collaboration. An increasingly complex and interdependent global economic environment is now exposing hierarchical institutions as being deeply limited and perhaps even a liability as we enter an era in which the upper bounds of human ingenuity will be tested.

2. Openness. Among other things, openness is associated with candor, transparency, freedom, flexibility, expansiveness, engagement and access. Recently, because of the digital age, smart organizations have been



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rethinking openness, and this is beginning to challenge conventional business wisdom and transform a number of important functions and institutions.

3. Sharing. If openness is about the communication of pertinent information to stakeholders of firms, governments and other organizations, sharing is about the releasing or handing over of assets by placing them in “the commons” for others to use or by sharing them with interested users under agreements that may generate license revenue.

4. Integrity. Companies that do bad things tend to fail. There is strong evidence that companies and other organizations are being forced to act with integrity, not just by regulators and institutional shareholders, but also because of the forces of this complex networked age, in particular, transparency.

5. Interdependence. The interdependence of actions and events means we have no option other than to try to encourage and enforce mutual cooperation through a new division of labor among the four key pillars of society: business, government, the civic sector and a new pillar enabled by the Internet: the individual citizen. ●

Rethinking the Fundamentals

A discontinuity, the dictionary says, refers to a break or gap in the logical sequence or cohesion of things. By the year 2008, in the financial world, the term became a deeply cynical euphemism summing up the reckless, sometimes unscrupulous behavior that led to the global financial and economic crisis of 2008–2009. Mortgage brokers convinced people to buy houses they couldn’t afford, on the premise that housing prices would forever go up, and then, with the help of the investment bankers, handed the risk of default to unsuspecting institutions and investors. This was a scheme that greatly enriched the brokers and bankers, at least for a while, because of one key feature: It was so obscure that virtually no one could understand what was going on, and at what real risk.

When the game ended, and the market toppled, it cost American taxpayers billions of dollars. Faced with a historic market crash, the worst recession in three generations, plus government guarantees that exceed the cost of every war the country has ever fought, American taxpayers are understandably furious. Many people are reviving calls for updated regulations, more government intervention and even the breakup of the big banks. But most of the proposals are pretty much tinkering within the existing framework.

The Transportation Revolution

New forms of green transportation infrastructure are being built and tested in various countries in hopes that such infrastructure could eventually power a worldwide electric car fleet and end our dependence on oil. Innovative car sharing services, like Zipcar, are beginning to reshape car ownership, while a ubiquitous transportation data network, should it be built, could help optimize our roads and unleash a large interoperable cloud of new services that do everything from real-time traffic shaping to in-car shopping and entertainment.

Opening Up the Financial Services Industry

Restoring long-term confidence in the financial services industry in the United States and other industrialized nations will require more than government intervention and new rules. What’s needed is a new modus operandi, one where all of the key players (banks, insurers, investment brokers, rating agencies and regulators) embrace transparency and other wikinomics principles in order to develop credible practices and policies that will ensure the crisis doesn’t reoccur. If the investment community and the broader public understand the true causes of the financial disaster, perhaps they can protect themselves against financial adventurers in the future.

In short, it is time to shine the light on the opaque products and activities of the financial sector that have threatened the entire economy, and the Web provides a platform to do this. A digital response involving collaboration on a mass scale may be the best way to properly evaluate and assess the value and risk of new financial instruments as they are produced. New models based on openness, transparency and participation are already changing many parts of the industry from venture capital to mutual funds and even lending, so why not apply the same thinking to the obscure mathematical models that value the risk and expected returns of the most complex instruments; expose them to the scrutiny of the thousands of experts who have the knowledge to vet the underlying assumptions?

Arguably, this is the perfect time for fresh and even radical thinking. When it comes to evaluating risk, this interconnected digital crowd comprises people who are financially sophisticated and can provide the innovative insight that will clarify the questionable dealings in the financial services business. A more open and collaborative approach would restore trust in banks, kick-start venture capital, unfreeze the paralysis of lending markets and lay a foundation for a financial service industry that

continues to underpin the growth and prosperity of the world's economies.

Bootstrapping Innovation and Wealth Creation

Twitter, Facebook and Wikipedia may have captured the popular imagination, but collaborative innovation goes a lot further. It's a new way for people to socialize, entertain and transact in peer communities of their choosing and it opens up exciting new opportunities for individuals to participate in the economy — from designing and selling T-shirts through Threadless.com to helping NASA build a better astronaut glove.

Indeed, for the first time in history, individuals and small businesses can harness world-class capabilities, access markets and serve customers in ways that only large corporations could in the past. Small and medium-size enterprises, for example, can make and sell products to a global market without having to manufacture anything themselves.

Reindustrializing the Planet

Greg Asner and Carlos Souza, two scientists at the forefront of forest science, are hoping to uncover the location and rates of deforestation around the world and link them to climate change. But instead of traversing through vast tracts of jungle in Indonesia or Brazil, they have been using Google Earth, available to anyone with a computer and Internet connection. The scientists are working with Google's team to analyze satellite images that can shed light on the status of the world's forests, without the need for expensive field studies.

While free tools like Google Earth empower the world's scientists and policy makers, they also make information that was once inaccessible and hard to understand available to the broader public. Indeed, Google Earth, along with the data-crunching capabilities of Google's server farms, provides an ideal platform on which to enhance our understanding of humanity's impact on the biosphere.

Reversing the Tide of Disruptive Climate Change

Of course, fostering understanding on its own is not enough to heal our imperiled planet: We need innovative solutions and we need to take the necessary actions to put those solutions in motion. On Jan. 21, 2008, millions of American students in nearly 2,000 academic institutions stepped up to the plate as part of the day-long civic engagement discussion called Focus the

Nation, which focused on climate change, its consequences and potential solutions. Joining these students were some powerful players, including 64 members of Congress, 15 state governors and countless local politicians. The event created a groundswell of activism and helped spur government policymakers into action. Thousands went online to vote on a list of possible solutions — with the most votes going to a proposed increase in federal spending on clean energy R&D.

What do scientists like Asner and Souza and these students have in common? On one hand, they share a belief, one increasingly backed by scientific evidence, that problems like pollution, water shortages, habitat degradation and climate change threaten the ecological systems that sustain our economy and our way of life. On the other hand, they are part of a broader mass movement — a growing network of people with the motivation and the capacity to enact the deep changes required to bring our modern way of life into balance with nature's support systems.

For the first time we have one global, multimedia, affordable, many-to-many communications system that we can use to better understand the causes and consequences of climate change and develop appropriate responses with input from a global array of citizens, governments and businesses.

Wikinomics Meets the Green Energy Economy

A growing number of companies are developing intelligent infrastructures to measure everything from water to natural gas flows. For example, SAS business analytics allow utilities, such as Brazilian utility Cemig, to precisely forecast electrical demand in both the long and very short term. Cemig can even predict how demand will change when a World Cup soccer game starts or ends and televisions are turned on or off. Others, like IBM, are piloting schemes to monitor entire systems, such as supply chains and transportation networks. The company has developed sensors and Radio-Frequency Identification (RFID) tags that can track foodstuffs, such as meat or other horticultural products, from the producer all the way to the supermarket shelf. Armed with this data, retailers can ensure the quality of supply while customers can make smarter purchasing decisions.

The drive to make all things “smarter” by connecting electrified objects on the Internet will, within a few years, result in a flood of new data that can be aggregated and analyzed, providing a powerful engine for energy dashboards and trading platforms that help households and businesses optimize their consumption. ●

Learning, Discovery and Well-Being

In an age of unprecedentedly high enrollment, there is evidence that universities are losing their grip on higher learning as the Internet inexorably becomes the dominant infrastructure for knowledge — both as a container and as a global platform for knowledge exchange between people — and a new generation of students requires a much different model of higher education. The transformation of the university is not just a good idea — it is an imperative. Luckily, we are living in a time of great opportunity and there is a stream of proposals for change coming from within academia itself.

Some say the Web enables distance learning and the elimination of campuses. Others argue that we need more technology in higher education, or colleges should be opened up and made free to all. There are renewed calls to abolish tenure and even to replace traditional departments with a new set of problem-focused disciplines. The trouble is that most of these ideas don't address the fundamental problems with the university or show a way forward.

Rethinking the University: Collaborative Learning

Rather, change is required in two vast and interwoven domains that permeate the deep structures and operating model of the university. First, we need to toss out the old industrial model of pedagogy — how learning is accomplished — and replace it with a new model called collaborative learning. Second, we need an entirely new modus operandi for how the content of higher education — the subject matter, course materials, texts, written and spoken word and other media — is created.

Rather than the old textbook publishing model, which is both slow and expensive for users, universities, professors and other participants would contribute to an open platform of world-class educational resources that students everywhere can access throughout their lifetime. If universities open up and embrace collaborative learning and collaborative knowledge production, they have a chance of surviving and even thriving in the networked, global economy.

Igniting Knowledge Creation in a Networked World

The Internet is not just a low-cost medium for disseminating scientific information; it's the new platform for doing science, period. Thousands of scientific pioneers now rely less on "the paper" as the prime vehicle

for scientific communication and more on tools such as blogs, wikis and Web-enabled databanks. Rather than wait a year or more to crank out a traditional publication, they use Twitter and other social media to share day-to-day findings and observations with a global network of peers. Better and cheaper access to knowledge and scientific tools, in turn, is making the whole process of learning and economic change more efficient.

As these new forms of mass collaboration take root in the scientific community, there is an opportunity to completely rethink not just how we publish science, but how we apply science to drive innovation, solve problems and create economic opportunity.

Collaborative Health Care

Web 2.0 also puts the informed patient into a new context. It enables a new model of medicine called "collaborative health care," which would give us a system that is cheaper, safer and better than what we have today. A key component of collaborative health care is user-generated medical content, just as new user-generated content is becoming an essential component in fields such as journalism, learning, science and the media. In the health care industry, Web 2.0 enables people to self-organize, contribute to the total sum of knowledge, share information, support each other and become active in managing their own health. Citizens will be active in researching their own health, sharing their experience with others and consulting with health care professionals when necessary. Because patients are engaged, they are managing their own health more effectively, reducing costs and improving outcomes. This is already happening on a small scale, and we're only scratching the surface of the possibilities.

Not only is collaborative health care focused on the patient; the patient co-creates health care and wellness, producing an outcome that is more evidence-based and cost-effective. ●

Turning the Media Inside Out

The digital revolution has affected no sector more than media and entertainment. Newspapers throughout the United States and Canada are collapsing.

The Demise of the Newspaper

The collapse of newspapers is not coincidental, conjectural or containable. It is systemic — rooted in the digital revolution. So the leaders of the old media should take a deep breath and get going on the kind of experimentation required to forge some new approaches that are sustainable.

As the media becomes democratized and as those vested in the old paradigm fight change, a historic period of calamity is in the making. At the same time there are fresh, sometimes breathtaking new innovations in every medium — experiments and juggernauts that show us the way forward.

Professional Bloggers

Technorati reports in its 2009 State of the Blogosphere that a whopping 28 percent of bloggers report earning income from their blog. Half of these “professional bloggers” write full-time either to support their business or as a business itself. A remarkable 17 percent say blogging is their primary source of income.

Though the majority of blogs or other citizen-producer media are typically not of a quality to compete with commercial media, they point to the increasing ease with which anyone can create their own news and entertainment and bypass established sources.

Inside the Future of Music

Playing for Change is an outstanding Web site that shows the power of digital technologies being used to help create innovative and exceptional music. Through videos, photos and blog entries, the site tracks the travels of award-winning filmmaker and producer Mark Johnson, who has circled the world to showcase the world’s incredibly rich diversity of musical genres. From a blind street singer in New Orleans to Native American drummers and South African choral singers, Johnson uses the power of the Internet to bring hundreds of talented and colorful musicians from dozens of regions to the world’s attention. Johnson’s got it all on his Web site and he’s inspired some pretty unique musical collaborations as a result.

Johnson’s first recording was of a street musician in California singing “Stand by Me.” Then he recorded and filmed 37 other street musicians in different countries singing or playing the same song. Each musician could hear and play along to the music of the other musicians already recorded. When the individual recordings were woven together, the result was a true musical tapestry and an unparalleled international musical collaboration. The song was a hit too — its riveting video was a favorite on YouTube and Facebook and has been viewed more than 30 million times.

As the Playing for Change project shows, the Internet opens new doors for creative collaboration and new models in the arts. Just about everywhere, the Web and the principles of wikinomics are changing the way music is produced and disseminated, deepening the bond between performers and music lovers.

The Future of Television and Film

Just as MP3s and the Internet have turned the music industry upside down, emerging technologies in the film industry promise equally dramatic changes coming soon to a theater near you. Or to your computer screen. Or big-screen TV. Or mobile phone. The current model of the film — two hours in a dark theater with popcorn — won’t disappear, but it will become just a small piece of the bigger market that is best described as Film 2.0. Movies, video games, digital effects and networking will all mesh to change where and how we watch films. And how films are created, distributed and monetized. Wikinomics is beginning to transform the movie, the movie business and how people interact with video content.

In 2010, Google announced it would build trial ultra-high-speed broadband networks in a small number of locations across the United States. The project promises fiber-to-the-home Internet speeds of 1 gigabit per second, more than 100 times faster than what most Americans have today. At this speed, a high-definition movie can be downloaded in less than 30 seconds, which leaves cable and satellite twisting in the wind. ●

Rebooting the Public Square

Despite being a decade into the 21st century, the unfortunate reality is that most governments still reflect industrial-age organizational thinking, based on the same command-and-control model as industrial-age enterprises.

Despite numerous attempts, very little has changed in the past half century. Too many government organizations are still largely locked into old structures and outmoded ways of working.

Creating Public Value

The good news is that just as new waves of innovation are washing over the private sector, opportunities to harness new models of collaboration and innovation are arriving at the doorstep of governments everywhere. Indeed, if mass collaboration is changing how enterprises innovate, orchestrate capability and engage their stakeholders, why can’t the public sector seize networked business models to cut across departmental silos, improve policy outcomes, reduce costs and increase public value? Market forces alone cannot meet the needs of today’s citizens. But neither can the old industrial age models of government.

Aging demographics, rising deficits and a hatful of planetary challenges demand new models of government and democracy based on the five principles of wiki-

nomics: openness, collaboration, sharing, integrity and interdependence. If politicians and public servants are to ensure their relevance and authority going forward, they must move quickly to meet rising expectations for openness, accountability, effectiveness and efficiency.

The Rise of the Citizen Regulator

With the proliferation of RFID, satellite imagery, cheap personal video recorders, powerful mobile computing devices and an array of Internet-connected sensors, a vision of millions of citizens participating in an act of civic regulation is increasingly plausible. Indeed, the question raised is whether a combination of new technologies and citizen participation could unleash an era of participatory regulation, where citizens and other stakeholder groups play an active role in designing and enforcing regulations. The idea is that just about every area of regulation today — from air and water quality to food and safety and financial services — could benefit as a result of having a larger crowd of informed and empowered individuals helping to protect the public interest.

Even a small, well-organized group of highly motivated citizens with access to information can use social networks, like Facebook and Twitter, to make a big impact. Regulatory agencies would need to open up, rethink old processes and supply the tools and data that citizens would need to contribute meaningfully. But, given the depleted state of regulatory agencies around the world, greater citizen participation in regulation would be a very good thing indeed.

Solving Global Problems

The nongovernmental organization (NGO) sector is exploding in size and influence on the international scene and increasingly setting the agenda in areas such as human rights and the environment. Meanwhile virtual communities linking cultural and ethnic diasporas around the globe are breaking down the boundaries of geography and creating bridges based on values. These worldwide virtual communities not only provide a sense of belonging, they can become a conduit for problem solving by bringing together people who share a heritage or a worldview, but not a physical location.

Will a completely different, more appropriate form of governance succeed the nation-state, just as the nation-state itself was built on the foundations of early and more limited forms of government? The answer to that question remains anybody's guess, but one fact seems beyond doubt. As we go forward, governance will be increasingly co-owned by a variety of stakeholders,

including NGOs, multinational corporations and emerging countries, such as Brazil, China, India and Russia. Even individual citizens have an unprecedented ability to participate and engage in global activities.

Fighting for Justice

There is one human institution that urgently needs nurturing and expanding. That institution is human freedom: the right of people everywhere to determine their own destinies, to be free of oppression and to enjoy bedrock liberties, like the right to free speech, a free media, free association and, most of all, the opportunity to participate equally in building a more prosperous, free and sustainable global economy.

Extinguish the flame of democracy and you dampen the spirit of economic creativity and innovation as well. Succeed, on the other hand, in extinguishing the dictators, and the world will liberate countless people to participate in wealth creation within every sector of the economy. And it turns out that wikinomics presents our best hope for promoting freedom and defeating its enemies.

In the wiki world, there is a new bottom-up model of international diplomacy where hundreds of millions of oppressed people use mobile phones and modern communications platforms like Twitter to advance their causes. This new generation of citizen activists is wired for social change, united in their aspirations and equipped with a global platform for collaboration that has even the most ardent authoritarian freedom haters running scared. In fact, everyone can help promote freedom — not just oppressed people. And expectations are growing that the business community will play a major role too. ●

Conclusion

Macrowikinomics is the story of a world with two starkly contrasting realities. On one hand, many of the institutions that have served us well for decades — even centuries — seem frozen and unable to move forward. On the other hand, there are sparkling new possibilities as people with drive, passion and expertise take advantage of new Web-based tools to get more involved in making the world prosperous, just and sustainable. It's a story of atrophy versus renewal, stagnation versus renaissance. And now every organization, and every budding leader within them, must grapple with a profound choice: Participate in rebooting all the old models, approaches and structures or sit on the sidelines and risk institutional paralysis or even collapse. We're not talking

about tinkering around the margins, but about reinventing and overhauling crumbling institutions and outmoded ways of working.

Ground Rules for Reinvention

After studying hundreds of organizations across a dozen sectors of society, there are six rules, or ways of working, that successful individuals and groups follow to enable wikinomics in their organizations and sectors:

1. Don't just create; curate a context for people to self-organize. Instead of creating something and guarding it aggressively, as most organizations do, turn your thing (be it a good or a service) into a platform where others can self-organize and create new value. In other words, don't just be a creator, be a curator too.

2. Rethink the commons. In order to collaborate, you're going to need to share some intellectual property (IP) and get your IP lawyers on board. So think about what parts of your business activities could benefit from being released and what parts you'll keep inside.

3. Let go. To control your future in this volatile world, you also need to start with a paradoxically different attitude: You need to let go. Encourage people to organize themselves to help you solve problems and come up with new ideas.

4. Find and strengthen the vanguard. Of course, even self-organization needs prodding, and the requisite leadership in any large-scale collaboration usually comes from a small group of enthusiasts in the vanguard. So strengthen that vanguard and spur them on by providing incentives, recognizing excellence and promoting talented individuals to positions of leadership.

5. Create a culture of collaboration. Broadening and deepening the culture of collaboration in your organization is essential to making a lasting change in the way you create value. Transcend the old-style hierarchy and, instead, create a dynamic meritocracy where ideas and information can flow freely through the organization.

6. Empower the Net Generation. Today's young people are the first to grow up with an innate understanding of the digital world and its possibilities. Collaboration comes naturally to them. Wise leaders can leverage this by empowering young people to help lead the process of reinvention.

Leadership for a Changing World

Arguably it is now possible, with modern technology, for organizations and even societies to share a perspective and even some kind of consciousness, a state of

Five Priorities for Innovation in Participatory Regulation

Making the transition to participatory regulation will require regulators and their partners in industry and civil society to master five key areas of innovation:

1. Create a culture of openness.
2. Build platforms for participation.
3. Foster dialogue and continual improvement.
4. Protect the public interest.
5. Organize collective action in industry.

Participatory regulation is based on the notion that concern for the public good, fidelity to norms and the capacity to operationalize those norms build faster when not induced by threat or coercion.

being aware, informed, concerned and intentional. If an organization becomes conscious as a group, then perhaps it can learn. Unconscious organizations, like people, cannot learn. Conscious ones can. It may turn out that networked intelligence is the missing link in creating so-called learning organizations. Indeed, this new consciousness and interconnectivity — this capacity to learn dynamically as organizations — could be key to making the transition from old industrial models of value creation to the new networked models. If networking can speed up the metabolism of our collaboration and enable shared thinking and learning, a new kind of collective consciousness could be applied within and between organizations to innovate better, create prosperity and advance society.

With today's communication breakthroughs we have a historic occasion to reboot business and the world using wikinomics principles as our guide. Because each of us can participate in this new renaissance, it is surely an amazing time to be alive. Hopefully we will have the collective wisdom to seize the time. ●

RECOMMENDED READING LIST

If you liked *Macrowikinomics*, you'll also like:

1. ***Wikinomics* by Don Tapscott and Anthony D. Williams.** The original collaboration between these authors describes how the Internet's social network offers new, decentralized ways to produce profit
2. ***Free* by Chris Anderson.** Anderson makes the compelling case that in many instances, businesses can profit more from giving things away than they can by charging for them.
3. ***Hot, Flat and Crowded* by Thomas L. Friedman.** The renowned economist attempts to address the global dangers facing society.

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The Industries of the Future

THE SUMMARY IN BRIEF

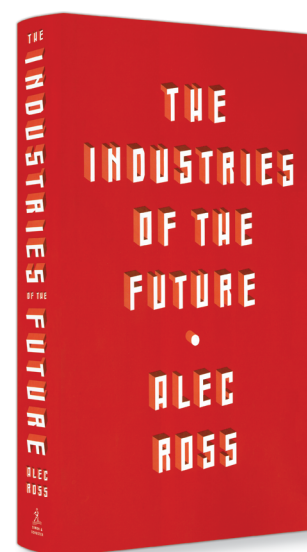
While Alec Ross was working as Senior Advisor for Innovation to the Secretary of State, he traveled to 41 countries, exploring the latest advances coming out of every continent. From startup hubs in Kenya to R&D labs in South Korea, Ross has seen what the future holds.

In *The Industries of the Future*, Ross shows us what changes are coming in the next 10 years, highlighting the best opportunities for progress and explaining why countries thrive or sputter. He examines the specific fields that will most shape our economic future, including robotics, cybersecurity, the commercialization of genomics, the next step for big data and the coming impact of digital technology on money and markets. In each of these realms, Ross addresses the toughest questions: How will we adapt to the changing nature of work? How can the world's rising nations hope to match Silicon Valley in creating their own innovation hotspots?

The Industries of the Future takes the complex topics that many of us know to be important and boils them down into clear, plainspoken language. This is an essential book for understanding how the world works — now and tomorrow — and a must-read for businesspeople in every sector, from every country.

IN THIS SUMMARY, YOU WILL LEARN:

- How robots will transform daily life and business opportunities.
- How digital technologies and big data can improve health and commerce around the globe.
- The dangers of cyberattacks and the growth of the cybersecurity industry.
- How countries can compete and succeed in the industries of the future.



by Alec Ross

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THE COMPLETE SUMMARY: THE INDUSTRIES OF THE FUTURE

by Alec Ross

The author: Alec Ross is one of America's leading experts on innovation. He served for four years as Senior Advisor for Innovation to Secretary of State Hillary Clinton, a role that earned him a Distinguished Honor Award from the State Department. He is currently a Distinguished Visiting Fellow at Johns Hopkins University and serves as an advisor to investors, corporations and government leaders.

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Introduction

The coming era of globalization will unleash a wave of technological, economic and sociological change as consequential as the changes in the 20th century and the changes brought on by the Internet and digitization.

In business areas as far afield as life sciences, finance, warfare and agriculture, if you can imagine an advance, somebody is already working on how to develop and commercialize it.

The near future will see robot suits that allow paraplegics to walk, designer drugs that melt away certain forms of cancer, and computer code being used as both an international currency and a weapon to destroy physical infrastructure halfway around the world. These key industries of the future — robotics, advanced life sciences, the code-ification of money, cybersecurity and big data — are important in their own right but are also symbolic of larger global trends and are symbiotic among each other.

Innovation brings both promise and peril. The same forces that are unleashing unparalleled advances in wealth and welfare may also allow a hacker to steal your identity or hack your home. A computer that can speed up analysis of legal documents can also shrink the number of lawyers in the workforce. The digitization of payments can facilitate commerce or allow for new forms of fraud.

Advances and wealth creation will not accrue evenly. Many people will gain. But many will also be displaced. Unlike the previous wave of digital-led globalization and innovation, which drew enormous numbers of people out of poverty in low-cost labor markets, the next wave will challenge middle classes across the globe, threatening to return many to poverty. The previous wave saw entire

countries and societies lifted up economically. The next wave will take frontier economies and bring them into the economic mainstream while challenging the middle classes in the most developed economies.

The industries of the future will both be created within the current geopolitical structure and transform it. In the 20th century, the dominant divide between political systems and markets was along the axis of left versus right.

In the 21st century, the dominant divide is between those that have open political and economic models and those that are closed. Moreover, innovation doesn't happen in closed environments, and innovative companies will continue to steer clear of countries with regressive policies on gender. We can draw from the wisdom of innovators to prepare both ourselves and our children for what's coming in the next economy — for the economy that begins now. ●

Here Come the Robots

Japan is home to the longest-living citizens on earth and the biggest elderly population of any country — and it's not getting any younger. Today, 25 percent of Japan's population is age 65 or older. By 2020, this is projected to increase to 29 percent and reach 39 percent by 2050. All of those long-living elderly will need caretakers.

Yet Japan's low birthrates mean that what once was a staple of Japanese family life — taking care of one's grandparents and great-grandparents — will no longer be a viable model at the scale the nation needs. Japan's Ministry of Health, Labor and Welfare predicts a need for 4 million eldercare nurses by 2025. Right now there are only 1.49 million in the country.



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This labor shortage will hit service-industry jobs like eldercare with ferocity and will be exacerbated because caretakers have a high job turnover rate due to low pay and high rates of work-related injury from lifting patients.

Enter the robots.

Our future caretakers are being developed in a Japanese factory right now. The robots depicted in the movies and cartoons of the 1960s and 1970s will become the reality of the 2020s. Toyota built a nursing aide named Robina — modeled after Rosie, the cartoon robot nanny and housekeeper in *The Jetsons* — as part of their Partner Robot Family, a line of robots to take care of the world's growing geriatric population. Robina is a “female” robot, 60 kilograms in weight and 1.2 meters tall, that can communicate using words and gestures. She has wide-set eyes, a mop-top hairdo and even a flowing white metallic skirt.

In response, Honda has created ASIMO (the Advanced Step in Innovative Mobility robot), a fully functional humanoid that looks like a four-foot-tall astronaut stuck on Earth. ASIMO is sophisticated enough to interpret human emotions, movements and conversation. Equipped with cameras that function as eyes, ASIMO can follow voice commands, shake hands and answer questions with a nod or by voice. He even bows to greet others, demonstrating good Japanese manners. ASIMO can fulfill a range of tasks, from helping the patient get out of bed to holding a conversation. As the populations of developed nations continue to age, they create a big market for those Japanese robots.

Humanizing Robots

Tasks once thought the exclusive domain of humans — the types of jobs that require situational awareness, spatial reasoning and dexterity, contextual understanding and human judgment — are opening up to robots. Almost every major car company is researching and building its own version of a driverless car. Robots are also beginning to play an important role in the operating room.

As the technology continues to improve, there is an ongoing debate about just how radically human life will be transformed by advanced robots and whether robots will ultimately surpass us.

Just as it would have been difficult in the days of dial-up modems to imagine an Internet video service like YouTube streaming over 6 billion hours of video every month, it is difficult for us to imagine today that lifelike robots may walk the streets with us, work in the cubicle next to ours, or take our elderly parents for a walk and then help them with dinner. This is not happening today and it will

not happen tomorrow, but it will happen during most of our lifetimes.

Robots and Jobs

Two Oxford University professors who studied more than 700 detailed occupational types have published a study making the case that over half of U.S. jobs could be at risk of computerization in the next two decades. Forty-seven percent of American jobs are at high risk for robot takeover, and another 19 percent face a medium level of risk.

Those with jobs that are hard to automate — lawyers, for example — may be safe for now, but those with more easily automated white-collar jobs, like paralegals, are at high risk. In the greatest peril are the 60 percent of the U.S. workforce whose main job function is to aggregate and apply information.

The effect of robots on job loss will be highly differentiated by country. The countries that are best positioned are those that are developing and manufacturing robotics for export, that house the headquarters, the engineers and the manufacturing facilities. These are nations like South Korea, Japan and Germany.

There needs to be investment in growing fields like robotics but also a social framework that makes sure those who are losing their jobs are able to stay afloat long enough to pivot to the industries or positions that offer new possibilities. ●

The Future of the Human Machine

Over the past half century, we've witnessed unparalleled advances in the life sciences. Artificial hearts, new wonder drugs, organ transplants and other developments allow people to live longer, healthier lives.

These advances may be dwarfed by the innovations yet to come. In the years ahead, we will live in a world where we'll be able to target cancer cells with true precision, breathe air out of lungs transplanted from farm animals, and deliver medical treatment from the best hospitals in the world to the poorest, most remote corners of the earth.

The announcement of the completion of the first “rough draft” of the human genome was made in June 2000 by President Bill Clinton, and three years later the International Human Genome Sequencing Consortium announced that it had finished the job.

The size of the genomics market was estimated at a little more than \$11 billion in 2013 and is going to grow faster than anyone could imagine.

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Bert Vogelstein is a Johns Hopkins oncology and pathology professor and an expert on cancer and genomics. His latest effort is what he calls a “liquid biopsy.” A blood sample is taken and tested for the presence of even the tiniest amounts of tumor DNA. A tumor detected by Vogelstein’s liquid biopsy can be detected at just 1 percent the size of what is necessary to be detected by an MRI, currently the most reliable tool for finding cancer. The amount can be so small that the cancer is discovered even before any symptoms have developed.

In 2009, Vogelstein’s key partner, Luis Diaz, and some colleagues launched Personal Genome Diagnostics, PGDx. If you’re diagnosed with cancer, PGDx can become your cancer specialist. Your oncologist sends in your tumor sample and a spit vial, allowing your cancer cells and normal cells to be compared. Once PGDx gets your samples, its scientists work their genomic sequencing magic. They clean your samples, scrubbing them down so they’re ready to take a lengthy ride in a PGDx sequencing machine. When the sequencing is done, your DNA’s output is hundreds of gigabytes of information — big data now — waiting to be analyzed.

What sets PGDx apart is its proprietary computer program, which functions as a high-speed detective. It parses out exactly where proteins are mutating. It makes sense of why your cancer is growing. It gives you more information about your tumor than any oncologist can. When things go right, the PGDx team can tell you why you have cancer and which medicines might stop these mutations.

The field of genomics is expanding well beyond cancer prevention and treatment, but there is a dark side to genomics. One of the primary concerns, and one of Luis Diaz’s own worries, is that as genomics grows more sophisticated, it will begin a process of creating designer babies. It is possible today to take a blood sample from a pregnant woman and reassemble the genome of the fetus. Fetal DNA tests have been used in the past to screen for Down syndrome. With advances in genomics, all the genetics of the fetus are now accessible and will force societies around the world to grapple with the issue of genetic selection.

Innovation for Everybody

Much of the innovation in the life sciences coming from China, Europe and the United States is initially benefiting wealthier households and societies. Delivery of medical services will never be equal, but pioneering initiatives to expand access to care across socioeconomic lines are beginning to take hold and improve lives on a huge scale.

The infrastructure that makes this possible is the mobile phone. Six billion of the 7 billion people on earth have mobile phones, more than have access to toilets. One of the most interesting ways mobile telecommunications have been used to address health problems in the developing world comes from a company called Medic Mobile. Twenty-seven year-old Medic Mobile CEO Josh Nesbit worked, as an undergraduate, at St. Gabriel’s Hospital in rural Malawi, one of the poorest countries in the world. He was struck by how far many of the patients had to travel for simple care. A trip to the doctor often meant a 100-mile trek to the hospital.

Later, Josh returned to St. Gabriel’s and set up a program equipping the hospital’s 75 community health workers with mobile phones and training on how to use the phones to allow patients to respond to medical questions and monitor how well patients were adhering to their prescribed course of care. The pilot program ended up saving over 2,000 hours of worker time and doubled the capacity of the hospital’s tuberculosis treatment program.

Today Josh and Medic Mobile’s big project is to try to develop a tool that uses the light and camera on a mobile phone to diagnose malaria and tuberculosis, and for under \$15.

In 10 years, Josh says, “there will be many new types of health workers, all supported by mobile technologies. Health systems will be decentralized, local and preventative.” He adds, “Health equity will exist in many more places, and the biggest gains will come from delivering basic services to the hardest-to-reach communities. Primary health care information will be free for every family, zero-rated by governments and mobile operators. There will be vaccines for malaria, cholera and other deadly diseases, and mobile technologies will play a critical role in distributing them to everyone.”

This is the future of health care in rural areas. For just about any part of the body or any illness, there is an entrepreneur thinking about how mobile technology might be applied to narrow the divide in access to health services. ●

The Code-ification of Money, Markets and Trust

While our genomes are being decoded over the next 20 years, our money will be coded — broken down into 1s and 0s and wrapped within powerful tools for encryption. We’re still only beginning to discover the possibilities that digital currency will open up. But the code-ification

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of money, markets, payments and trust is the next big inflection point in the history of financial services. Understanding what it means for you and your business will be important regardless of whether you are a plumber or the CEO of a Fortune 500 company.

Bitcoin and the Blockchain

Bitcoin, a new transnational currency released in the midst of the financial crisis in 2008–2009, offers a case study for the future of currency as the code-ification of money intensifies. Bitcoin is a “digital currency” — a currency that is stored in code and traded online. It is also a “cryptocurrency,” a term that is often used interchangeably with “digital currency” but signifies that the currency uses cryptographic methods in an attempt to make it secure.

At first glance, Bitcoin looks kind of like PayPal in that it offers a way to pay for goods online, with no physical interaction needed. Bitcoin is more easily thought of as a public ledger system than as a physical currency. If you mine or purchase bitcoins, you don’t ever receive any actual coins or tokens; instead you’re given a slot in Bitcoin’s ledger. Each slot has a public address (a long string of numbers and letters saying where the slot on the ledger is) that can be used to send or receive bitcoins. And ownership — your slot in the ledger — is verified through a secret, cryptographic “private key.”

To use bitcoins in a transaction, you just need to know the public address of your coins and the public address of whomever you’re paying, and then verify your ownership of your coins by entering the private key from your wallet. Cryptographic algorithms ensure that no one else can use your funds without access to the private key, which makes it crucially important for users to keep their private keys private (and, often, stored offline).

What’s to prevent me from copying my coins just as I can every other file on my computer, or counterfeiting new ones that follow the same pattern as the bitcoins already out there, or using two different devices to spend the same coins twice, simultaneously, before anyone can figure it out? How do I know that anyone I’m selling a product to actually has the bitcoins they say they do? And won’t the best hackers in the world be able to break this system wide open?

Bitcoin’s answer to all these questions, and its method for establishing a genuine breakthrough in digital trust, is a cryptographic invention called the blockchain. At its core, the blockchain is the big ledger on which all transactions are logged. And every single transaction going back to the very first Bitcoin payment is recorded on the blockchain, though they’re logged anonymously or

pseudo-anonymously. One of the blockchain’s key characteristics is that it is public, and instead of being stored at one central location, it is distributed to every Bitcoin user.

By making everything public, the blockchain reduces the possibility of fraud drastically, because you can’t counterfeit the existence of property in public view. Fraud is further diminished by the fact that every bitcoin carries its history with it; to try to counterfeit a coin would require counterfeiting a false lineage going back all the way to the beginning of Bitcoin. It would never be accepted by the system, since the millions of copies of the ledger that reside throughout the rest of the Bitcoin network would not have any record of this counterfeit coin or its invented history.

Both the regulation of the blockchain infrastructure and the money supply, through mining, are entirely decentralized and involve no nation-state or central bank. In addition, the blockchain has the potential to make regular transactions — like the online purchases we make every day — much more reliable and much less vulnerable to fraud. Bitcoin at its best could make fraud impossible, unless one’s private key is stolen, and make the thieves easy to find even if a key is stolen. The result could be a major drop in fraud.

Furthermore, as venture capitalist Marc Andreessen describes, there is an enormous space for Bitcoin to fill: “Only about 20 countries around the world have what we would consider to be fully modern banking and payment systems; the other roughly 175 have a long way to go. As a result, many people in many countries are excluded from products and services that we in the West take for granted ... Bitcoin, as a global payment system anyone can use from anywhere at any time, can be a powerful catalyst to extend the benefits of the modern economic system to virtually everyone on the planet.”

The real security threat to Bitcoin is not the security of the blockchain but the infrastructure around it. Bitcoin still needs an enabling ecosystem including trading platforms, payment systems and pricing indexes to function smoothly and create the level of confidence necessary for high-trust transactions. ●

The Weaponization of Code

Malware. Virus. Worm. Trojan horse. Distributed denial-of-service. Cyberattack. The terms for the weaponization of code are by now well known, but we are just beginning to understand their full implications.

It is perhaps ironic that one of the earliest purposes of the Internet, among certain of its developers, was to create

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a decentralized, distributed communications network that could survive a nuclear attack. That same distributed structure has led to a whole new class of possible attacks.

And as more individuals, businesses and governments have been incentivized to move their assets online, the weaponization of code has grown more lucrative and more destructive. The potential for real damage on a personal or systemic level is frightening. Whether motivated by politics or profits or mayhem, the cost of cyberattacks has now eclipsed \$400 billion a year, a number that is larger than the gross domestic product of about 160 of the 196 countries in the world.

Types of Attacks

There are three main types of cyberattacks today: attacks on a network's confidentiality, availability and integrity.

Attacks that compromise confidentiality aim to steal or release secure information like credit card or social security numbers from a given system in an illicit or unauthorized manner. The retailer Target was the victim of a confidentiality attack during the 2013 holiday season. Hackers accessed Target's payments systems and managed to steal the credit and debit card numbers of more than 40 million customers.

The second type of cyberattack hits a network's availability — attacks typically known as denial-of-service (DoS) or distributed denial-of-service (DDoS) attacks. Denial-of-service attacks aim to bring down a network by flooding it with a massive number of requests that render the site inoperable. Distributed denial-of-service attacks are exactly the same except that the attacker has mobilized several systems for the attacks.

Last, cyberattacks can also affect a network's integrity. These attacks are more physical in nature. They alter or destroy computer code, and their aim is normally to cause damage to hardware, infrastructure or real-world systems. Once an integrity attack has taken over a machine, the machine ends up being rendered useless and is added to the waste stream.

In 2011, Secretary of Defense Robert Gates formally declared cyber a domain of warfare, alongside air, land, sea and space, and President Obama declared America's digital infrastructure a "strategic national asset," which created the legal cover for a wide variety of offensive and defensive measures to be enacted at the newly created U.S. Cyber Command, as well as in other parts of the U.S. government. It's a domain that the United States takes as seriously as the more conventional modes of warfare.

Cyberattacking Everything

As the Internet grows, it is expanding not simply to new users but to entirely new devices, well beyond standard computers, tablets and smartphones. The costs of sensors and data storage have recently plummeted — in part due to cloud computing. As a result, the stage is now set for what has become known as the "Internet of Things," where any object has the potential to transmit and receive data, from cars and farm equipment to watches and appliances, even clothing. From 2015 to 2020, the number of wireless connected devices is going to grow from an estimated 16 billion to 40 billion.

There's one huge catch: with the rapid growth of these technologies, we are also creating an almost unimaginable new set of vulnerabilities and openings for cybersecurity hacks. In July 2015, hackers managed to remotely infiltrate and shut down a Jeep Cherokee while it was speeding along the highway. What if, 20 years from now when some variant of the Google car has taken over the highways, someone were to hack the entire network of Google cars? Imagine a highway's worth of connected cars all going haywire at the same time — the potential for a pileup bigger than anything we've ever seen.

The growth of cybersecurity into a large industry is the inevitable result of the weaponization of code. Research reports valued the global cybersecurity market at \$64 billion in 2011 and \$78 billion in 2015; they project it to be at \$120 billion by 2017. The Bureau of Labor Statistics, hardly prone to hyperbole, reports that there will be "a huge jump" in demand for people with information security skills. The industry is going to get very big very fast. ●

Data: The Raw Material of the Information Age

We are at a pretty remarkable inflection point in history. The first time a child is handed a phone or plays his first video game, he begins building a stack of personal data that will grow throughout his lifetime, a stack that can be constantly collated, correlated, codified and sold. Private companies now collect and sell as many as 75,000 individual data points about the average American consumer. And that number is tiny compared with what's to come.

Digitization dialed up the possibilities for data collection in a remarkable way. Ninety percent of the world's digital data has been generated over the last two years. Every year, the amount of digital data grows by 50 percent.

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“Big data” is a catchall phrase used to describe how these large amounts of data can now be used to understand, analyze and forecast trends in real time. The term can be used interchangeably with big data analytics, analytics or deep analytics.

The value derived from big data is partially a function of the amount of data created, but as or even more important is our new ability to use that data in real time to make smarter, more efficient decisions. Big data is further aided by new developments in data visualization that allow humans to see and understand patterns that might not be apparent on a spreadsheet full of numbers. Think about the difference between the years-long analysis of the national census and the real-time analysis required if you want to get out the vote in an ongoing national election. Speed makes entirely new projects possible.

Nine Billion People Will Need to Eat

The World Food Programme reports that one out of every nine people on earth, 805 million people, does not have enough food to live a healthy, active life. As the population grows as expected to more than 9 billion people over the next 30 years, the amount of food produced will need to increase by 70 percent lest the world grow even hungrier. This comes in the midst of climate change, as temperatures rise and potable water becomes an ever scarcer resource (70 percent of freshwater used globally goes toward agriculture).

The best hope for feeding our more populated world comes from the combination of big data and agriculture — precision agriculture. The promise of precision agriculture is that it will gather and evaluate a wealth of real-time data on factors including weather, water and nitrogen levels, air quality and disease — which are not just specific to each farm or acre but specific to each square inch of that farmland. Sensors will line the field and feed dozens of forms of data to the cloud. That data will be combined with data from GPS and weather models. With this information gathered and evaluated, algorithms can generate a precise set of instructions to the farmer about what to do, when and where. As the cost of such equipment goes down, it will be more accessible to farmers in the developing world. This is where its impact may be greatest.

Everybody Will Have a Scandal

The rise of big data has reawakened the world to privacy as a public-policy issue. It is difficult to bring big data technologies and the value of privacy into alignment. The difficulty is brought about by both surveillance and sousveillance. Government intelligence and law

enforcement agencies vacuum up a huge amount of communications data from above through surveillance.

Less discussed, but an even bigger problem for people who are not targets of terrorism or law enforcement investigations, are cell phone cameras and wearable technologies capturing what we do and say “from below” — sousveillance.

Whether or not we may want to respect a stronger version of privacy, it's possible that we're now unable to turn back and actually reach that notion of privacy. With the proliferation of sensors, devices and networks sucking up data everywhere, we may be past the point of being able to halt data collection in any meaningful way. Instead, we may have to concentrate on retention and proper use, that is, clearly setting out how long data can be retained and governing how it can be used, whether it can be sold, and the kind of consent required from the person providing the data. ●

The Geography of Future Markets

Let's talk about what it will take to compete and succeed in the industries of the future and which of today's societies are positioned for success.

The countries that are going to be able to succeed economically won't be able to do so by being control freaks. To be successful in the next wave of globalization and innovation, a society must be open in order to exchange new ideas, conduct research free from political interference and pursue creative projects, even if they fail. Innovation requires this stripe of openness. It cannot see outside markets as enemy territory.

Following Estonia's independence with the collapse of the Soviet Union, its economy was left reeling. Its currency was stripped of any value. Shops were empty and food was rationed. The gas shortage was so bad that the tattered government planned to evacuate the capital of Tallinn to the countryside. Industrial production dropped in 1992 by more than 30 percent, a higher decline than America suffered during the Great Depression. Inflation skyrocketed to over 1,000 percent, and fuel costs soared by 10,000 percent.

Led by the then 32-year-old historian Mart Laar, elected prime minister in 1992, the new Estonian government wasted no time charting a new course. Laar's first step was to stabilize the economy. Because it couldn't yet print money and had no effective mechanism to raise cash, the government cut expenses, particularly to traditionally insulated sectors. In ending subsidies to state-owned

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companies, Prime Minister Laar announced that companies must “start working or die out.”

After the economy had been stabilized — inflation had dropped from 1,000 percent in 1992 to 29 percent in 1995 — Estonia opened its doors to the world economy. It reduced trade tariffs and ended all export restrictions, turning the small country into a trading hub. The government also reached out to foreign investors. The citizenship law was amended to provide equal civil protection to resident aliens. Estonia passed laws to ensure that foreigners could purchase land.

As it developed its own government, it began putting its services online from the outset. In 2000 Internet access was legally enshrined as a human right by parliament. Estonia quickly became a center for global investment. This investment allowed Estonia to upgrade its technological and industrial base, and laid the ground for an innovation economy.

The strategy was one of near-radical openness combined with an orderly and disciplined framework for how and when to open up the economy. The result is that Estonia's GDP of over \$25,000 per capita is 15 times what it was at the fall of the Soviet Union and ranks number one among the 15 former Soviet republics. The real success of Estonia is reflected not only in these statistics but also in its place as one of the world's leading centers of innovation. Estonia has not produced a centi-billion-dollar company like Google, but it has achieved some notable successes, including Skype.

Half of the World

Going forward, a crucial factor in countries' success will be their ability to empower their own citizens — and this means all of their citizens. Too often countries still focus on only half — their male population — and ignore or abuse women, even as they hold so much potential.

It does not matter how many men have degrees from MIT, for example, if 90 percent of Pakistani women are victims of domestic violence and only 40 percent are literate. The states and societies that do the most for women are those that will be best positioned to compete and succeed in the industries of the future.

Treating women well is not just the right thing to do; it makes economic sense. Women are half of every nation's workforce — or potential workforce. To be a prosperous and competitive country requires access to the best-educated pool of workers. If a country is cutting off half of its potential workforce, it is taking itself out of the game.

According to the World Bank, 93 percent of Middle Eastern and North African countries have restrictions on the kinds of jobs that women can have. As long as these regions remain regressive, most American and European investors and executives will avoid them and pivot toward sub-Saharan Africa, Asia and promising parts of Latin America. Put simply, nations that empower women reap the benefits.

When leaders wonder what they can do to position their societies for the industries of the future, they need to open up and resist control-freak tendencies. The 21st century is a terrible time to be a control freak; future growth depends on empowering people.

Conclusion

What attributes do today's kids need for tomorrow's economy? In the same way that entrepreneurs, businesses and investors who engaged in China and India 10 to 20 years ago were able to build big businesses, people who can look around the world and see and understand the opportunity in the next wave of high-growth markets are those who will realize the greatest gains. Multicultural fluency is increasingly important in a business world that is growing more global.

Others say that foreign language skills are only part of the equation. Many believe that today's kids must also become fluent in a technical, programming or scientific language. If big data, genomics, cyber and robotics are among the high-growth industries of the future, then the people who will make their livings in those industries need to be fluent in the coding languages behind them.

For most of the world's 7.2 billion people, innovation and globalization have created opportunity the likes of which has never before existed. These changes mean new opportunities for all of us — for businesses, governments, investors, parents, students and children. ●

RECOMMENDED READING LIST

If you liked *The Industries of the Future* you'll also like:

1. **Peers Inc** by Robin Chase. A co-founder of Zipcar, Robin Chase introduces the collaborative economy in which companies and governments are using the Internet's ability to facilitate collaboration.
2. **Leadership 2030** by Georg Vielmetter, Yvonne Sell. The authors present six converging megatrends that will reshape businesses by the year 2030.
3. **Flash Foresight** by John David Mann, Daniel Burrus. The authors provide an easy-to-implement blueprint for enabling you to see the invisible and do the impossible.

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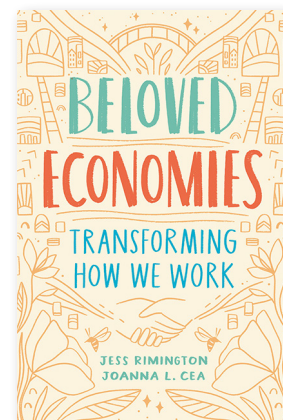
Beloved Economies

Jess Remington, Joanna Levitt Cea

Beloved Economies

Transforming How We Work

by **Jess Rimington and Joanna Levitt Cea**



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THE SUMMARY IN BRIEF

In *Beloved Economies: Transforming How We Work*, authors Jess Rimington and Joanna Levitt Cea explore possibilities for how we work, learning with more than sixty people from a wide array of enterprises. What these groups have in common is that they are generating forms of success that audaciously prioritize well-being, meaning, connection, and resilience—alongside conventional metrics like quality and financial success.

Beloved Economies offers seven specific practices as a springboard for changing how we work. As the book reveals, it's not only what we do but how we do it that can be a powerful lever to move us into economies that all of us can love. Based on extensive research with organizations and companies that are boldly breaking out of business as usual, *Beloved Economies* offers readers an imagination-expanding vision of what work could be.

IN THIS SUMMARY, YOU WILL LEARN:

- Seven specific practices as a springboard for changing how we work.
- How to guide yourself and your teams toward a more beloved way of working.
- How to make a change as an individual within a team or as a whole team, department, community group, or business.
- How groups, organizations, and enterprises can turn into a powerful lever for economic change.
- How to step out of business as usual into an audacious, healing future.

Introduction

The research and this book itself have been co-creatively shaped by more than one hundred people. Sixty people stand out in the contributions each made to the research findings and analyses. Each person played a different role: some engaged during a particular phase of the research, while others continued to participate and shape the emerging analysis throughout all phases of the research.

Together we formed a co-learning community. The common thread among all members of this co-learning community is a commitment to, and strong practice of, changing how we work to embrace power-sharing ways that depart from business as usual.

Wherever someone's words, ideas, or stories are shared, they co-created this part of the content and had ultimate decision-making authority on what appears in these pages. Many of those featured read and informed the book's narrative, ideas, and structure, or had the opportunity to do so, through co-creation workbooks and prototyping of the research findings and draft content.

Work Isn't Working

This book is for anyone looking—or longing—for ways to pull open the escape hatch and guide themselves and their teams toward a more beloved way of working. It is for anyone exhausted and fed up with what's not working about work and who has the will and latitude to make a change as an individual within a team or as a whole team, department, community group, or business reading this book together.

This book offers findings alongside seven concrete, actionable practices that our research has found can activate the potential of our groups, organizations, and enterprises to turn into a powerful lever for economic change. It is also a love letter to the people we have learned alongside on this journey—and to you, dear reader. This book admires our collective power to step out of business as usual into audacious, healing futures. It asks you to join us in dreaming and building ways of work that bring to life beloved economies.

Reclaiming Our Rights to Design

Breakout innovation is transformative change that is far-reaching, enduring, and imaginative in its departure from the lovelessness of the status quo. The plans, processes, and/or products that emerge from breakout innovation

share three key qualities. 1. Such ideas are bold reimaginings that support what makes life good. 2. These ideas achieve widespread adoption. 3. The process awakens a deep sense of agency to innovate.

Rights to design are what we exercise when we imagine, decide, and build together—when we hold the designer's pen and sketch our individual and collective futures. We understand rights to design to be linked with internationally recognized rights,² and primarily, they allow one to engage in imagining, deciding, and building the circumstances of our everyday lives.

As we studied the ways in which breakout actors transformed their work, we came to understand that there was a clear pattern in what they did that led to deconsolidating rights to design. This pattern is the seven practices we share with you in this book.

The Seven Practices

The seven practices are a way you can deconsolidate rights to design and set yourself on paths away from the loveless economy and toward breakout innovation. 1. Share decision-making power. 2. Prioritize relationships. 3. Reckon with history. 4. Seek difference. 5. Source from multiple ways of knowing. 6. Trust that there is time. 7. Prototype early and often.

In the following chapters, we explore each of the seven practices—what they are, how and why each one works, stories of the practices in action, and tips for how you might begin or deepen your own practice. Learning to apply and embody these practices “isn't just a one-time thing; it's something you do over time.” They are, in fact, a practice.

While breakout innovation is about the possible and emergent not yet, it is crucial to note that the seven practices are not new.

Share Decision-Making Power

When decision-making power is shared through a thoughtful and deliberate process, the practice can elevate a team from feeling like a set of disjointed individuals at work to operating as a tight-knit community.

While there is no set formula for how to share decision-making power, there are several common elements we observed and discussed with co-learning community members. Standout among these are: Customized decision-making protocols;

Full and accessible information-sharing; and Shared leadership, shared responsibility, and shared rewards.

When decision-making power changes from something we shoulder alone or fight to access into something we approach creatively together, each of us becomes more powerful.

Prioritize Relationships

Business as usual teaches that relationships matter: it's who you know, not what you know. There is a clear distinction between the business-as-usual view of work relationships and the breakout actors' view.

There is a paradox in play here: when we stop focusing only on what we can get from someone to achieve a goal and start caring about our connection for its own sake, the people around us rapidly become the greatest blessing to the task at hand.

For breakout actors, the practice of prioritizing relationships is about building caring, strong relationships across differences. At its essence, a practice of prioritizing relationships comes down to caring about one another and expressing this care in our day-to-day actions.

Reckon with History

In business as usual, history is often viewed as irrelevant to current work and as something to be retold only by expert historians. For breakout actors, history is inextricably connected to the present; it is a group's living teacher, and all group members have histories to share and teach one another.

Katherine speaks about "how important it is to look back and reflect"—both for individuals personally and for teams, organizations, and whole communities. For Katherine, exploring history together in a shared space is about creating "an opportunity for everyone to tell our stories... to understand the larger context in which you live and work. Because that context is always affecting what you do and how you respond."

Seek Difference

The practice of seeking difference is not about superficial efforts that aim to check a box or do a one-time step to expand the demographics of a group's members. It is instead a commitment to continually seek out relevant forms of

diversity and create team cultures that effectively engage differences. It is a stance of genuine curiosity and eagerness to hear and act upon the pulsing brilliance that exists when the richness of diversities is tapped into.

Naturally, a practice about forms of difference tends to look many different ways. Yet there are clear commonalities in how breakout actors seek difference. These include: Inviting multiple perspectives on diversity, Creating conditions that support safety and bravery, and Using varied channels for contribution.

Source from Multiple Ways of Knowing

In the status quo of the loveless economy, it can be jarring for some people to reawaken and realize that technical expertise or academic learning, for example, are not the only ways of knowing that have value. Though such a transition in perspective can be uncomfortable for some at first, our research shows that it is often joyful and restorative for people to see themselves as part of a broader web of knowledge.

Sourcing from multiple ways of knowing is the practice of considering, valuing, and attuning to multiple types of knowledge, ranging from technical training to lived experience to spirituality to what we sense from the living world around us. This practice actively examines and unravels biases that keep groups from appreciating certain ways of knowing, and it breaks down power dynamics that prevent people from expressing intrinsic knowledge.

Trust There is Time

Trusting there is time—to build relationships and shared language, to confront the exclusive histories within their field, and to account for power differences in the room—is a central practice of breakout actors to ensure that their efforts will result in meaningful outcomes.

Trusting there is time means believing there is always time available to prioritize engagement and care in how we work. This practice invites us to question the assumed urgency that is so pervasive in business as usual and to be critical of the frazzled state in which so many of us frequently operate. This practice applies the paradox of going slow to go fast. It means strategically investing time at the front end of a process—and at points all along the way—to nourish the solid foundations necessary for lasting transformation.

Prototype Early and Often

While many business-as-usual organizations are increasingly using elements of collaborative design when engaging with clients, community members, and other stakeholders, quite often this engagement still means sharing predetermined scenarios already passed through multiple rounds of tweaking and technical review behind the scenes, before getting feedback from external stakeholders.

Prototyping early and often is the practice of sharing and testing ideas at each step of a process. Prototyping early means that from the very beginning of working together, assumptions are tested and space is allowed to course-correct and refine before ideas are finalized or launched. Prototyping early and often means that along the way, there is transparency about the ways in which feedback and ideas from colleagues, collaborators, and other stakeholders has been assessed and integrated.

They May Try to Stop You

Here, we discuss two particular forms of resistance that breakout actors encounter, which they report can feel surprising and can sometimes even thwart a group's efforts.

The resistance faced by the breakout actors in our co-learning community most commonly came in two forms: external backlash and internalized doubt. Breakout actors shared that sometimes resistance bubbles up from their closest collaborators—or even from themselves.

In our research, we've also seen other forms of internalized doubt that limit what groups do, even when there isn't necessarily a work culture that people perceive as discouraging new ideas. For instance, some people report feeling nervous the first time they are invited to join together as peers with people they perceive as different from them in terms of class, race, gender, professional background, or ability. Others—when faced with the prospect of sharing decision-making power, for example—worry that everything will fall apart if they release control. Some people share feelings of confusion: will they still have a place in the work once change happens?

Practicing Beloved Economies

Any society's economy is inextricably linked to its rules and laws, which determine how people engage within that economy—what is allowed, encouraged, and prohibited. The rules and laws are usually established by the processes of

government. For this reason, we cannot ignore the critical role of legislation, which can encourage or imperil a shift toward a beloved economy.

Strikingly, the ripple effect in people, enterprises, industries, and regions seems to persist even if the initial effort that inspired the change bumped up against individuals trying to stop them—even when those individuals did stop the initiative. In those cases, the people involved were still transformed, and these internal shifts generated something profound beyond the scope of the specific project they were working on, something that no one could stop or erase.

Reorienting Work Toward Life

There are many examples throughout nature of living organisms having evolved behaviors and strategies similar to those we see in the practices of breakout actors.

These practices enable groups of people to change how they work in response to signals all around us, which seem to scream that work isn't working. The practices operate by activating the inherent potential of people across an entire system to reimagine and reorient toward that which sustains life and makes it good for all. As these changes ripple across our economic system, our economy as a whole has a far greater chance of evolving toward ways of operating that nourish, rather than endanger, life itself.

Conclusion

To support our readers in getting started with the seven practices, we want to share three points that may be useful. First, we share more about the value proposition—the return on investment, as some might say—of the practices. Second, we offer a concrete suggestion for how to start this conversation within your group(s). Last, we touch on a key point of advice co-learners have shared over the years for groups to start strong, stay the course, and tap into the practices' potential for breakout innovation.

When people commit to their own journey of self-reflection and growth, their individual transformation can shape collective action, and the resulting ripple effects are profound.



Jess Rimington is a next economy strategist focused on the design and ethics of emerging post-capitalisms. Her practice and research is grounded in historical analysis, accessible truth-telling, and present-day experimentation.



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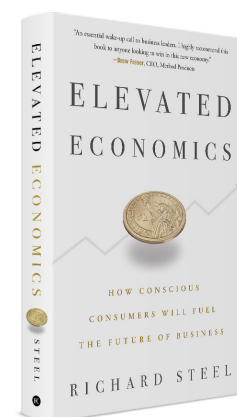
Elevated Economics

Richard Steel

Elevated Economics

How Conscious Consumers Will Fuel
the Future of Business

by **Richard Steel**



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THE SUMMARY IN BRIEF

If you are a business leader or someone with any influence over the decisions your company makes, then the information and analysis presented in ***Elevated Economics*** will serve as your guide into a brave new world, a world where consumers have begun to do the one thing that the capitalists of the last 150 years feared: care. Not just about product, price, place, and promotion.

Author Richard Steel spoke with professors of business, marketing, and consumer behavior, and drew from his own experience running public and private companies. Drawing from countless hours poring over research, dissecting charts and graphs, and extrapolating trend line, Steel saw a future that is fluid, chaotic, and rapidly iterating. Setting your firm up for success in this sort of environment won't be as simple as adjusting a few sentences on your mission statement. This is a street fight. If you don't keep your hands up and your eyes open, you'll likely find yourself knocked out—trampled by a stampede of radically altered consumers. But if you do come to fight, and prepare to fight well, then the potential upside is immense.

IN THIS SUMMARY, YOU WILL LEARN:

- The consumer's interest intersects with business self-interest.
- Consumer purchases are identity-driven.
- When consumers care, business must also care.
- Environmental, social, and governance factors matter.

Introduction

Businesses will always act primarily in their own interest. In the same manner, consumers will always make purchases that reflect their own interests. Commerce lives at the intersection between the self-interests of these two groups, but it's the consumer that sets the rules of the relationship.

The Future of Business

Business leaders like to think in numbers, but the bigger reality is that the hearts and minds of people are changing—and those hearts and minds are attached directly to their wallets.

Up and to the Right

Consumers no longer make buying decisions based solely on product, price, place, and promotion. They now make purchases that reflect their values. In the next decade, firms won't be able to win simply by offering the most convenient, cheapest, or cleverly marketed products. They will win by establishing, fostering, and communicating an identity that consumers are willing to vote for. Consumers want their purchases to reflect not just their needs and wants, but their hopes, dreams, and aspirations for a better future as well.

Survival of the Physics

A Bloomberg article recounts the major rift between ExxonMobil and one of its largest stakeholders, LGIM, a hedge fund that controlled \$1.3 trillion in assets and a top 20 shareholder for ExxonMobil. According to the article, during a particularly fraught meeting between Exxon's leadership and hedge fund: "The Exxon delegation listened, but it didn't accept the suggestions," says LGIM's head of sustainability and responsible investment strategy. Around the same time, Exxon persuaded the US Securities and Exchange Commission to block a shareholder resolution that pushed the oil giant to do more to address climate risks. Finally, London-based LGIM announced that it had dumped about \$300 million worth of its Exxon shares and would use its remaining stake to vote against the reappointment of Exxon Chairman and CEO.

Physics doesn't change. When it comes to a speeding car and a brick wall, there are only three options: you can turn, you can stop, or you can crash. In a few short years, the CEO of every company will be faced with those same three options—turn, stop, or crash. Shifting the focus of your business from just product, price, place, and promotion to

include purpose may be difficult, but the tide of change, like the laws of physics, is oblivious to these sorts of complications. As a business leader, the choice is yours.

The New Consumers

Let's take a look at how a consumer shapes their identity. Christina moves to New York when she's 22. She's fresh out of college and just starting a career. As she lives through her first year in the city, Christina meets new people and has new experiences. These new variables will introduce Christina to new identities and eventually, she will settle into one, or an amalgamation of several.

Let's say Christina's new friends are liberal, unmarried, have no children, and love the outdoors. As Christina self-selects these experiences and interactions, she is beginning to associate with a certain identity. Over time she will test this identity's relevance and verify that it fits her. One of the ways she will express her identity is by making purchases. Christina is going to need clothes, a place to live, furniture, food, entertainment, and transportation. Unlike her mother or grandmother, however, she won't be making those decisions in the aisles of a store. Christina has disposable income and access to the Internet and the most sophisticated logistical distribution system in human history. The entire world's new catalogue of goods is available to her. Her choices do not have to be limited by anything other than what she wants. Christina's wants are inexorably linked to who she wants to be. Purpose is what powers Christina's buying decisions. She can spend days researching and selecting the jacket that most closely fits the identity she's chosen. And more often than not, that product will be selected by Christina because it projects the identity that most closely resembles her own.

"What should our identity be?" is therefore quite easy to answer. The answer is: whatever our consumer's identity already is.

The Age of Convenience

Before 2000, it would have been madness for anyone to expect their order from the Sears catalogue to arrive in less than a week. Today, we get upset if Amazon doesn't deliver our packages in a day. But a revolution has begun, and the money is already moving. Consumer behaviors are changing because consumers have changed. The age of convenience is over. The Age of Elevated Economics has taken its place.

Generations of very successful business leaders built their companies and their bank accounts by providing the most

value they could in the shortest time possible. No CEO in 2001 would be celebrated for costing investors millions in lost productivity, by granting time off so more warehouse pickers could be home with their families for the holidays. But today, such practices can send public sentiment, stock prices, and actual profits up and to the right. Why? Because just like people, businesses act in their self-interests. And for a business, acting in its self-interest means acting in the self-interests of its customers. If the customers decide they're suddenly going to care, then businesses are going to have to start caring as well.

The Fourfold Foundation

Succeeding in business is an exercise in consistent humility. The power lies with your consumers. The cornerstones of elevated firms are indifferent to product, service, location, or years in business. Every business must take heed if it wants to thrive among the rapidly emerging changes in consumer.

Diversity and Inclusion

Recently, a cadre of African American Facebook employees made headlines when they released an anonymised collection of racially motivated disadvantages plaguing the social media giant's inner workings. The response from Facebook was swift and promises for change were forthcoming, but the damage was done. Management was on the offensive, and the company's ability to attract and retain diverse talent was called into question.

The goal cannot be just to build multicultural or multiethnic teams. The definition for diversity and inclusion needs to be that all employees and stakeholders have equal abilities to thrive, not just that they have equal access to roles and upward mobility.

Pay Equality

Numbers don't lie. As a company spends, it defines its identity and its culture. If two people doing the same job receive different compensation, that is an issue. A full 90 percent of the world wants men and women to be paid equally, and yet the disparities remain. Consumers and current and potential employees have more access to data now than ever before and are making decisions based on how firms behave.

Impact

One of the most successful early adopters of the Elevated Economy is Wells Fargo. Wells Fargo pours money into affordable housing, sustainable transportation, and local

initiatives that matter most to the people in their area. Its initiatives include intentional strategies to support family housing, financial education, disaster relief, military families and veterans, and the environment. It also has an extensive grant program for local charities and communities. In 2019, for the 10th year in a row, United Way Worldwide has recognised Wells Fargo as No. 1 in workplace giving.

Companies that focus on improving their communities, their supply chains, and the lives of the employees they provide for are generating shareholder value while simultaneously building more valuable organizations altogether.

Bring the Market

A unique example of bringing the market can be seen in the video game industry. A recent trend in video games has been the inclusion of "loot boxes"—digital crates that contain mystery bonuses for players. These boxes cost small amounts of real cash for the chance to earn digital goods. The gambling aspects of the system have raised eyebrows from the PTA to Congress. Legality aside, these loot boxes drew scorn from players around the world and were largely seen as predatory by the gaming community. The rub, however, is that these boxes generate millions of dollars for the studios and publishers. In the old-world product-driven model this would simply be seen as an annoyance but not as a fundamental issue. The product fits with the market. Money is being made, and until a law is passed it will remain on the balance sheet for many fiscal years to come. But this is not how the world works anymore.

Electronic Arts (EA), one of the largest video game companies on earth, was the primary loot box offender of 2018. Just one year later, their new games had done away with this highly lucrative but frowned-upon practice. Electronic Arts would rather pivot from, or abandon, lucrative revenue streams to win hearts and minds as well as wallets. Not because they're nice. But because they want to be sustainable—to thrive for years to come.

ESG

ESG stands for environmental, social, and governance. Together, E, S, and G comprise the investing world's best attempt to measure the impact of business practices that relate to the good of the planet, society at large, and how firms behave.

Where We Came From

In 1982, cyanide-laced pills were found in several bottles of

Tylenol and seven people died. The leadership of Johnson & Johnson (J&J) had a choice. They could take all the stock off the shelves, take the loss (estimated to be well over \$100 million), open the door for competitors to decimate its market share, and risk permanently damaging the Tylenol brand. Or they could decide to not take action and hope it didn't happen again. Even in the face of those deaths, business pundits at the time were still shocked to see J&J make the hard choice. They pulled all of the stock off the shelves of every store. They lost market share. But they did not damage their brand. Instead, Tylenol and J&J became synonymous with integrity. Johnson and Johnson was an ESG company before the term existed.

Where We Are Now

Adidas recently announced that it would collaborate with a nonprofit committed to reducing waste products in natural water sources. The partnership would see Adidas releasing a limited-edition sports shoe made entirely from recycled plastics pulled directly from contaminated oceans. Each of the 7,000 shoes in the initial run would be created from roughly 11 plastic water bottles. Adidas said it plans to expand this eco-friendly technology into both its mainstream shoe and apparel lines. This is good news for the planet, but it is fascinating news for business leaders.

Moves like this used to be labeled as “stunts” or “marketing,” but in the age of the Elevated Economy, the Adidas strategy takes on much greater significance. This is not a one-time maneuver to score some political or cultural points. This is a massive top-to-bottom shakeup in supply chains, production, manufacturing, shipping, sales, and advertising. This one move may net the company \$1

billion over time, but the cost to pivot toward that billion is significant. In days past, this would have been seen as a short-term cash grab or a marketing ploy. If ESG is a measurement of how individual firms are measured against environmental, social, and governance practices, then SRI (socially responsible investing) measures how much money investors decide to invest in those firms. The numbers are astounding, and Adidas is playing the long game.

Whom Do You Serve?

The Elevated Economy is here. You now know how your next customers' and investors' thinking has changed. You know how they evaluate your company before making a purchase decision, and how they vote with their dollars. You know how to begin an authentic plan for change, and how to compete by telling who you are, not selling what you make. What happens next doesn't just have to be great. It can also be good.



Richard Steel is an American entrepreneur, investor, and consultant. He has run private and public companies, served on nonprofit boards, and advised the White House Business Council. He is an advisor to large and mid-size companies, governments, startups, and nonprofits. Currently, he is the CEO of a venture firm and chairs a philanthropic fund. Richard is an alumnus of Harvard Business School where he serves on the Alumni Board.

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Galaxy



Featured Book Review

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Is America in a State of Decline? It's Time for a 'New' New Deal, and Another Marshall Plan

by Philip Shropshire

If you traverse the Internet quite a bit, then it can safely be observed that *The New York Times* columnist Thomas L. Friedman finds himself the target of much abuse, perhaps earned, but abuse nonetheless. For example, go to Google and type in "David Sirota and Thomas Friedman" to see what I mean. Yet as someone who has just completed his 600-page opus *The World Is Flat*, let it be said that he has written a comprehensive book that goes beyond the state of international business, providing a snapshot of the state of the multinational world in 2006. It's subtitled "A Brief History of the 21st Century," and he's not kidding.

Not Afraid to Name Names

In fact, Friedman goes even further and lays out not only the problem with American business competitiveness in this brave, flat, new world, but he identifies the solutions. Here's the short version: The United States has a dangerous fixation on oil and terrorism and he thinks the enabler of that problem is President George W. Bush, who he thinks should be instituting a "New" New Deal — involving massive infrastructure investment in both education and broadband — that would radically reform the society and better prepare us for the future. A lot of his online critics, especially the liberal ones, would be shocked to know this.

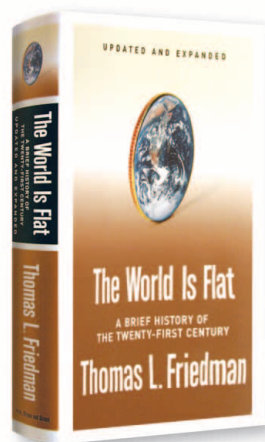
You may not agree with all of his solutions, or even his diagnosis of various problems. For example, he displays a massive blind spot about connecting Europe's superior worker productivity to its extensive socialist welfare programs. The theory here is that people might work better if they have four to six weeks of vacation, health care and state-sponsored childcare services. See T.R. Reid's book on the sub-

ject: *The United States Of Europe: The New Superpower and the End of American Supremacy*. Nonetheless, you will be impressed by the level of thought, depth, breadth and sheer scope of Friedman's ideas. And as a reviewer who has read and abstracted some 50 business books within the last seven years, it can be said that you'll find three or four of the best of those books in *The World Is Flat*.

What Are the Flatteners?

"The global competitive playing field was being leveled. The world was being flattened," writes Friedman. "As I came to this realization, I was filled with both excitement and dread ... what the flattening of the world means is that we are now connecting all the knowledge centers on the planet together into a single global network, which — if politics and terrorism do not get in the way — could usher in an amazing era of prosperity, innovation and collaboration, by companies, communities, and individuals." Friedman continues, "But contemplating the flat world also left me filled with dread, professional and personal. My personal dread derived from the obvious fact that it's not only software writers and computer geeks who get empowered to collaborate on work in a flat world. It's also Al Qaeda and other terrorist networks."

This is powerful stuff. As a former newspaper reporter, I can't describe to you the exhausting amount of work that Friedman must have put into his first big section of the book, titled "How the World Became Flat," which takes up the first third of the book. There are literally hundreds of quotes, and they're not just from functionaries. He includes quotes from Marc Andreessen, the founder of



THE WORLD IS FLAT
by Thomas L. Friedman
Published by Farrar,
Straus and Giroux,
Copyright © 2006, 593
pages, \$30.00

“Just when all of this flattening was happening, a whole new group of people, several billion, in fact, walked out onto the playing field from China, India, and the former Soviet Empire.”

Netscape, Meg Whitman, the CEO of eBay, and even a number of interviews with Bill Gates. It also features worldwide travel, observations and anecdotes from Europe, India and China.

This is also where readers get their money’s worth. This first section of the book is one of the most concise histories of the Internet that I’ve ever read. He includes just about every important player — from World Wide Web creator Tim Berners-Lee, to the founders of Google, to the origins of the Open Source Apache software server, to what the explosion of fiber optic capacity actually means worldwide. Furthermore, he buttresses this very interesting history with an analysis of perhaps the best business practices of the last 15 years. If you missed out on the importance of supply chain management, building the eBay community or tracking point-of-sale information, then you can catch up by reading *The World Is Flat*.

The neat trick Friedman accomplishes is tying all these innovations — from the development of the first browser to instantaneous worldwide broadband communications — together into one narrative whole. By the time you’ve read and understood all 10 flatteners, you have a pretty good understanding as to why outsourcing to India works or why firms like Wal-Mart do a lot of their production overseas, not to mention how a single product can be routed through a dozen or more countries.

The Triple Convergence

There are parts of this book where Friedman sounds more like futurist Ray Kurzweil rather than a staid business columnist for *The New York Times*. This section is one of them. He makes the argument that the 10 flatteners have brought about a kind of Triple Convergence.

1) The world is changing dramatically because the flatteners started to merge right around 2000.

2) Businesses and people started to adopt new skills and habits to get the most out of those changes. Just try to imagine a world without Google or cell phones.

3) Finally, as Friedman writes: “Just when all of this flattening was happening, a whole new group of people, several billion, in fact, walked out onto the playing field from China, India, and the former Soviet Empire.” In fact, because of this, Friedman makes what can only be described as a stunning prediction: This is just the beginning.

The entirety of the IT revolution is just a prologue. He quotes former Hewlett Packard CEO Carly Fiorina, who claims that we are moving into an era where technology will change every aspect of our lives and society. Put in other terms: You haven’t seen anything yet.

Problems and Prescriptions, or ‘The Quiet Crisis’

In a chapter titled “The Right Stuff,” Friedman writes, “Put all the above together and you have America’s secret sauce — a mix of institutions, laws, and cultural norms that produce a level of trust, innovation and collaboration that has enabled us to constantly renew our economy and our standard of living.” He continues, “There is nothing about the flat world — nothing — that Americans cannot handle, as long as we roll up our sleeves, educate our young people the right way for these times, and tend to and enrich the secrets of our sauce.”

Friedman attempts to answer the question: What skills and tools will your children need to excel in this new flattened world? His answers include learning how to learn, understanding social intelligence and nurturing your right brain instincts — where he quotes extensively from Daniel Pink’s book *A Whole New Mind*. The short version of Pink’s book: Learn to do something right-brained and intangible that can’t be reproduced in Bangalore.



In the chapter titled “The Quiet Crisis,” Friedman goes where no business book has gone before. Let’s be honest: most business books don’t make political enemies by naming names. In theory, impartial journalists probably should because, at some point, you need to have an honest assessment of the facts. But, truth be told, even journalists don’t make those calls anymore, which probably explains the rise of the blogosphere. These participants might not be able to spell, but they’ll call a spade a spade. Most business books don’t touch upon the bigger issues of the day, such as the Iraq War, global warming and the use of Chinese slave labor to make market quotas.

But this is not “business book as usual,” and Friedman names both the problems and the people behind those problems in “The Quiet Crisis” chapter, which could be a whole book in itself, bearing the subtitle: “The Coming Decline of the United States.” Friedman describes no less than six dirty secrets behind the coming American decline:

- 1) **There’s a numbers gap:** The scientists who brought us the space age after Sputnik will not be replaced, and that threatens United States hegemony.
- 2) **There’s an education gap at the top:** We aren’t getting enough of our young people interested in math and science.
- 3) **There’s an ambition gap:** Outsourcing not only results in lower costs but it increases productivity as well. The Indians and Chinese are outworking us.
- 4) **There’s an education gap at the bottom:** Poor kids are being short-changed by the public education system.
- 5) **There’s a funding gap:** We’re not investing enough in basic research.
- 6) **There’s an Infrastructure gap:** We’re way behind on broadband penetration.

Friedman makes an argument for a solution that hasn’t been whispered by either political party. “Our fate can be different, but only if we start acting differently ... we should be embarking on an all-hands-on-deck, no-holds-barred, no-

budget-to-large crash program for science and engineering education,” he writes. “Scientists and engineers don’t grow on trees. They have to be educated through a long process, because, ladies and gentleman, this really is rocket science.”

Controversy and Criticisms

According to Friedman, “If societies are unable to manage the strains that are produced by this flattening, there will be a backlash, and political forces will attempt to reinsert some of the frictions and protectionist barriers that the flattening forces have eliminated, but they will do it in a crude way that will, in the name of protecting the weak, end up lowering everyone’s standard of living.”

David Sirota, a vocal critic of Friedman, points out that *The New York Times* columnist has a blind spot when it comes to the rights of working people.

For example, even though Friedman admirably calls for what he terms “compassionate flattism” — where no one is left behind by way of heavily subsidized worker retraining programs — he endorses North American Free Trade Agreement (NAFTA), which has spurred the immigration crisis. A lot of people leaving Mexico are rural farmers who have been put out of work by the new trade agreement, resulting in a number of workers on both side of the border losing their jobs.

Sirota defines this as a race to the bottom.

There are a number of times in the book in which Friedman makes pointed criticisms of both Wal-Mart and Microsoft. But he looks at their faults as some kind of inevitable Third Wave. Friedman never seems to explore the idea that these multinationals may be riding or even creating the waves that benefit them so much by way of their lobbyist armies in Washington. It’s one thing to

“Our fate can be different, but only if we start acting differently ... we should be embarking on an all-hands-on-deck, no-holds-barred, no-budget-to-large crash program for science and engineering education.”



say outsourcing is a reality, so deal with it. It's quite another to lobby the U.S. Congress to reward you for moving jobs overseas. Friedman doesn't seem to address this point.

What About the EU?

Exhibit one in this argument is the book's scant mention of how the European Union does things. It's a massive hole in this otherwise exhaustively researched book. There are just four mentions of the EU in the index on four pages, and they're mostly negative. How can the EU, with its well-educated workforce and rising Euro, not even rate enough for its own chapter?

Here's the miracle of the EU: They're producing a capitalist economy with a collective Gross Domestic Product bigger than that of the United States (see T. R. Reid's book). They do this even though they have massive and subsidized health care, childcare and vacation packages — six mandatory weeks off in France, for example. And there's a bonus: their workers are more productive and happier as well.

Friedman also fails to mention that Europe doesn't do free trade the way the United States does it. While there are income inequities within European states, they usually insist on a minimum standard of civil rights and mandatory income minimums before countries are approved to join the EU. Just look at what Turkey has to do to join.

This leads us to another problem. While Friedman makes accurate critiques about the American decline in technology, he seems to leave out the role of corporate lobbyists and the two-party system in this discussion. It would not be unlike a book, written in 1935, indicating that Germany treats its Jewish population badly, while leaving out information about the Nazi Party.

Isn't there a move to de-fund public education by way of vouchers that would exclude or make impossible the educational Marshall Plan Friedman has in mind for the United States? How can you give people basic health care when the insurance lobbyists destroy politicians who even hint at single payer

What Makes This Book Special

The World Is Flat is one of the top bestselling business books of all time and has sold more than 1.4 million copies. It was also awarded the *Financial Times* business book of the year award. As of August 2006, it is number three on *Publisher's Weekly* bestselling nonfiction books list.

The World Is Flat also provides an engrossing and concise history of the Internet age. It touches on all of its facets, from the beginning of the World Wide Web to the meaning of what excess fiber optic cable means.

The World Is Flat not only identifies six danger signs regarding United States' technical preeminence, but Friedman even lays out a number of policy proposals, which include an educational Marshall Plan for the United States, a "New" New Deal and even retaining insurance for unemployed workers who have been displaced.

plans? How can you critique the country's dependence on oil and yet not notice the oil lobbyists' negative influence on alternative fuel research? If you're writing a comprehensive book, as Friedman purports to do, then these issues should be addressed.

Those critiques aside, this is still a very important book. There are faults with Shakespearean plays and the Bible, but to be an educated person you have to read and understand them. Likewise, if you want an understanding of how technology is changing the American business landscape, you would be hard-pressed to find a better book than *The World Is Flat*. It does that rare thing: It not only gives you well written explanations of what has happened and where we've been, but some good ideas on where the country should be going. ■

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The author: Thomas L. Friedman has won the Pulitzer Prize three times for his work at *The New York Times*, where he serves as the foreign affairs columnist. He is the author of three previous books, all of them bestsellers: *From Beirut to*

Jerusalem, winner of the National Book Award for Nonfiction; *The Lexus and the Olive Tree: Understanding Globalization*; and *Longitudes and Attitudes: Exploring the World After September 11*. He lives in Bethesda, Md., with his family.

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· Book 11 of 32 ·

Featured Book Review

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Smart Strategies for Saving the Environment and Ourselves

Review by Chris Lauer

HOT, FLAT, AND CROWDED: Why We Need a Green Revolution — and How It Can Renew America

by Thomas L. Friedman

*Farrar, Straus and Giroux, © 2008, 438 pages, \$27.95,
ISBN 978-0-374-16685-4.*

Renowned author and journalist Thomas L. Friedman has a habit of opening up all the world's largest cans of worms so we can collectively see what we're dealing with before things get really messy. With a deeply humane concern for the welfare of the United States and the rest of the world, he writes books that expertly describe our collective troubles as well as many of the ideas that can help us wrangle these wild issues into a manageable, sustainable future. Describing the global struggle for conservation and sustainability with clarity and wisdom, Friedman uses his gifts as a journalist and storyteller to shine a welcome light on the most important issues of our time.

Thankfully, Friedman's keen sense of humor keeps the seriousness of his monumental topics from becoming oppressive. His down-to-earth perspective — spiced with a hint of sarcasm, a dash of irony and many splashes of wit — goes a long way toward conveying the troubles ahead without ever sinking into the morass of the alarmists. Through entertaining storytelling and highly researched journalism, Friedman turns the jumbled entanglement of issues overflowing from our past into a compelling tale that both analyzes deeply seated problems and

thoughtfully finds solutions to their growing threats.

Friedman has written *Hot, Flat, and Crowded* to elevate an equation whose analysis is vital for building the momentum necessary to organize and control the writhing mess of possible calamities that an increasingly hot, flat and crowded planet creates.

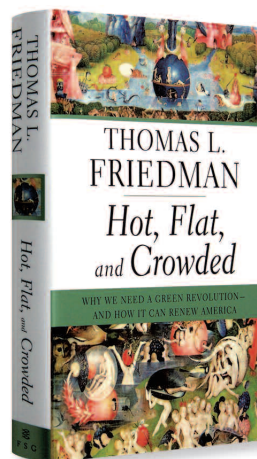
Controversy and Provocateurs

While establishing a well-documented critique of our current state of national and global economic affairs with dozens of examples and opinions from a variety of industries and experts, Friedman's political and social insights are neither partisan nor polemic. Friedman sticks to the facts while mingling his opinion with the thoughts and insights of hundreds of knowledgeable people and friends who serve as his resources and provocateurs.

As a three-time Pulitzer Prize-winning author and master of the long-form, non-fiction narrative, Friedman offers a collection of news items, facts and opinions that

turn a diverse stew of dire issues into a well-developed plan for collectively and individually taking action in the 21st century. The realistically optimistic path he travels in his book is cleverly paved with compelling anecdotes and studies, which ease his ideas for creating deep global changes into readers' minds while also offering alternatives to the status quo.

Hot, Flat, and Crowded wanders deep into the tangled jungle of global issues, following a route made up of three main points that are brought into view by Friedman's journalist's eye and foreign correspondent's instincts.



“Friedman reminds us that our oil dependence not only supports those who seek to destroy us, but also feeds a system that destroys the environment in many dangerous ways.”

The “hot” part of the book title refers to the most important topic Friedman addresses: climate change. The vital importance of examining climate change is echoed in its placement at the forefront of his equation for a “green revolution.” By starting with the topic of climate change, Friedman also exclaims the importance of a rapid response to the habitat loss and environmental degradation that have resulted from the world’s growing dependence on fossil fuels.

Friedman’s response to the environmental damage that is spiraling out of control across the globe is a challenge he calls “Code Green.” The stories and opinions he offers throughout *Hot, Flat, and Crowded* provide the strength of knowledge necessary to change the colossal lens through which we view our energy consumption and lifestyles on the micro and macro level. He calls our new age the “Energy-Climate Era,” in which individuals and leaders must rise to the challenge of not only understanding the issues we face today, but generating the vision and authority to pull that system together.

The “flat” part of the title and Friedman’s economic equation describes the social leveling off that has taken place over recent years. Middle classes are rising like never before in many developing countries, such as China and India, which have only recently begun to tap into their potential to capitalize on globalization. The world has been made “flatter” by the ease with which digital information can be created and spread worldwide by individuals, wherever they sit at their PCs, and shared through the interconnectivity of the World Wide Web.

Another flattener Friedman describes is the elimination of physical and political barriers on the international economic playing field, such as the fall of the Berlin Wall, the dismantling of Communism and the disappearance of the Soviet Union’s iron curtain. The result is a flatter, unobstructed global marketplace where people can sell their goods and services faster and cheaper than ever before.

The “crowded” part of the equation Friedman describes throughout his book is the simple fact that the world’s population is growing. Right now, he points out, there are 6.7 billion people on the planet. By 2050, experts estimate that there will be more than 9 billion people on Earth. Because all these people will need to be fed, housed, educated and employed so they do not

become violent and extreme in their actions, we need to start making decisive moves today in order to avoid the catastrophes that could result if we don’t start to prepare infrastructures and resources to deal with the rising number of people.

Cradle to Cradle

To help readers prepare for the future, Friedman has collected many of the most important international stories and ideas offering alternatives and hope. One concept that clarifies the thinking necessary to reach more positive conclusions is the “cradle-to-cradle” philosophy, which helps us rethink the materials and products we create. Rather than striving to create things that last only from “cradle to grave,” we need to go further. Pointing out the insights found in the book *Cradle to Cradle: Remaking the Way We Make Things*, Friedman describes the effort necessary to create a future in which all the products we create and purchase are reengineered to include only components that are either biodegradable, recyclable or able to be infinitely reused.

For example, instead of buying appliances that will become obsolete in only a few years, all appliances could be leased from the companies that manufacture them. These companies, using cradle-to-cradle thinking, would take back obsolete products and use the old components to create updated versions of their appliances. This way, nothing is wasted, landfills cease to rise, toxic chemicals remain out of the water and air, and all waste is eventually eliminated.

Hot, Flat, and Crowded also looks deeply into the multifaceted issue of oil. For example, when tackling the problems of the “petrodictators” that Americans inadvertently create by using oil from intolerant countries that oppress women and hate Westerners, Friedman reminds us that our oil dependence not only supports those who seek to destroy us, but also feeds a system that destroys the environment in many dangerous ways. Never forgetting the mass murder of nearly 3,000 people in New York City on September 11, 2001, Friedman exposes the truths behind our oil addiction that must be changed with serious attention and cooperation if we want to help the next generations avoid serious trouble.

‘Petroauthoritarianism’

Times have changed and continue to change at an accelerating rate. These changes have created many new economic conditions that those of us who don’t regularly follow the Kuwaiti daily newspaper *Al-Siyasa* or the *American Political Science Review* or *Foreign Policy* magazine might have missed. For example, one trend that Friedman articulately points out while citing these types of sources is that the high price of oil has helped to

increase a rising “tide of petroauthoritarianism — from Russia to Venezuela to Iran to Sudan to Angola, all the way to Turkmenistan.”

It seems that our oil dependence is helping to fund a rapid dismantling of many of the democratic social advances and freedoms that followed the fall of the Berlin Wall. How do we know this is true? Friedman backs up his powerful statements with the results of studies conducted by Freedom House, a nonprofit organization that works to expand political and economic freedom around the world. According to the results of one Freedom House study, 38 countries saw their freedoms decline in 2007, while only 10 saw their freedoms increase. In other words, the latest developments on the global stage and the ways we fill our tanks and spend our money lead to many dangerous ramifications around the newly interconnected globe.

A Seasoned Storyteller

Hot, Flat, and Crowded readily highlights the news-gathering skills Thomas Friedman acquired as a foreign affairs columnist for *The New York Times* and the storytelling skills he has honed as a best-selling author. Nearly 20 years ago, Friedman published *From Beirut to Jerusalem*, an eye-popping account of his many years as a reporter for UPI and *The New York Times* documenting the changes taking place in the turbulent Middle East. Ten years later, in 1999, Friedman wrote *The Lexus and the Olive Tree* to describe his perspective of the rise of globalization and its impacts on the global marketplace.

Friedman’s next book, *Longitudes and Attitudes*, became his third best seller: a collection of his columns after September 11, 2001, in which he explores his observations and interpretations of a post-9/11 world. This book was published shortly after Friedman received his third Pulitzer Prize “for his clarity of vision, based on extensive reporting, in commenting on the worldwide impact of the terrorist threat.”

Three years later, Friedman published his fourth best seller: *The World Is Flat*. Throughout this book, which was number one on *The New York Times* best-seller list, Friedman charts the world’s brief history since Y2K, showing how the Internet, globalization, China’s rise, religion, outsourcing, off-shoring and numerous other issues have created a flatter, more interconnected world that wrestles with the hope of stability while coping with increasing pressures and populations.

The World Is Flat ends where Friedman’s next number-

one best seller enters the picture. Three years after *The World Is Flat* was published, Friedman once again addresses the seriousness and immediacy of his concerns by delivering his descriptions of globalization and his prescriptions for a healthier world economy in *Hot, Flat, and Crowded*. Here he uses all of his journalistic expertise to deliver another powerful message from the front lines of the global economy. His reporting on the world’s latest progress and areas for improvement offers people the stories and data that can help them get on the same page and find sustainable answers to the world’s problems together.

The Green Revolution

Hot, Flat, and Crowded culminates in a level-headed analysis of the best answers to the hot-plus-flat-plus-crowded equation. Friedman’s goal is to energize a green revolution, the likes of which the world has never seen. Since climate change, rising middle classes and swelling populations are vital concerns, Friedman’s response is more than a simple, short-term solution. Instead of only fighting the symptoms of planetwide problems, he proposes a complete “Clean Energy System” to eliminate the many sources of our possible demise.

Friedman’s latest book also serves as a wake-up call to leaders at all levels to “actually generate the vision and authority to pull that system together.” This requires thinking past the next round of sound bites

and the next season of elections to develop a plan of action for guiding the country to better economic and environmental health. Friedman writes that this effort also requires the leadership of a U.S. president who is capable of rallying the country to change its wasteful ways and igniting the innovation of a nation. That kind of authority can be rare, Friedman points out, but it will be required for a truly green revolution to make the necessary changes to avoid disaster.

Presidential Power

While analyzing the role of the U.S. presidency in leading the country through the massive changes needed to keep the country competitive, Friedman points out that Abraham Lincoln won the Civil War by expanding the federal government. He adds that Franklin Roosevelt also transformed a weak federal government, turning it into the organization that conquered the Great Depression and won World War II.

Likewise, Friedman writes that it is possible for another strong president to lead the country through the green revolution. Using every democratic means neces-

“Instead of only fighting the symptoms of planetwide problems, he proposes a complete “Clean Energy System” to eliminate the many sources of our possible demise.”

sary, Friedman explains, the president must have priorities that include a new integrated national energy system that replaces our currently inefficient grid. Regulated by too many agencies rather than a single powerful guiding entity, the current system, Friedman says, is a jumble of mismatched parts that makes it hard to improve efficiency and add alternative sources of energy to the mix.

Friedman writes that the United States needs an energy policy whose primary focus is making clean power a priority. It starts with innovating cleaner alternatives to oil and generating cleaner power. It continues by building a real system for creating greater efficiency and conservation. In other words, Friedman proposes, the country needs a “real” Department of Energy that works to help the green revolution take root.

Turning problems into opportunities is the underlying power of *Hot, Flat, and Crowded*. By considering all the facts and issues involved in the big picture, and then formulating the data into answers to the enormous difficulties he describes, Friedman aims to shift the world’s perspective away from conspicuous consumption and toward conscious consumption. Meanwhile, he offers the tools to make those adjustments permanent. Friedman proposes immediate actions that can lead the country and the world down a more sustainable path. He also confronts our issues head on, turning them into opportunities for valuable rewards. Through well-rounded reporting and encouragement of positive change, he offers clarity and ammunition for the uphill battle through the hot, flat and crowded quagmire to a better place.

The Energy-Climate Era

At this pivotal point where the Energy-Climate Era could go in an even more dangerous direction, we have a chance to build sustainable solutions before our problems grow too large to manage. Friedman’s latest book offers timely hope to those overwhelmed by the clear evidence of our difficult path ahead, which grows wilder

with challenges from all sides. The ride to prosperity will be long and daunting, Friedman writes, but the solutions to our problems are possible and abundant with the proper attitudes and leadership.

Sustainable development is within our grasp, and the green revolution is a helpful guide through which we can review our actions and our work. By showing readers how this revolution works, what it is trying to accomplish and how each individual can make a difference on a planetary scale, *Hot, Flat, and Crowded* offers both concern and hope, along with the rich ideas that can help hope become contagious. In it, the opinions and ideas of many experts make the imperative for action clearer with every chapter, so readers can understand the importance of sustainable solutions to entrenched habits and behaviors. According to environmental law expert John Dernbach, the decisions Americans make about sustainable development “are decisions about who we are, what we value, what kind of world we want to live in, and how we want to be remembered.”

Thanks to Friedman’s vast experience and insight into globalization and the resources involved in its evolution, he is revered as a writer who works to keep humanity from becoming an endangered species. His prescription for redefining the most important issues of our day and reigniting the passion of the country for innovating solutions where they are needed most is massive yet realistic. In the end, he points out, we need to rise to this enormous challenge if we want to continue to live on a planet that is hotter, flatter and more crowded than ever before. By helping to clarify the focus of the United States and the rest of the world on the most pressing issues they face together, and on better strategies for moving forward together, Thomas Friedman and his book *Hot, Flat, and Crowded* deserve all the praise and popularity they’ve been given by worldwide institutions, media and admirers. ●

The author: Thomas Friedman has been awarded the Pulitzer Prize three times for his work with *The New York Times*, where he serves as the foreign affairs columnist. He is the author of four previous books, all of them bestsellers: *From Beirut to Jerusalem* (1989), *The Lexus and the Olive Tree* (1999), *Longitudes and Attitudes* (2002), and *The World is Flat* (2005). He lives in Bethesda, Maryland.



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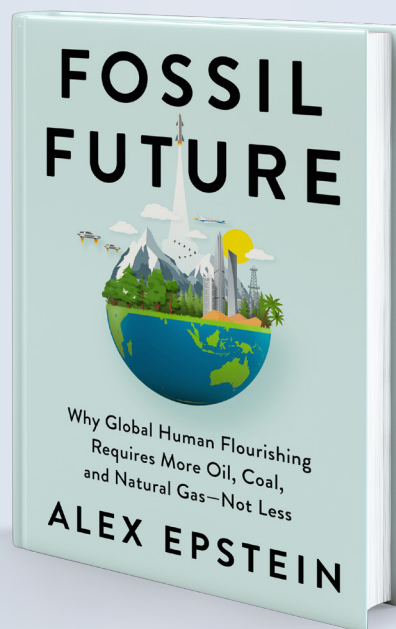
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Fossil Future

Alex Epstein

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Fossil Future

Why Global Human Flourishing Requires More Oil, Coal, and Natural Gas - Not Less

By Alex Epstein

Alex Epstein is an American author, and commentator who advocates for the expansion of fossil fuels. He is the founder and president of the Center for Industrial Progress, a for-profit organization in San Diego, California. He is the author of *The Moral Case for Fossil Fuels* (2014), and *Fossil Future* (2022), in which he argues for the expanded use of fossil fuels like coal, oil, and natural gas

The Future of Energy As We Know It

A significant portion of those who engage in public discourse regarding fossil fuels promote the idea that fossil fuels and greenhouse gases are producing a climate that will become ever more inconducive to human flourishing. According to Alex Epstein in his book, *Fossil Future: Why Global Human Flourishing Requires More Oil, Coal, and Natural Gas - Not Less*, this is because those who society has deemed as experts are operating on an anti-impact framework when it comes to the environment rather than on a human flourishing framework. In his book, Epstein posits that while human activity is generating more carbon emissions and that these carbon emissions are affecting the environment, the risks are not as great as those proposed by those who he calls the designated experts. In fact, he says that the positive effects of technology outweigh any negative consequences stemming from human development. He encourages his reader to try to confront the assumptions in climate change conversations and argue that a cost/benefit analysis is the most effective and instructive way to approach the topic.

Epstein begins his discussion by exploring the role experts can and should play in shaping our opinions. He notes that people should take note when a majority of experts claim something to be true. After all, in our “modern, specialized society, we need to rely on experts.” This does not, however, mean that experts have not been wrong in the past or may not be wrong in the present or in the future. The question then becomes one of figuring out how to use experts responsibly. Part of this, Epstein claims, is distinguishing between what experts in a field are saying and what the people who report on those experts are saying. Most people do not have direct access to experts and rather have access to those who synthesize expert information and disseminate it. Errors can and do occur in this process.

Epstein then moves into a discussion about an evaluator’s standard of evaluation, and this becomes the basis for much of his argument. He claims that many designated experts are not relying on a model where human flourishing is considered the highest good. Rather, he says, they are basing their conclusions off the assumption that an unimpacted world is the highest ideal. He calls this the anti-impact model. He says that people operating on the anti-impact model often have a view that the Earth is a delicate nurturer that, lacking human intervention, can provide a delicate balance that is nurturing to life. Epstein

does not believe in this model, and he supports his stance by showing that storms, drought, predators, and any other number of harmful potentialities exist in nature and harm human flourishing if left unchecked. He then goes on to claim that the advances made using fossil fuels have made the world incredibly more livable for humanity.

Epstein rejects the anti-impact model, and he believes we instead should be focusing on a human-flourishing model. Under this model, many changes may be considered beneficial even if they greatly impact the world. In fact, some changes may even be beneficial if they have negative impacts on humanity and the world if those impacts are either less negative than the positive benefits or if humanity can use fossil fuel derived energy to overcome those harmful effects. According to this standard, Epstein proposes that instead of focusing on climate change, it is more prudent to focus on climate danger.

Also underlying Epstein's ideas are three key facts he provides:

Fossil fuels are cost effective.

“Cost-effective energy is essential to human flourishing.”

Billions of people around the world suffer for lack of this energy.

He claims that two ways that fossil fuels aid human flourishing is by amplifying and expanding human capabilities. In short, machines allow people to produce far more than they ever could without machines, and machines allow people to do types of things they never could do without machines. As an example of the latter, he describes incubators that are capable of creating the perfect environment for a premature baby.

A major problem Epstein sees with the ideas generated by those on an anti-impact framework is the catastrophizing of side-effects. Part of the problem with accurately assessing climate change is that it is all based on predictions. It is difficult to tell whether a future prediction will come to be, but it is much easier to examine whether past predictions played out. Epstein goes on to show that many claims were made in the past about catastrophic side effects that would come to pass and yet never did.

Epstein goes on to explain that as CO₂ emissions have increased, the death rate caused by climate disasters has actually decreased substantially to the point where “the average person is fifty times less likely to die of a climate-related cause than they were in the 1920s.” This reduction is due to our improved ability to protect ourselves. This is largely the product of fossil-fuel energized machines and what they can produce. Another way Epstein proposes that designated experts are catastrophizing or looking only at worst case scenarios is in regards to the availability of fossil fuels. Instead of running out like has been predicted, as “fossil fuel use and other resource use increased, which “should have” led to an even faster decline of resources - especially fossil fuels themselves,” availability has in fact increased. Part of this is because of resource mastery or the idea that human beings develop ever better ways “of transforming unusable raw materials into usable resources.” Through all of this, Epstein maintains that

the problem is not mainly with the researchers but with those who society has designated to be the experts.

In Epstein's argument, the use of fossil fuels has had many more beneficial effects than negative ones on humanity. His claim is that the planet was largely unlivable before the advent of fossil fuel powered machines and it has become far more livable. For this reason, it is important to increase fossil fuel-provided energy to those billions in the world who still lack it so that they, too, can reap the benefits. To determine livability, Epstein looks at how nourishing, safe, and opportunity-filled the world is. Life expectancies have gone dramatically up. When a person has to spend all of their time meeting their basic needs, there is no time for innovation. With machines, human beings can rely on them to do a lot of the work necessary for survival and the people can then focus on other goals conducive to flourishing. The degree to which people can use machine labor is dependent upon the price of that labor. That is why cost-effectiveness, which fossil fuels provide, is so important.

Human flourishing is more possible with machines because of improved shelter, sanitation, and medical care. In regards to sanitation, Epstein refers to claims that fossil fuels make the world dirtier. In fact, he makes the claim that fossil fuels take an unnaturally dirty environment and make it clean enough for humans to thrive in. In terms of medical care, he references the Covid-19 pandemic and how quickly the world was able to mobilize scientific resources in order to come up with vaccines. Finally, he discusses fossil fuels' impact on human flourishing in terms of how people spend their productive time, how easily they are able to procure nourishment and protection, and how fulfilling their leisure time is.

A key benefit Epstein finds in the use of fossil fuels is their ability to counteract any negative consequences. If stronger storms occur, so will stronger shelters and better warning systems. If significant warming does occur, so does the ability of people to cool their environments with air conditioning. In terms of pollution, he believes negative side effects like those that occur in China can be mitigated. Crucial to Epstein is the idea that we do not always need to eliminate a side effect if we can instead reduce or eliminate the negative consequences of it to humanity.

The need for energy in the future will rise. Billions of people still lack the energy they need in order to thrive. When they acquire this energy, energy use will rise. Energy use, he claims, will also increase as people use new types of machines. We already use machines for much manual labor, but machine use will increase in terms of what mental labor it can do and will be asked to do. Part of this will occur with machine learning. He sees the need and opportunity for machine mental labor to be almost limitless. Energy efficiency, therefore, is key as demand for energy skyrockets. It is important when looking at alternatives to consider not just the energy needs of today but those of tomorrow as well.

Epstein then explores what makes fossil fuels so desired, what their “secret sauce” is. Much of their desirability comes from the attributes of coal, oil, and natural gas. For one, the energy is available in its naturally stored form making it much more



... forcing the unempowered world to receive their power from solar and wind is to be indifferent to their suffering.”

reliable. It is also cheaper because we do not need to pay for storage. Second, it is highly concentrated. It is energy dense. Finally, it is abundant. On top of all of this, fossil fuels benefit from the generations of people who have worked on innovation in this area. He believes that if this continues, even more people will be able to become empowered.

Epstein believes that nuclear energy is the most likely possible alternative to fossil fuels. This is resisted by many, however, who work on the anti-impact framework. He writes about the current emphasis on wind and solar energy, but he claims that in order to have these take over fossil fuels by 2050, is “about as far-fetched as you can get.” He says that the claims that this energy is cheap do not take into account the government subsidies that support these industries. Not only do solar and wind suffer because they are intermittent sources of electricity, but they are also quite dilute, meaning that it will take a large amount of space to harness them. He believes that forcing the unempowered world to receive their power from solar and wind is to be indifferent to their suffering. He then goes on to discuss using biomass to replace fossil fuels. While biomass does have some of the positive attributes that fossil fuels have such as storage and concentration, it is not scalable. There is simply not enough farmland to grow new biomass. Hydroelectric energy is another source that Epstein states is unscalable. Geothermal energy is not currently cost effective in most places. Epstein believes that nuclear energy is the most promising alternative but is frustrated by the anti-impact framework’s refusal to see it as such. He does not believe that most such people oppose it on the grounds of safety; rather he believes they oppose it because it impacts the environment, especially as it must be stored. Regardless, Epstein believes nuclear is still decades away from being a top global energy source.

Epstein devotes the third part of his book to discussing climate side effects. He sees our environment as being diverse, dangerous, and dynamic. By diverse he means that the effects of any man made climate change will not be the same everywhere. Our climate has always been dangerous and dynamic far before the use of fossil fuels for energy. Our climate is not inherently stable. It is dynamic and changing throughout history. Fossil fuels allow us to overcome changing temperatures, increased wildfires, and major storms and floods. Even rising sea levels can be overcome or adapted to as shown by the rising number of people who choose to live below sea level.

Epstein does not believe that rising CO2 levels will lead to an unlivable planet as CO2 has been higher deep in our history, and life continued to exist. In short, he says that we are currently near historic lows in terms of both CO2 and temperature. Not to mention the fact that he says that most climate warming actually happens in cooler areas rather than in those closest to

the equator. He goes on to say that “There is no direct correlation between temperature and CO2.” He says that there likely may be natural warming occurring concurrently with man-made warming. He believes that when looking at side-effects, we need to ensure that they are both harmful and preventable, and he believes that CO2 emissions are neither.

Epstein believes freedom is a key component in the empowered world’s ability to become so, and he fears restrictions on this freedom could stop others from flourishing as well. Human flourishing requires freedom to trade, freedom to compete, and freedom of property rights. Government-control of land limits this freedom. Policies regarding development also stymie energy growth. Epstein believes people should be protected from abuses of energy but not necessarily from natural side effects of energy use. To consider a side effect endangerment and thus in need of regulation, he believes the side effect must be both significantly harmful and preventable.

In his book, Epstein takes on what he calls the designated experts of today who claim that fossil fuel use has to be eliminated. Most of these experts give the date of 2050 for this elimination of carbon emissions. Epstein believes that these people place a non-impacted world over the flourishing of human beings. He analyzes the assumptions that underlie their beliefs and then goes on to question the claims they make and the opportunities they eschew. By the end of his book, Epstein has laid out his case that the truly moral way to move forward is to actually expand rather than restrict the use of fossil fuels.

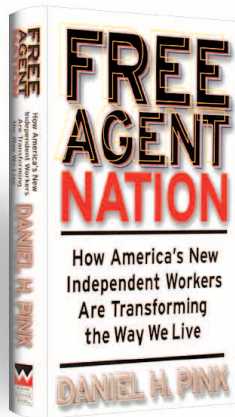
· Book 13 of 32 ·

Free Agent Nation

Daniel H. Pink

SOUNDVIEW Executive Book Summaries®

FILE: ECONOMICS



By Daniel H. Pink

How America's New Independent Workers Are Transforming the Way We Live

FREE AGENT NATION

THE SUMMARY IN BRIEF

Over the past decade, in nearly every industry and region, work has been undergoing its most significant transformation since Americans left the farm for the factory a century ago. Legions of Americans are abandoning one of the Industrial Revolution's most enduring legacies – the “job” – to become free agents – as self-employed knowledge workers, proprietors of home-based businesses, temps, freelancers or independent contractors. Daniel H. Pink spent a year traveling the country, talking with hundreds of these workers. The composite sketch Pink reveals in *Free Agent Nation* displays the effect these individualists are having on all our institutions – political, economic and personal. As a manager, business owner, or perhaps someone thinking of becoming a free agent, you'll want to understand this powerful new demographic and its impact on your company and industry.

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What You'll Learn In This Summary

● **The Organization Man is dead.** To better understand the swell of influence free agents have on our businesses, you need only compare them to that paradigm of the ultimate worker, the “Organization Man,” and the business climate in which he existed. You will see how far we have come.

● **There are many kinds of free agents.** Whether you're a soloist, a microbusiness or a temp, your influence is being felt in the Free Agent Nation.

● **Old concepts die hard.** Free agents are changing the ways we view success, freedom, loyalty and authenticity, among other business concepts. Even a concept as stalwart as time must be looked at in a different manner.

● **Free agents support their own infrastructure.** A loosely aligned compendium of businesses, from copy stores to coffee shops, meet the special, specific needs of free agents and their businesses.

● **Retirement must be reconsidered.** Free agents are providing opportunities galore for older specialty workers, who may want to forgo shuffleboard for the chance to make a load of money on their own terms.

FREE AGENT NATION

by Daniel H. Pink

— THE COMPLETE SUMMARY

PART I: WELCOME TO THE FREE AGENT NATION

The Death of the “Organization Man”

For several generations, the American working economy had a single, stalwart human emblem — the “Organization Man,” so dubbed after the 1956 book of the same name by William H. Whyte, Jr. The label described what was then the quintessence of work in America — an individual (nearly always male) who ignored or buried his own identity and goals in the service of a large organization, which rewarded his self-denial with a regular paycheck and, most importantly, job security. Instead of living by the ethic of rugged individualism (as they often preached to others), the Organization Men abided by what Whyte named a Social Ethic, a secular theology that placed the organization at the center of the universe. Entrepreneurs were “selfish type[s], motivated by greed.”

But beginning in the 1980s and reaching a crescendo in the 1990s, conditions and attitudes changed. Companies that had formed the bedrock of American work — large organizations like Bell Telephone and Kodak — began winnowing their work forces, in response to economic stimuli, corporate restructuring, and technology that could do people’s work for less money. The social contract of job security was broken; the Organization Man was relegated to the annals of history.

The Organization-less Worker

What replaced him as the archetype of work in America is the free agent — the independent worker who operates on his or her own terms, untethered to a large organization, serving multiple clients and customers instead of a single boss. Consider this: The largest private employer in the United States is not General Motors, Ford, Microsoft or any of the other accepted corporate behemoths. It is Milwaukee’s Manpower Inc., a temporary help agency with more than 1100 offices in the United States.

Free agency has already begun overturning many of today’s central assumptions about American work and life, among them the following:

- **Loyalty is dead.** It’s not dead; it’s different. Instead

of up-and-down loyalty that runs from individual to institution, free agents practice side-to-side loyalty — an allegiance to clients, colleagues, teams, projects and industries. In some ways, loyalty is stronger than ever.

- **The work force is adrift, operating without a broad social contract.** The implicit employment promise that reigned in the days of the Organization Man has disappeared, replaced by a new one, one of trading talent for opportunity.

- **The free agent economy makes workers less secure.** As free agents compile a diverse portfolio of clients, customers and projects, they often find themselves in a more secure position than traditional workers.

- **Parents must try to balance work and family.** Corporate and government efforts to be more family-friendly offer a one-size-fits-all approach to the work/family balance. Free agents tend to erase the boundaries between the two, blending, rather than balancing.

- **“Empowerment” and “retention” are wise strategies for corporate managers.** These concepts are built on the fact that organizations hold all the power. In a free agent economy, organizations need individuals more than individuals need organizations, which can inspire and challenge people, but cannot “empower” or “retain” them.

- **Rampant individualism is fraying our social fabric.** Critics claim our common culture is corroding, and the free agent economy is speeding the problem. In actuality, it may be providing a solution, mending bonds and repairing our concepts of community. ■

The author: Daniel H. Pink, a former White House speechwriter, is a contributing editor at *Fast Company* magazine. His articles on technology and the new world of work and business have appeared in the *New York Times*, *Washington Post*, *New Republic* and *Salon*.

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How Many Are There? The Three Free Agent Species

Work has changed so swiftly and profoundly in recent years, traditional methods of measuring it are, at best, weak. The Bureau of Labor Statistics (BLS), for instance, still divides all American workers into two categories: “farm” and “nonfarm.” In fact, the BLS compiles some figures for temps, self-employed Americans, and independent contractors, but all are likely undercounted; indeed, those three categories are but subsets of free agents.

Which poses an interesting dilemma: unlike Organization Men, free agents don’t fit into neat taxonomic compartments. Through his experience and research, however, the author has found that most free agents are at least approximations of one of three basic free agent species — soloists, temps and microbusinesses.

Soloists

The most common variety of free agent is the soloist — someone who works for him- or herself, generally alone, moving from project to project, selling his or her services. Over the years, soloists were termed “freelancers” in the cultural vernacular; “independent contractors” in legal vernacular; and any one of a dozen or more terms for self-employed soloists (“consultants,” “permalancers,” “hired guns,” “nomads,” “1099ers,” etc.).

Whether they’re management consultants, plumbers, graphic designers or workers in another of a countless number of fields, we do know that there are a lot of them — the percentage of self-employed workers jumped from 22 percent in 1998 to 26 percent in 2000, totaling 33 million workers, by one reliable account. Other research indicates that four out of five soloists prefer to be soloists, and that full-time soloists earn an average of 15 percent more than their employee counterparts.

Temps

If soloists are free agents by design, temps are often free agents by default. Many of the 3.5 million workers in the temp population would rather have a permanent job with a company, but coldly efficient corporations, temp agencies looking after their own interests, and the temps’ own lack of ambition or ability conspire to pin them to the bottom of the economic ladder. Temps have gone from being a short-term corporate cost saver for business downturns into a long-term business strategy for corporate survival. The evidence abounds:

- In the first half of the 1990s, the temporary personnel business created more net new jobs than any industry in America.
- On a typical day in 1992, 415,000 Americans were

How Did Free Agency Happen?

To understand how free agency became as rampant as it is, it helps to think less in the mechanical terms of cause and effect, and more in the culinary terms of ingredients and tastes. In a chocolate cake, for example, it’s difficult to tell where the flour stops and the sugar begins, or which part of the cake is egg and which is cocoa. Is flour a cause of the chocolate cake? Not really. Is flour crucial to the chocolate cake’s existence? Yes, of course. Does the flour need the egg and the sugar and cocoa to create the final product? Absolutely.

There is, in other words, no single cause of the chocolate cake, but a number of ingredients combined. Free agency is like that — it has no single cause, but it does have four essential ingredients:

✓ **The end of America’s economic adolescence.**

The loyalty-for-security pact that was the ultimate reward for the Organization Man crumbled in the face of changing economic realities. The most potent example of this shift was IBM, which, for 50 years, had maintained a full-employment policy; it would never lay off its employees. . . . ever. This policy was abandoned in 1992 and 1993, when the company whacked its payroll by 120,000 employees. The event was the workplace equivalent of the tumbling of the Berlin Wall.

✓ **Cheap, houseable means of production.**

Individuals needed a large company less, because the means of production — the tools necessary to create wealth — went from expensive, huge and difficult for one person to operate, to cheap, houseable and easy for one person to operate.

✓ **Prosperity.** The astonishingly high standard of living that has reached deep into the middle class has not simply improved lives; it has altered expectations, from the fear of privation to the expectation of comfort. This, in turn, has changed the prevailing attitude of work; people work not to make money to survive, but to make meaning for themselves and their families.

✓ **The shrinking half-life of organizations.**

Individuals will likely outlive any organization for which they work. It’s hard to imagine a lifelong job at an organization whose lifetime will be shorter — often much shorter than your own.

working as temps. By 1999, that number had reached three million — a 600 percent increase.

- Twenty-five years ago, the temporary staffing industry had revenues of less than \$1 billion. By 1990, that figure had reached \$20 billion; today, it is \$80 billion.

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How Many Are There? The Three Free Agent Species

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Microbusinesses

Erupting across the Free Agent Nation is a blaze of enterprises that are smaller than the typical “small business” — sometimes consisting of only two or three people. These microbusinesses are a growing force — more

than half of American companies today have fewer than five employees. The growth of the Internet is due at least partial credit for this upswing; with limited barriers to entry, robust and inexpensive information networks, and the wider availability of capital, starting a business is not much harder than buying a home or getting a driver’s license. Indeed, economists have found that as an industry uses more information technology, the average size of firms within that industry shrinks. ■

PART II: THE FREE AGENT WAY

The New Work Ethic

Many traditional workplaces — whether they are colorless Organization Man monoliths, cynical cubicle farms out of “Dilbert,” or sleek, high-tech corporate campuses — often do not allow employees to pursue meaningful work, work that enables them to achieve their highest potential. In our new age of comfort, work has taken on a larger purpose — one that many large organizations seem incapable of accommodating, even with their offers of paychecks and stock options. To the Free Agent Nation, work is not simply about making money; it’s about making meaning.

How does this new work force make meaning? The answer: by assembling four pieces that together comprise the new free agent work ethic — **freedom, authenticity, accountability** and **self-defined success**.

Freedom

Freedom — the ability to exercise one’s will — has become essential for making meaning in work. Freedom means different things, however, to different people. For some, freedom might connote freedom of speech (to be able to say what one thinks and be taken seriously). For others, it might mean freedom of selection (of projects and schedule). For still others, it might mean freedom of conscience (maintaining a high ethical standard). Companies, likewise, respond to these freedom-centric needs in different ways: some smother their employees in affection; others try to purchase individual freedom with lucrative stock options, and the like; still others ignore the need entirely, monitoring their employees’ workstations and e-mail.

Authenticity

In the traditional workplace, authenticity — the freedom to be one’s self — is neither condoned nor rewarded. Many workers feel they have to put on the “costume” of their 9-to-5 selves in order to succeed in the corporate environment. Free agents, conversely, express their authenticity by being passionate about their work, fully integrating their work into who they are.

Accountability

Most people want to be held accountable for their work, providing they reap both the rewards of success and the penalties for failure. In the typical corporate environment, workers get little blame and less credit, making it difficult to know how well they’re doing. Free agents, however, are accountable directly to the market, existing in a fast-feedback world that gives them instant responsibility for their actions.

Self-defined success

Free agents are redefining our notions of what constitutes success, and it’s not all about money or promotions. Free agents tend to measure success on growth and the simple joy of getting up in the morning and doing what they want to do. ■

The New Social Contract

In the old social contract of work, the organization offered individual security and, in return, the individual gave the organization loyalty. In the twenty-first century, free agent values are redefining and recasting security and loyalty in interesting ways.

Security

For years, most Americans did not diversify their work lives; they signed up with one company, investing all their human capital in one stock, as it were. Today, doing that makes as little sense as investing all your financial capital in one stock. Free agents tend to diversify their work investments, often juggling multiple clients in an effort to increase their job security by relying on their own talents to get ahead, not the whims of a boss. There is risk involved in this approach; many recoil at the prospect of taking on more risk, noting that more risk might mean more pain. Others embrace the risk and the potential payoffs that come from spreading their talent across a portfolio of projects, clients and skills. Freedom, once a detour from security, is now a pathway toward security.

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The New Social Contract

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Loyalty

When the job security at the heart of the old social contract collapsed and was reconfigured by free agents, its counterpart — loyalty — met the same fate. In the Organization Man's world, loyalty moved vertically, flowing from subordinates to authority figures, who graciously conferred some benefit in return. When employers could no longer offer security, loyalty became at best an act of charity, at worst an act of folly. That vertical loyalty was replaced with a more horizontal loyalty — one that flows from workers to teams and colleagues; to professions and industries; to clients and customers; and to family and friends. Whereas vertical loyalty depended on one strong connection, horizontal loyalty depends on multiple connections, all of varying strength and endurance. ■

The New Time Clock

Time, the saying goes, is money; it's something we spend, save, and sometimes waste. But time is unlike money in at least one crucial aspect — it is resolutely democratic. We all get the same amount — 168 hours — every week. The number of hours in which we work are unparalleled. One survey determined that since 1969, the average worker spends an additional month on the job every year. Another bit of research discovered that, on average, Americans work 350 hours more per year than Europeans, and 70 hours more per year than the Japanese, who even have a word — *karoshi* — that means “death from overwork.”

On the front lines of the New Economy, workers find themselves not only putting in longer periods of time on the job, but also losing control of their time off the job. Pagers and cell phones keep them tethered to their jobs psychologically no matter where they are physically. They never feel truly free.

Free agents recognize that they are not merely bushels of hours. Many are selling more than just units of their time — they're selling insight, talent, expertise, ideas,

creativity and solutions, all of which are difficult to measure. They recognize that what matters in the course of a given day is how much one accomplishes, not how long one is at one's desk. They are applying an ethic of “my size fits me” with every unit of time:

● **The day.** Free agents are redefining the idea of the workday — working eight hours could mean working any eight hours of a given day. You could start at 6 a.m. and finish at 11 p.m., fitting work into the nooks and crannies of time in the course of the day. If you can answer a client's e-mail at 10 p.m. from your den, your idea of your workday is likely more amorphous than the typical company worker, certainly more so than that of the Organization Man.

● **The week.** While days are variable and years are long, weeks tend to be the unity around which much discussion of work occurs. Free agents, however, tend to maintain a boundary-free workweek, unbound by the eight-hours-times-five-days mathematics that define the corporate week. There are trade-offs in these differences: what a free agent gains in flexibility (the ability to work shorter or longer days, depending on need or preference) he or she gives up in predictability (many wind up working for at least a portion of their weekends). The old way of work was Monday through Friday — five days of work and two days of weekend; the free agent way is Monday through Sunday — seven days of everything.

● **The year.** The traditional annual vacation arrangement at most companies is 50 weeks of work and two weeks of vacation. For free agents, however, vacations are dependent strictly on how much they can afford and how much work they need.

● **The lifetime.** As the unit of the day, the week and the year, free agents are making changes in the accepted definition of a working lifetime. The typical lifetime followed a set course — a dose of education, followed by several decades of work, followed by a short period of retirement. The free agent way rejects that approach, dramatically changing how and when people participate in the first and last stages, and redefining that length of work time in between. ■

PART III: HOW AND WHY FREE AGENCY WORKS

While many pundits bemoan the loss of a sense of community in the business world (and elsewhere), free agents are, as a result of and in response to their independence, finding ways to create their own communities, with their own infrastructure, and their own network of professionals whose business it is to make their lives and work easier. It is in part due to these things that the Free Agent Nation continues to grow, not just in numbers, but also in richness and depth of community. ■

Small Groups, Big Impact

Instead of laboring in loneliness, independent workers are constructing small communities, where like-minded, like-laboring professionals can collaborate, commiserate, and provide encouragement and support to one another. These groups are truly grass-roots efforts and, as a result, they elude much notice, particularly from

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Small Groups, Big Impact

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Organization Man types and other critics of free agency.

Such professional groups are but one segment of the kind of decentralized collectives that flourish in everyday life. Book groups, small religious groups, even Alcoholics Anonymous fall into this category, in which people from all professions and walks of life can come together on a regular basis to hold discussions, pray, or just talk through problems and receive encouragement or help. Yet, the world of work is where small groups might produce their deepest influence. The Free Agent Nation's propensity toward horizontal loyalty is best displayed in such group settings as the following:

- **F.A.N. Clubs.** Free Agent Nation (F.A.N.) Clubs are merely clusters of free agents who meet regularly to exchange business advice and offer support. They are part board of directors, part therapy, combining a search for clients with a quest for meaning; they emerge from self-interest, but endure through trust, often meeting on an ad-hoc basis. While that loose status often makes them difficult to sustain, F.A.N. Clubs have their place in the Free Agent Nation, if only to remind soloists that working solo is not working alone.

- **Confederations.** These informal work collaborations of free agents are growing in the same self-organized fashion as F.A.N. Clubs. Several soloists or microbusinesses, often from multiple disciplines, create a virtual community, coming together in various forms and numbers to create custom solutions for clients; once the solution is delivered, each member returns to his or her own work. Confederations create the right mix between individual freedom and group power.

- **Entreprenetworks.** These are groups of small entrepreneurs who pay a fee to participate in facilitated brainstorming and strategy sessions. They are more formal than F.A.N. Clubs (and usually more expensive), more oriented toward strictly business functions, such as generating new business leads and networking, than social interaction. In many ways, entreprenetworks are the chambers of commerce for the Free Agent Nation.

- **Alumni associations.** The common bond these groups share is that their members graduated not from the same college, but from the same company. Free agents use these groups to gain knowledge and make connections, as well as to keep up with industry gossip and information. These groups tend to thrive in business segments in which turnover is high and free agency is the reigning ethic, such as the technology sector. ■

Kinko's: The Cheers of the Free Agent Nation

Kinko's founder, Paul Orfalea, began his chain of copy shops in 1970, near a taco stand in Santa Barbara, Ca. From those humble beginnings, a great chunk of the Free Agent Nation infrastructure was born. Orfalea was one of the first business leaders to understand the rise in free agency, the resulting boom in home offices, and the need that soloists and micropreneurs would have for services such as high-speed copying, color printing and professional-quality duplication.

In recent years, he has outfitted more than 150 Kinko's locations with videoconferencing facilities, providing a service no single free agent could pay for on their own. In addition, the company's Web site (www.kinkos.com) and its alliances with other organizations like Federal Express and America Online give soloists the technology they need to compete with bigger companies. To top it off, their clerks (or "co-workers," to many free agents) are friendly, helpful, and understand the needs of their free agent customers, particularly those who return again and again.

The result: a place that always knows your name and is always glad you came — the Cheers bar of the Free Agent Nation.

The Free Agent Infrastructure

The Free Agent Nation has been at the center of an emerging economic infrastructure whose many components exist solely or in part to help free agents do their work. Like America's system of federal highways, the free agent infrastructure forms the physical foundation on which the economy operates. Unlike the highway system, however, this infrastructure emerged spontaneously, organically, rather than as a result of an influx of funding from a government agency or other benefactor. Like so many other aspects of the Free Agent Nation, it is self-organized, which probably explains why it works so well. There are eight key elements to this infrastructure:

- **Copy and printing shops.** Copy shops like Kinko's (see sidebar) provide invaluable services to free agents, even those who have equipment like copiers and color printers in their home office. Most free agents can't imagine working independently without the assistance of this vital infrastructural component.

- **Coffee shops.** Coffee shops like Starbucks and Xando Cafés are fertile common grounds where free agents can gather, network, even hold meetings. Many such outlets have even changed the layout of their stores

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The Free Agent Infrastructure

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in order to accommodate the space requirements of soloist gatherings.

- **Bookstores.** Bookstore cafés offer the comforts of Starbucks with one considerable advantage — most major chains encourage you to browse while you sip your mocha latte, which turns your nearby Borders or Barnes & Noble into a research facility as well.

- **Executive suites.** These operations rent private offices with shared reception areas to micropreneurs who wish to supplant or supplement their home offices. Many also provide meeting rooms, mail delivery and secretarial services, as well.

- **The Internet.** The Web has enabled free agents to access the latest versions of software applications, free fax services, free voicemail, free calendar programs, and, through companies like BigStep.com, free electronic storefronts.

- **Office supply superstores.** National chains like Staples and Office Max allow soloists and micropreneurs to get their office supplies easily and at a fair cost. People who are self-employed and work at home are 41 percent more likely than the average person to shop at an office supply superstore.

- **Postal service centers.** Establishments like Mail Boxes, Etc. offer a post office box, assistance shipping packages, and a small selection of business services and office supplies, making it, in essence, the mailroom of the Free Agent Nation.

- **Overnight package delivery.** Overnight delivery services like Federal Express have helped free agents achieve the speed of a giant corporation. Indeed, nearly one million individuals now have their own FedEx accounts. ■

Matchmakers, Agents and Coaches

The free agent economy differs from the Organization Man economy in two fundamental ways. First, as power has shifted from organizations to individuals, talent has replaced capital as the economy's most important resource, and a new talent market has emerged to organize, price and allocate it. Secondly, instead of being free of personality, work has become more emotionally complex. Work has increasingly become a source of meaning, which makes careers resemble mountain climbing — full of great heights and potential peril, a self-directed quest rather than a passive ride.

These economic and emotional elements have given rise to several specialized industries that help grease the wheels of the Free Agent Nation's economy, by helping soloists and micropreneurs find work and improve themselves. Those industries include the following:

- **Matchmakers.** This group, an outgrowth of the temporary staffing industry, connect buyers seeking free agent talent with free agents seeking projects, thereby making the market for new talent run more smoothly.

- **Agents.** Just as talent agents have long represented actors, authors and athletes, “free agent agents” represent independent workers, negotiate on their behalf, and advise them on personal and professional matters, which means they straddle the realms of the economic and emotional elements mentioned above.

- **Coaches.** This group has grown because they help free agents answer more fundamental questions about their lives. Coaches never existed in the era of the Organization Man, because those men prided themselves on their ability to get along with their bosses, rather than getting in touch with themselves. Today's workplace is a more emotional place, and the role of the coach — part counselor, part priest — has become an increasingly essential one. ■

PART IV: THE FREE AGENT FUTURE

What will the future look like for the Free Agent Nation? If the Nation's numbers continue to grow and their influence in the marketplace grows with them, you may see a number of shifts in work-related paradigms in the middle and distant future, among them “e-tirement” and “Individual Public Offerings.” ■

“E-Tirement”

One reason our economy has always grown is that our work force has always expanded; by 2013, however, the labor force will stop growing, leaving the economy with

plenty of work to do by not enough people to do it. Enter “e-tirees,” a demographic group of 60- and 70-somethings who may wind up back in the work force, on their own terms, as free agents. They'll be able to customize their work preferences and negotiate arrangements that will square with family commitments and leisure desires. The demand for their services will almost certainly be there.

The author anticipates a strong supply of e-tirees to meet the needs of the economy, due in part to five key reasons:

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“E-Tirement”

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1. Americans are living longer and better. When President Franklin Roosevelt signed the Social Security Act, establishing 65 as the standard U.S. retirement age, the average life expectancy was 63. Today, life expectancy has soared to 76, rendering age 65 as an outdated demarcation of old age in this country.

2. Older Americans are ready, willing and able to work. An AARP study found that 80 percent of baby boomers expect to work during their retirement years. This is doable for many, due in part to the fact that Medicare will negate the need for employer-provided health insurance, the lack of which prevents many prospective free agents from going solo. It won't be a problem for e-tirees.

3. Older Americans will be in a position to demand their own terms. Too many years of working for a boss can take a psychological toll, one reason the self-employment rate among people age 55 to 64 is two-and-a-half times greater than among those between 25 and 34.

4. Baby boomers are about to inherit a bundle. One university study found that a windfall (lottery winnings or inheritance) of \$8,000 or more doubles the probability that someone will become self-employed. In the coming decades, baby boomers will inherit more than \$10 trillion from their parents, rendering millions of boomers financially capable of launching a new career as senior soloists.

5. Older Americans are jumping into the Net. People over the age of 50 are the second-fastest-growing group on the Internet. This can be seen in the growth of Internet companies like Third Age and Seniors.com, which have built thriving memberships of older Americans.

Of course, e-tirement won't be for everyone, but you can expect that millions of older Americans will make retirement an aberration and e-tirement a way of life. ■

IPOs — The Path Toward Free Agent Finance

As power continues to devolve from firms to individuals, we see a democratization of finance, one that is intensifying considerably. The first stage was expanding the number of people who invest in stocks and bonds; the next stage — just a few years away — will be expanding the number of people who issue their own stocks and bonds, including freelancers, home business owners and self-employed persons. These people will go directly to markets in order to get the funds they need to finance their startups, expansions and improvements.

The initial push toward market-based financing of individuals came from an odd source — the world of rock and roll. In 1997, musician David Bowie raised \$55 million in investments, using his song publishing and album royalties (which provide a steady stream of income) as collateral. Bowie issued 15-year Bowie Bonds, which offered a 7.9 percent return, and which were assigned an AAA rating by Moody's. For those who bought the bonds, Bowie's offering represented a consistent, predictable income stream; for Bowie, the deal offered a large sum of money he could use to invest or expand into new areas.

FAN Bonds

Bowie's trail-blazing effort has been copied by several other musicians and songwriters, and will likely expand to regular folks — perhaps in the form of Free Agent Nation (FAN) Bonds — to become another instrument free agents use to raise capital for their enterprises. These bonds would carry higher interest rates than other current debt markets (like student loans), but they would be available to more people and for a broader set of purposes. Soon after, you would likely see ratings agencies evaluating bond offerings of individual freelancers and microbusinesses. An all-star marketing guru with a history of success might be an AA-rated FAN Bond, while a graphic designer just out of art school might receive a BB rating — higher risk, but higher yield.

This democratization could also move into forms of equity financing, such as venture capital. In this theoretical landscape, a free agent could raise equity financing through a new kind of IPO — an Individual Public Offering. Modeling their offering after current direct public offerings, free agents could sell their shares directly to the public, without the help of underwriters.

***A free agent
could raise
equity financing
through a new kind
of IPO — an Individual
Public Offering.***

Small companies have done this, to the tune of hundreds of millions of dollars (\$439 million in 1998 alone). Some professional boxers are doing it right now, financing their training by selling shares to their investors, yielding those investors a percentage of the boxer's earnings over a period of time. Soloists willing to forgo some autonomy in exchange for an influx of cash for improvement or expansion costs could find themselves in the same ring as their pugilist counterparts.

As power shifts from companies to individuals, so, too, will the financial instruments that provide capital. We have met the market, and it is us. ■

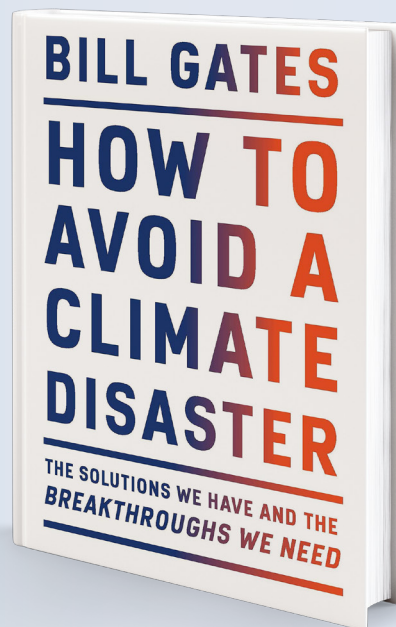
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How to Avoid a Climate Disaster

Bill Gates

BOOK SNAPS™

Zooming In On Your Next Read



How to Avoid a Climate Disaster

The Solutions We Have and the Breakthroughs We Need

By Bill Gates

Bill Gates is a technologist, business leader, and philanthropist. In 1975, he cofounded Microsoft with his childhood friend Paul Allen; today he is cochair of the Bill & Melinda Gates Foundation. He also launched Breakthrough Energy, an effort to commercialize clean energy and other climate-related technologies.

How the World Can Avoid a Climate Catastrophe

The world typically adds approximately 52 billion tons of greenhouse gases into the world each year. Following the reports and suggestions of experts in the field, Bill Gates, in his book, *How to Avoid Climate Disaster: The Solutions We Have and the Breakthroughs We Need*, lays out what the world needs to do in order to reduce that number to zero by the year 2050. In his book, he takes into account both the current energy needs of the world, the projected needs in the future, both current and hopefully forthcoming technological advances, and the need of the developing world to increase their energy usage. Gates says, “The only solution I could imagine was to make clean energy so cheap that every country would choose it over fossil fuels.” He does not envision or desire a world in which less energy is used; rather, he desires a world in which more energy is used but that that energy is carbon free. Gates acknowledges the difficulties inherent in getting the world to net zero carbon emissions, but he remains hopeful throughout the book that it can be achieved.

In Gates’s estimation, continuing to release carbon into the atmosphere will result in an inevitably hotter planet and that this heat will make it more difficult for people to thrive. Because the world is so reliant on fossil fuels for certain processes, he does not believe it will be possible to get to a point where humans are not emitting some carbon. Instead, he thinks the path to net zero emissions will require humanity to figure out ways to remove the carbon that is released. When he refers to net-negative emissions, he is referring to the concept that at one point humanity will have to start removing some of the gases from the atmosphere that have already been emitted.

Gates gives a basic explanation of greenhouse gases and how they impact the environment. In short, “they absorb heat and trap it in the atmosphere. They work the same way a greenhouse works.” As an example most people are familiar with, he explains how a car’s windshield allows heat in and then traps some of it in there, making a car sitting in the sun quite hot. Gates states that the temperature has raised about 1 degree celsius since pre-industrial times and would likely raise another 1.5 -3 degrees Celsius by mid-century and 4-8 degrees celsius by the end of

the century. While not everyone will suffer equally from these changes, he predicts stronger storms, more severe droughts, more and worsening wildfires, and rising sea levels. In order to stop or mitigate these disasters, human beings can adapt to the changes that have already occurred by trying to minimize their impacts, and they can mitigate these changes by stopping the emission of more greenhouse gases to the atmosphere.

Gates explains that fossil fuels are “so pervasive that it can be hard to grasp all the ways in which they - and other sources of greenhouse gases - touch our lives.” One main reason for this is that fossil fuels are very inexpensive. This is because they are “abundant and easy to move.” Gates makes the claim, however, that their purchase price does not take into account all the damage they cause. The demand for these fuels will rise as people in the developing world advance their energy use to be more on par with that of the developed world. Gates does not believe it is moral to ask those in the developing world to consume less energy than those in the developed world do; therefore, humanity needs to find a way for poor people to use energy while avoiding making climate change worse.

Gates goes on to mention certain considerations to take into account when someone discusses greenhouse gases. First, he suggests converting the amount into a percentage of the 52 million that needs to be eliminated. Next he suggests people consider more than just electricity use because electricity use accounts for just 26% of the problem. These gases are also emitted from making things, growing things, getting around, and keeping warm and cool. Finally, cost needs to be considered. Here he discusses Green Premiums or the added cost that these carbon-free emissions cost. He suggests considering whether green premiums are low enough for middle-income countries.

He then goes on to say that “figuring out how to get all the benefits of cheap, reliable electricity without emitting greenhouse gases is the single most important thing we must do to avoid a climate disaster.” In terms of electricity, he believes that only a modest Green Premium would be required to actually eliminate emissions from electricity. In the United States and Europe, he believes that rates would go about 15 and 20% respectively. In the rest of the world, however, this low premium may not be possible because they do not have the same breadth of natural renewable resources that the US does in varying parts of the country. One of the problems, however, with the use of natural resources is they are intermittent. The sun does not shine all the time and the wind does not always blow. Therefore, in order to make these massive parts of the electrical supply, people will need to develop a method to store this energy from times when it is plentiful to times when it is lacking. This is both difficult and expensive on a large scale. Gates believes these energy sources can play an important role in helping humanity get to net-zero emissions, but they will need to be supplemented by other sources. Gates then goes on to explain nuclear fission as a possible way to get more electricity. This is cheap, reliable, and carbon-free. It is, however, expensive and can be dangerous. Nuclear fusion is another option. This option is cheap and plentiful but is still at least ten years away from feasibility. Offshore wind is a third option that has fewer intermittency problems

and is becoming more usable as prices come down. Finally, he mentions geothermal energy as another possible source of electricity. This requires digging up to a mile down into the Earth to get hot rocks that are capable of generating electricity. The downfall of this approach is that it is not energy dense, meaning that there is not a lot of energy per square meter. Also, experts are incapable of determining where to dig the wells because they do not know where the needed heat is.

Gates then moves on to examine greenhouse gas emissions involved in how things are made. He reiterates his belief that progress is a good thing and that it is good that people are getting more benefits from energy. He believes, however, that we have to eliminate these gases to net-zero in order to stop catastrophic effects. In his section on making things, Gates goes into detail about just how much carbon dioxide is released in the making of steel, cement, and plastics. Gates provides several avenues for mitigating these emissions. One of these is to use carbon-free electricity in the processes used to make these materials. Another is to create public policies that encourage the greening of these industries. Carbon capture will also play a role in eliminating the carbon that is still released.

Gates then discusses how things are grown and the impact this has on carbon emissions. Part of the problem with food production is that people eat more calories as they get richer. Meat and dairy require more resources because for each pound of meat produced two pounds of grain are required. As the world becomes richer, demand for these meat products will increase. Another problem regarding how things are grown is that as there is a push to increase energy coming from plants, those plants will compete with plants grown for human consumption.

In regards to farming, animal poop is actually one of the biggest problems because as it decomposes, it creates greenhouse gases. Gates believes this can be partly mitigated by using better breeds of animals who do not produce as many gases. New techniques can be improved, as well, for getting rid of manure with fewer emissions. Another partial solution to the problem of meat production is for people to eat plant based meats instead of real meat that comes from animals. In addition, meat can also be produced in a plant. This is actual meat, albeit artificially made, rather than plants that have been prepared to taste like meat.

Moving on to transportation, Bill Gates mentions two crucial facts about gas: it is cheap and it is powerful. Transportation does not count for the largest amount of emissions in the world, but it does count for the largest number of emissions in the United States. Gates suggests one possible alternative to gas is to use cars that run on carbon already in the air rather than on fossil fuels. Electric vehicles are also another option, and Gates believes the Green Premium on these vehicles will be nonexistent by the year 2030. The downfall to electronic vehicles is that their price is good relative to the price of gas. Also, it takes longer periods of time to charge a vehicle than it does to fill up with gas. Another alternative is the use of biofuels that get their energy either from plants or from combining “the hydrogen in water with the carbon in carbon dioxide.” These are called hydrocarbon fuels. The situation



... the people who will be most affected by climate change are the poorest people in the poorest parts of the world.”

is different with cargo trucks as it is not feasible to electrify them. Therefore, in order to reduce their emissions, electro-fuels and biofuels may be required although as of today, they have a hefty Green Premium. To reduce the Green Premiums for all forms of transportation a combination of government policies, green electricity, possible nuclear powered ships, and advanced biofuels and electrofuels will be needed.

Gates next discusses heating and cooling. He proposes that simply purchasing greener appliances can make an impact. One of the reasons people do not already do this, he claims, is that the information on energy efficiency is not readily available enough for consumers. Furnaces and water heaters are generally run on fossil fuels rather than on electricity. For this reason, greening the electricity will not provide any improvement. In regards to heating and cooling, Gates recommends electrifying anything that can be and creating better fuels for anything that cannot. One way he proposes to do this is with heat pumps.

In regards to all of the categories he previously discussed, Gates boils it down to three main points. The first is that the situation is complex as we use greenhouse producing products in almost every aspect of life. The second is that we already have some of what we need to make the situation better. The third point is that we do not yet have everything we need, and in particular, we need to reduce Green Premiums.

Gates then explores adaptations people make and can make in order to adapt to a warmer world. He notes that the people who will be most affected by climate change are the poorest people in the poorest parts of the world. He says that adaptation occurs in three stages:

Reducing risks posed by climate change

“Preparing for and responding to emergencies”

Helping in the recovery period after a disaster.

Gates believes humanity should be preparing for the worst case scenario. Part of this involves studying and debating geoengineering. These are processes of last hope as they raise numerous issues. These approaches could involve shooting particles into the atmosphere which would scatter sunlight or brightening clouds which could scatter sunlight.

Gates emphasizes the need for policy in making some of these changes possible. Part of this involves governments investing in innovation. Another is by raising the prices of fossil fuels so that they truly reflect their overall cost; this would help lower Green Premiums. Gates provides numerous other ways policy can help including by mitigating the cost that some will occur as society

moves away from fossil fuels and making codes up to date so new technologies can be used.

When evaluating how close a country is getting to net-zero emissions, Gates encourages the reader to not just look at the current level but at what the country is doing to make it to zero by 2050 as sometimes some effective long-term policies take some time to make a difference. Using the idea of supply and demand, Gates says an increase in the supply of innovations is necessary alongside an increase in demand. He claims that governments need to expand investment in research and development, take bigger risks on R&D projects, match research with our greatest needs, and work with industry. He insists that all levels of government must be involved because they all have power over making different types of decisions. Gates ends his discussion with an analysis of what individual people can do to make a difference. This involves using their political voice, reducing home CO2 emissions, and using electric vehicles among other changes.

Bill Gates, in his book, does not oversimplify the problem of increased carbon emissions and the problems they can cause to our planet and the people who reside on it. He is insistent, throughout, that the poorest in our world need to be protected. After all, they are the ones releasing the least amount of carbon while being most greatly affected by it. Gates examines multiple different options to get to net-zero emissions by the year 2050. While he acknowledges that humanity does not currently have all of the technology necessary today, he remains optimistic that pursuing multiple avenues and greening different facets of society in ways most effective to that society, that we can, indeed, get to net-zero emissions by the year 2050.

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Peers Inc

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Peers Inc

How People and Platforms Are Inventing the Collaborative Economy *and* Reinventing Capitalism

THE SUMMARY IN BRIEF

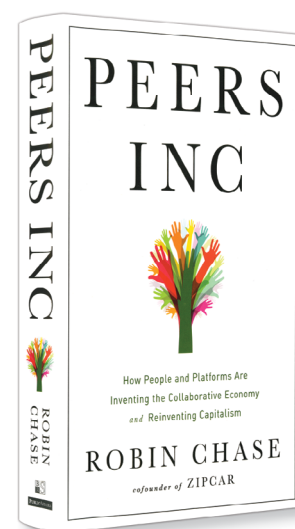
When Robin Chase cofounded Zipcar, she not only started a business but established the foundation for one of the most important economic and social ideas of our time: the collaborative economy. With this important book, she broadens our thinking about the ways in which the economy is being transformed and shows how the Peers Inc model is changing the very nature of capitalism.

When the best of people power is combined with the best of corporate power to form “Peers Inc” organizations, a potent creative force is released. The “Inc” in these collaborations delivers the industrial strengths of significant scale and resources, and the “Peers” bring together the individual strengths of localization, specialization and customization, unlocking the power of the collaborative economy. When excess capacity is harnessed by the platform and diverse peers participate, a completely new dynamic is unleashed.

In *Peers Inc*, Robin Chase brings her provocative insights to show how focusing on excess capacity transforms the economics of what’s possible and delivers abundance to all; how the new collaboration between the Inc and the Peers enables companies to grow more quickly, learn faster and deliver smarter products and services; how the Peers Inc model can help legacy companies overcome their shortening life cycle by inviting innovation and evolution; and more.

IN THIS SUMMARY, YOU WILL LEARN:

- The potential of “the three miracles”: excess capacity, platforms and peers.
- The process of building a Peers Inc organization.
- How legacy organizations can respond to the new Peers Inc economy.
- Potential roles of government and financing in the Peers Inc model.



by Robin Chase

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THE COMPLETE SUMMARY: PEERS INC

by Robin Chase

The author: Robin Chase is co-founder of Zipcar, Veniam and founder of Buzzcar and GoLoco, all businesses that have disrupted and innovated the transportation sector. She was named one of *Time's* 100 Most Influential People in the World and has been featured in the *New York Times*, NPR, *Wired*, *Newsweek* and *BusinessWeek*.

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PART I: THE BUILDING BLOCKS

“Hello, Zipcar. This Is Robin.”

My self-reliant, resourceful, adventurous and impatient attitude came into play in the early months of building Zipcar. Much later — post-Zipcar — I learned in conversation with a friend, Karim Lakhani, whose meticulously researched Ph.D. thesis was on innovation platforms, that the best solutions and the most creative practices usually come from people as far removed as possible from those who are “experts” in a field. I would be such a person.

By contrast, the people with the money, prospective angel investors and venture capitalists that Zipcar needed to make the company work, were car owners and daily drivers. Our idea of sharing cars, rentable by the hour and by the day, went against what they knew about people, status, lifestyle, technology, operational difficulty, financing and women as founders of car companies.

My three most fundamental beliefs, which gave me faith Zipcar would work, gave most investors and business reporters pause.

Robin's Thesis #1: People are willing to “share” cars instead of owning them because the economics make sense.

Robin's Thesis #2: A technology platform leveraging the Internet and wireless technology makes sharing effortless.

Robin's Thesis #3: The company can trust people to pick up and drop off the cars without supervision, fill them up with gas using the company credit card and take their trash when they go.

Peers Inc

Sharing is actually figuring out how to tap into existing excess capacity. Zipcar thrived by leveraging the opening provided by the wasteful economics of current car consumption models — the fact that personally owned cars sit idle 95 percent of the time.

Unpacking the Zipcar experience, seeing the commonalities with other emerging companies, and appreciating the scale of the firestorm that Zipcar helped catalyze took many years. By 2014, investment into companies whose core assumptions mirrored the ones Zipcar pioneered in 2000 had exploded. Airbnb, BlaBlaCar, Uber, Lyft — in total, companies building platforms to tap into excess capacity raised more than \$5.5 billion in 2014, which was close to four times what had been raised by similar companies in 2013, which was again more than double what had been raised in 2012.

Today, we see that the smartest companies and governments are using the Internet's ability to facilitate collaboration by leveraging expertise, assets and resources outside their sphere of control. The result is a very efficient, and often more humane, way of doing things.

On one side of the collaboration, we have *industrial strengths*: companies, governments and institutions (the “Inc”) that apply significant resources, talent and money to simplify the complex, apply standards and consistency, deliver economies of scale and create global brands. On the other side we have *individual strengths*: individuals and small companies (the “peers”) that engage in local, small-scale, customized and specialized efforts to create just-right unique goods and services, often tapping into their own social networks. Significant sectors of the economy are transitioning to this new approach — building



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platforms to unlock excess capacity and welcoming outside collaboration.

The three Zipcar theses are the kernels of the Peers Inc building blocks. The first is that excess capacity (sharing an asset) makes economic sense, the second is that platforms for participation make sharing simple and the third is that peers are powerful collaborators.

Enabled by new technology, a revolution is taking place inside capitalism as we reimagine the role of consumers, producers and even ownership. This new paradigm is called Peers Inc: a transformation of the relationship between companies and people.

Peers Inc finds abundance where there once was scarcity. It leverages the ability of individuals and small actors to experiment, adapt, iterate and evolve. When done well, Peers Inc can create change at a pace, scale and quality we previously thought impossible. Peers Inc is leading the transition from industrial capitalism to the collaborative economy. ●

Excess Capacity

Abundance in a World of Scarcity

Leveraging excess proved to be an important component of Zipcar. Before Zipcar, people in Boston who needed a car had just two options. They could rent in 24-hour bundles, or they could own their own car, paying an average of \$8,000 a year in depreciation and costs for insuring, parking, maintaining and fueling it. Zipcar allowed people to pay only for the amount of car they actually used.

In itself, excess capacity is just latent value. Actual value comes from making use of it.

Making use of excess capacity in small local ways is fulfilling and useful, but the interest here is in scaling this idea by making more efficient use of what we have around us and by uncovering totally new value there as well. Therein lies the path to abundance.

Etsy, an online marketplace for makers, is not like a really big craft fair. eBay is different from both classifieds and yard sales. Airbnb is much more than a listing of 1 million bed-and-breakfasts. What distinguishes and transforms these activities is that platforms connect, organize, aggregate and empower the participating peers. Without the platform — the peer co-creators would not engage, the leveraged excess capacity would be limited and the consumers of these products and services would not return again and again.

Excess capacity turns out to be a key input into a Peers Inc product or service. The cost of experimentation is lowered as new value is extracted out of something that already exists and is already substantially (or entirely) paid for. In all cases, leveraging excess capacity comes at a far lower cost than buying raw material. And execution can happen in a fraction of the time, since we don't have to find, source, build or finance inputs. ●

Platforms for Participation

Simplify, Organize, Empower

Excess capacity is the low-cost fuel that makes the effort of platform building worthwhile. Platforms organize, standardize and simplify participation. A company with a platform, like Zipcar, makes it easy and safe for friends (and even strangers) to use someone else's cars. It establishes and enforces standards and contracts. It routinizes procedures for picking up cars, refueling them and dropping them off. And it sets penalties for bad behavior and the means for recourse. These platforms took an idle asset — the privately owned urban car — and made it simple to share.

Peers choose to participate on a platform because a bigger entity (the Inc) has spent lots of time and money turning something complex and expensive into something simple and inexpensive. It is the Inc that has the ability to make long-term and large investments, marshal teams with many kinds of expertise, extract economies of scale and apply standard forms of interaction and quality. The unique role of the Inc is to do what peers can't — to create platforms for participation and put the assets of the large company, institution or government (such as billing or satellite maps) into the hands of the smaller, autonomous peers who participate.

The Ways Platforms Use Excess Capacity

There are three ways that platforms make excess capacity accessible to others. They can slice it or aggregate it, in each case letting co-creators use excess capacity more efficiently. Or they can open it, enabling co-creators to generate entirely new ideas, processes, products and services.

Zipcar slices. It takes big, lumpy options (owning a car or renting one in 24-hour increments) and slices them into half-hour increments so that people can consume just the amount of driving time they want and can pay only for what they actually use.

SUMMARY: PEERS INC

Other platforms aggregate the excess capacity of assets that were individually too small to bother with and make them into something reliable and consistent, thus creating enough value to make tapping into those resources worthwhile. Airbnb, which allows people to rent out all or a portion of their own homes, is definitely the company of reference here.

Now let's turn to the most amazing kind of platform, one that opens up excess capacity, the way Google Maps did. Not only does it deliver the efficiency of access platforms, but an open platform enables the creation of new value, and lots of it.

Once you've got the elements of the platform exactly right and people are interested in the excess capacity you are offering up, it will grow very quickly.

With growth come all the benefits of economies of scale. Platforms can be expensive to build, but the standardization of service provided, inherent in the platform model, means that each additional peer costs very little to add. At a certain point, the benefits are almost all to the upside. With a good idea, a great user experience and a large market, platforms offer the biggest possible punch per investment dollar.

Making use of excess capacity is fundamentally a collaborative act. It is sharing. The platform is half the handshake. Now we move on to the other half, the peers. ●

Peer Power

Localize, Customize, Specialize

We are all different. We live in different places and have different habits, interests, talents, life experiences, social networks, politics, communities, commutes ... the list goes on. Platforms take the individuality of peers and, through organizing and resourcing, ultimately turn it into society's greatest asset. With platforms, diversity rocks.

The Benefits to the Peers

Who are peers? It depends on the platform and the relative size of the Inc that developed it. Sites such as YouTube, Facebook, Twitter, eBay and Airbnb could not exist without co-creators, people who reach out to friends, strangers and colleagues across the Internet. These platforms need peers. And the advantages of engaging as a peer in this new organizational paradigm are plentiful.

The underlying gift of economic agency is the primary advantage of being a peer. You are in charge of when, where and how much you will earn. You don't have to sit passively waiting for an employer to choose you. You

now have multiple ways of making a living. Individuals are given the powers of the corporation, and in many cases they are valued for their unique contribution. With industrialization, we have been taught to value a steady job and benefits and to ignore boredom, underemployment and a tenuous reliance on a single source of income. The collaborative paradigm values economic agency, resilience, passion, learning, autonomy and unique contributions.

The Benefits to Institutions

There are always more smart people outside your organization than inside. And this is precisely why Peers Inc is the structure of choice if we want to speed the pace of innovation. Diversity allows Peers Inc companies to engage in customization, localization and specialization at a much lower cost than would be possible for a company trying to do it without the peers. The skills, knowledge and precise expertise found among peers give big companies immediate access to local partners, because the peers are the already established partners in these collaborations.

The Benefits to Consumers

Peer diversity and localization offer another win: a truly flexible offering. Every person can choose for him- or herself what matters most, because there is such a diversity of offerings. The world no longer needs to choose between the two stereotypes of commoditized industrial efforts (consistent, low-cost, yet faceless) and the unique vitality of local small-scale production (highly variable and unreliable). ●

Bringing It Together

The Three Miracles

People pondering the big picture on planet Earth right now are often worried; some slip into despondency. But transformation at the scale required to meet our growth challenges is ongoing. We can do this, together, and Peers Inc gives us an organizational framework that can help us meet many of our environmental goals profitably and with a higher quality of life than before.

The three miracles potentially provide us a way forward through climate change, resource scarcity and explosive population growth. They also produce some rewarding business opportunities along the way.

Miracle #1: Excess Capacity Lets Us Defy the Laws of Physics. Because platforms allow a multitude of peers to quickly transform existing untapped resources into compelling accessible products and services, the Peers

From Scratch

Learning, Power Sharing and Building a Peers Inc Organization

Grabbing an emerging opportunity and growing a market requires the right people with the right strategy at the right moment — and what's right changes over time — because they all must come together to create a resilient and inviting infrastructure for peers.

Special attention needs to be paid to the ebb and flow of power between the platform creators and the peers. Getting the balance of power right in the earliest stages will determine whether a platform takes off. Getting it right in the later stages will define the ultimate longevity of the company. Getting it right across the sum of Peers Inc organizations constructing the new collaborative economy as a whole will portend our ability to transition to an economy that provides people with more agency, more satisfaction, and more equality and that is ultimately more sustainable.

There are four phases that many (though not all) successful Peers Inc efforts travel through.

Controlled Kernel (Phase 1). During the controlled kernel phase, when the founders are first piecing together the platform, they necessarily exert maximum control, both forcing the participation to go where they want (or hope) it will go and watching closely to understand how actual participation is unfolding. If you allow a large and still dispassionate group of people to weigh in on too many decisions, you will never get the effort off the ground. If you can get the kernel — the balance of structure with freedom — correct, you'll be ready for the next, thrilling stage.

Everybody Welcome (Phase 2). By the end of the controlled kernel phase, founders will have used their vision and power to shape the platform into something that feels like half a handshake: The hand is extended outward, and everyone who sees it knows exactly how to react. The platform is robust and attractive. The rules and culture are relatively stable. The platform is flexible, fair, and ready for expansion. Phase two is the giddy everybody-welcome phase, where the power and force of the incentivized peers come into play. This is when we start up the steep-growth part of the curve. The everybody-welcome phase doesn't end — you are always hoping to keep expanding the number of collaborators. In retrospect, this phase feels like the naive heyday where everyone is really excited to

Inc model can spark exponential growth. It does not have to physically build many assets to grow — it leverages what is at hand, repatterning existing assets into vast new utility and value. This is the gift of a peer partnership. Airbnb and BlaBlaCar could not have done this on their own. The peers have been integral in building and financing these infrastructures.

Miracle #2: Small Platforms Produce Exponential Learning. By the end of its third year (2014), Duolingo had 50 million active users improving their language skills in one of fifteen languages for free! How can Duolingo possibly afford to do this? By multipurposing the efforts of those learning, using them to translate some of the Web for a fee. Duolingo's algorithms turn the real-time efforts of thousands of students into translations as accurate as those of skilled professionals in a matter of hours.

But the real beauty of Duolingo is the spectacular iterative learning. Founder Luis von Ahn has so many learners that he can conduct a hundred experiments simultaneously, each one tried by 150,000 people, and in 48 hours he can know categorically which is the best way to teach a language. Within just 20 months of launch, Duolingo had reduced the time it takes to learn a semester's worth (130 hours) of language to an average of 34 hours. This pace of learning is possible because of the collaboration between peers and platform. It requires knowledge inputs from both parties.

This sort of rapid prototyping and innovating is exponential learning. On attentive platforms, the pace of learning for the Inc accelerates with the number of participants on the platform.

Miracle #3: Diverse Networked Peers Means Instant Access to the Right Mind. Networked peers let us quickly find help or advice in unique situations when we need a different perspective. We need to hear from somebody whose experience closely matches our problem and who can guide us one step at a time. It's about the *right* person being there for us at exactly the *right* time (common examples would be Yelp, or Waze).

The miracle of instant access to the right mind has two very important implications as we move into the future. First, it means that each one of us has access to the collective mind of the world. Second, given the size, scope and location of problems in the world, it means that each person will, at different times, be the right person — if we've connected that person to others.

The much-needed response platforms that will allow us to share our excess capacity in order to help each other in a crisis, learning and becoming wise from our collective experiences, are coming. ●

SUMMARY: PEERS INC

be part of this new platform. But it soon gets replaced by other, more pressing concerns.

Power Imbalance (Phase 3). Phase three is about navigating power imbalance. The rules of engagement between the Inc and the Peers have been established long enough, and the benefits are clear enough that we see the rise of power players who've figured out how to succeed at the game — sometimes making it difficult for newcomers and potentially threatening the smaller and much more numerous peers. Other times, the Inc-owned platform has become so successful that it forgets the fact that this is a collaboration, and many of the benefits driven by peers (resilience, innovation) are lost. This is when we must remember the delicate and complex ballet of collaboration is what makes the whole thrive. The value sharing between the Inc and the Peers is the most vulnerable link.

Power Parity (Phase 4). The solution to building a long-term sustainable organization is to seek power equilibrium, the last stage and an ever-shifting almost-steady state. As the platform gets stronger, it must make overt and significant efforts to continually invest and share power with peer creators. Remember, we are looking for power parity, a dynamic yet stable end state. The platform doesn't need to give away too much power or do it too quickly. The goal is to keep all the parties in balance, continually making adjustments so as to maintain a kind of power stalemate.

To conceive of a long-lived Peers Inc organizational structure, power parity must necessarily be the end state.

Community Building for Power Sharing

Once a platform — a kind of standard — becomes widely adopted, business associations often form around these standards to protect the common interests of the businesses using that standard. Just like business associations, a peer community provides a whole host of benefits to both Inc and peer: meeting others in the network, sharing of best practices, exploring new ideas and problem solving in an informal, low-pressure setting. Ultimately, a long-term sustainable and thriving Peers Inc community will be the one that lets the Peers weigh in on the rules pertaining to their engagement. ●

For the People

Engaging Government

One of the best examples of a government unlocking excess capacity is when the United States opened up the space-based Global Positioning System, which was

originally built to aid in deterrence of nuclear attack during the Cold War. It was in response to the tragedy of a Korean Airlines passenger plane shot down by the USSR in 1983 after the plane strayed into prohibited Soviet airspace, and 269 people were killed. These tragic deaths could have been avoided if the pilot had had access to GPS. So President Ronald Reagan issued a directive making GPS freely available for civilian use, once it was sufficiently developed, as a common good.

Our lives have indeed been transformed by GPS, smartphones and real-time map applications. This significant improvement in our quality of life was only possible because of the size and scale of government-financed and led GPS research and development. But it is just as true that government alone could not have produced the economic engine, innovation and value creation found in the GPS ecosystem. It required the Peers Inc paradigm — leveraging of excess capacity (the R&D and the satellites), the platform for participation (the Standard Positioning Service) and the innovating peers to produce practical results on this scale, with this speed and with this immeasurably large economic impact.

Government as a Protector, Champion and Regulator for the People

The rise of the micro-entrepreneur requires reworking and rethinking laws that protect them and their rights to earn a living wage and to work in a safe and healthy environment. Platforms facilitate globalization, leveling wages around the world. The engineers, graphic designers, editors and architects in Delhi will be competing with those in Detroit, Dubai and Durban.

So what's a government to do when faced with the explosion of Peers Inc efforts? First, do no harm. Permit the small-scale experiments to happen. We need trials. New platforms that succeed and become big enough should be examined more closely, remembering that the tools needed to oversee and protect the public good are radically different from what they were in the 19th century. If regulation is necessary, the first instinct should be to put pressure on the platforms, preserving the fluidity of the peer economy.

Second, governments should make tax and regulatory compliance easy and workable for both parties. Third, labor standards, worker's compensation insurance, health benefits, sick leave, vacation time, parental leave, pensions, disability and child-care rights need to be granted to every citizen as a right, as is the case today in many European countries. We need to make sure that these benefits

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are available to everyone, regardless of their full-time employment status.

Lastly, government needs to protect these collaborating peers with a platform-independent contractor's bill of rights. Successful platforms have effectively become common-pool resources: the platform is producing a stream of benefits to the peers who are reliant upon it. At a minimum, peers collaborating on these platforms should be able to own, control and remove their own data. Rules for engagement with the platform should be spelled out in understandable ways (not buried in terms-of-service agreements), equitably applied and changeable only with adequate notice.

If platforms don't want to abide by a government-enforced contractor's bill of rights, they can self-regulate by giving power back to the peers. The ultimate in power sharing is to give peers the power to establish their own rules. Platforms that do right by their peers will naturally institute these rules, since they know that peer participation is voluntary and they need to treat them well. ●

Embracing the Change

Evolving Legacy Institutions

Company longevity is likely to increase as platforms get ever larger and more powerful. These institutions, these Inc's, will be faster, smarter and stronger than traditionally organized companies.

The capacity of the Peers Inc model for generating jaw-dropping value is evident to most executives. When they see a company going from zero to a multibillion-dollar valuation, they can't help but think how it might work for their business. But they face a conundrum. Peers Inc requires the opening up of long-guarded assets (data, patents, know-how, expensive assets) and entrusting these to outsiders with no guarantee of return. And to top it off, Peers Inc's most valuable assets — the peers' talent, creativity and drive — are the very things that are the least manageable and least predictable. So how do you spark the necessary change when your institution is deeply conventional and has been for decades? Dan Doney (head of innovation at the U.S. Defense Intelligence Agency) explains that “virtually everything in a bureaucracy resists change. It is always ‘We need to stick to the plan.’ But innovation requires creative destruction — that is, the free flow of resources from ideas that are falling behind to new and better ideas. To embrace this principle, an organization must decentralize decision-making, delegating to the edge as much as possible. Our mantra: Start small. Scale fast. Fail

cheap.” Regardless of whether you are big business or big government, this is sound advice.

Create Pilots Out of Edge Cases; Expand with Success. GlaxoSmithKline offers up an example of leading with a small “edge case” that doesn't threaten the whole organization. The goal: “To encourage innovation targeting diseases of the developing world — where there is not the same potential commercial return as in developed countries — we have changed the way we think about intellectual property and the way we work with others.” Taking aim at neglected tropical diseases such as dengue, rabies and Chagas disease, as well as malaria and tuberculosis, GSK has opened up some of its own data, patents and expertise in labs that it is financing collaboratively with other research institutions. The hope is that by working together, “a critical mass of knowledge around neglected diseases” will result in long-overdue progress. GSK takes a page from the Free and Open Source Software copyright approach: “A prerequisite for granting access to the data is that the researchers agree to put their findings into the public domain, thus encouraging further collaborative research by the scientific community on this challenging disease [malaria].”

Embrace the Change Rather than Fight It. In the late 1990s, Lego's market share had begun to decline as a new generation of children was attracted to electronic and video games. After unsuccessfully trying to launch some new products, the company turned to another source of creative talent — the passionate users of Lego products. In 1999, it launched Mindstorms, a robotics kit, and soon noticed that a number of users had hacked into the software for the kit. While these hacks were technically a violation of Lego's copyright, the company realized that many of the hacks significantly improved on the performance and features of the software. Lego decided to join forces with these hackers and provide them with tools and advice to help them pursue their hacking initiatives. As a result, Mindstorms became one of Lego's most successful products. ●

PART III: TRANSFORMING OUR FUTURE

Who Has the Gold?

Democratizing Power and Wealth

Let's look at Peers Inc financing options, with a deeper look at those that bypass both government and venture capital, leaving power and value distribution in the hands

SUMMARY: PEERS INC

of the peers. Capital will always be important. Most platforms fail. In order to accept this risk, investors — who pay for something before the product or service is realized — demand their hefty fraction of ownership. No investment is risk-free.

Broadly speaking, there are three options for financing the building of platforms: public financing, private investment financing and crowdfunding. Each choice has different implications for how power and value will be shared with the participating peers over the long term.

The public sector can finance it. The most basic and foundational platforms (public goods) have been and should continue to be financed by government with our tax dollars and made freely available to everyone. All of our basic utilities — roads, water, electricity — are effectively platforms for participation. The government provides the platform, and we (entrepreneurs and consumers alike) bring our cars, sinks and the cornucopia of devices that plug into outlets. It is easy to see how the Internet, the World Wide Web, GPS, data.gov and the Wi-Fi radio spectrum are all public goods that are platforms.

The private sector can finance it. Advocates for pure unregulated capitalism, where the only thing that matters is money, will build platforms that maximize shareholder value. If platforms are funded and run to please traditional private-sector investors, particularly those looking for short-term gains, things that have no financial value (known as externalities), such as social benefits and environmental damages, won't enter into the calculation. The power and income inequality that exists today will likely continue, and the innovation potential of Peers Inc will fall short. These platforms will lead short (if profitable) lives.

People can crowdfund Peers Inc platforms. Since 2009 Kickstarter has funneled nearly \$1.4 billion to more than 70,000 projects, which are usually small, one-of-a-kind efforts. It's great for pilots or small projects, but not enough to get a platform through the controlled kernel phase. Other crowdfunding alternatives — Angel List, Startup Crowdfunding and MicroVentures — offer equity stakes and therefore raise more capital and provide a longer runway for entrepreneurs. Since each individual investor is small and there are many of them, this kind of financing likely reduces the amount of control the investors can exert.

The most exciting possibility for crowdfunding platforms is what is happening in the Free and Open-Source Software (FOSS) movement. With FOSS, gains are socialized (the entire community benefits from improvements to the code), and losses have been privatized (individual

companies succeed or fail based on how they apply the code). Instead of using money from individuals to build a platform, the FOSS movement is built on in-kind free labor and then later supported in part by the private sector. Once a FOSS “code base” has become successful and widely adopted, the private sector's reliance on it means that these leading companies will contribute resources — money and engineers — to improve the code for their own self-interest.

The blockchain, the software underlying Bitcoin, might also prove to be a low-cost way of platform building. Like FOSS, building with the blockchain will result in platforms that are distributed and autonomous. ●

What Happens Next?

While industrial capitalism evolved to put the corporation's survival at the center, the collaborative economy thrives by putting people at the center — both customers and suppliers. Even mainstream economists are recognizing that measuring success and value creation through monetary growth alone is insufficient. The Peers Inc paradigm, with its different structure and means of value creation, will play an important role in transitioning world economies to a new value system and a new way of measuring prosperity.

The Principles of the Collaborative Economy

1. Open accessible assets > closed assets

Open assets deliver more value than closed assets because they are more efficiently used and let us continually uncover new valuable uses.

2. More networked minds > fewer walled-in minds

More people are smarter than fewer people, but only when they are networked together.

3. Benefits of openness > problems of openness

Collectively, the upside opportunities of innovation and shared learning are much larger than the downside problems, such as bad behavior, which we can identify and address with ratings, comments, and trust networks.

4. I get > I give

As individuals, each person who contributes assets to a platform necessarily gets more than she gives. This is how Wikipedia, potluck dinners, and taxes that pay for public libraries and national defense work.

Take everything you've learned and layer on a new meaning to Peers Inc. It is also People Incorporated: people incorporated into the dialogue, people incorporated into the value creating, people incorporated into the economy, people creating new organizations and entities among themselves and as unique individuals. ●

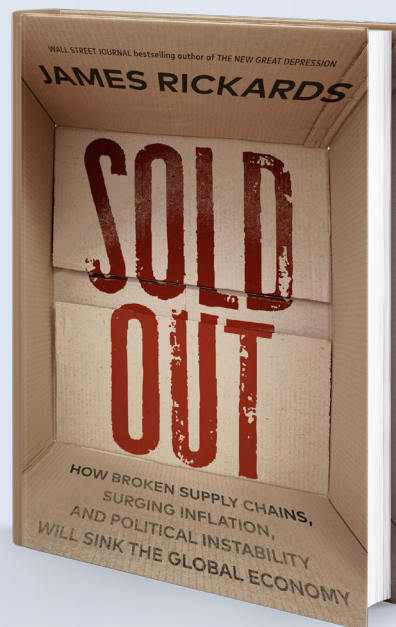
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Sold Out

James Rickards

BOOK SNAPS™

Zooming In On Your Next Read



Sold Out

How Broken Supply Chains, Surging Inflation, and Political Instability Will Sink the Global Economy

By James Rickards

James Rickards is the Editor of Strategic Intelligence, a financial newsletter, and the bestselling author of *The New Great Depression*, *Aftermath*, *The Road to Ruin*, and many more. He is an investment advisor, lawyer, inventor, and economist, and has held senior positions at Citibank, Long-Term Capital Management, and Caxton Associates.

Contemplating the Supply Chain Crisis

James Rickards, in his book, *Sold Out: How Broken Supply Chains, Surging Inflation, and Political Instability Will Sink the Global Economy*, tells his reader that supply chains are nothing new. He discusses a sunken ship that is dated back to 1300 B.C. The ship contained much cargo including food, tin, art, lavender, and weapons, among other objects. This ship followed a well known trade route of the time and the items originated from and were destined for numerous different locations including Egypt, Syria, and Greece. Of this trade, Rickards says that it may not be as efficient or quick as the Amazon Prime many rely on today, but its purpose was the same, to match supply and demand.

In the years since 1300 B.C. supply chains and trade routes have changed and been altered due to sociopolitical circumstances and technological advances around the world. Supply chains are tied to military successes and failures to the point that Chinese military threats are currently “tempered by the reality that China has no oil or natural gas, and their maritime supply lines can easily be shut down.” Covid 19, according to Rickards, has proven to be a major challenge to supply chains around the world. He goes on, however, to say that supply chain breakdowns today are greater than those experienced at the beginning of the pandemic.

Rickards poses and attempts to answer the question, “If there’s nothing new about global supply chains, why the frantic headlines?” While supply chains have been around for centuries, modern supply chain management and the capability to closely track and manage supply chains is relatively new. The study of supply chains has led to innovations such as “just-in-time inventory, intermodal transportation, overnight delivery, cross-docking, radio frequency identification, GPS tracking, and more” according to Rickards.

Supply chains have become much more efficient as the result of all of these advancements, but this efficiency comes at the price of increased risk. For example, when just-in-time delivery is utilized, entire plants can shut down when needed materials do not arrive on time. For Rickards, redundancy provides security, and a lack thereof takes away security. Failures can and have cascaded and have put the world in the position it is in today where shelves are empty and inflation is high. As Rickards says,

“Any system that scales too far will collapse of its own weight.” He sees the world at being at a state where Supply Chain 1.0 is over, but Supply Chain 2.0 has not yet been developed.

The Global Supply Chain

The first topic Rickards addresses in detail is the global supply chain. Rickards says that the supply chain “is just a name we give to a nexus of logistics, inputs, processes, transportation, packaging, distribution, marketing, customer relations, vendor relations, and human capital that in the aggregate supports the supply and demand for every physical, digital, intellectual, or artistic artifact on the planet and in space. The supply chain is everywhere.” Consumers have become accustomed to the supply chain working quickly, cheaply, and efficiently, and as such, consumers have the luxury of the items they want being where they need them when they expect them. Consumers, however, are able to observe some of the breakdown in the system as expected items are not always on the shelves or in people’s mailboxes when they expect them.

Rickards explains that there is an entire endless process that must go according to plan if consumers are to avoid empty shelves in the stores. Most of this is unseen by the consumer because there are backups for when one chain breaks down. These supply chains contain not only truck drivers and warehouse workers, but also farmers, seed providers, raw material providers, and countless other links often from around the world. To illustrate just how endless supply chains are, one could think of bread on the shelves. Not only is the wheat grower and baker part of that supply chain, but so are the people who fix the ovens and those who mine and develop the tools and parts necessary to fix the ovens when they break down. In addition, energy must be sourced to the baker and the shop that is selling the bake. The extended supply chain is endless according to Rickards.

Rickards explains that not all supply chains are “spread among numerous suppliers and logistics providers. In fact, one of the most extensive supply chains in history was confined to a single firm - the Ford Motor Company between 1927 and 1940.” At that time, Ford attempted to confine everything it needed to its own company, eliminating the need to rely on outside companies. This is not, however, how most supply chain managers run business today. In fact, it is looked down on.

Customer satisfaction and low cost are seen as the primary goal of supply chain management, and those goals can be best achieved by using as many suppliers as necessary, aided by supply chain technology to manage it all. This leads to optimal efficiency. Unfortunately efficiency requires accurate assessment of supply and demand, and this is simply not always possible. Rickards then goes on to explain numerous companies currently experiencing difficulties with their supply chain. According to Rickards, this is an international problem.

Rickards discusses some effects of these supply chain problems apart from empty shelves. One of these is inflation which he discusses in detail in the second half of his book. Another is

skimpification. Here companies offer fewer services for the same price. He considers this to be inflation by another name because the consumer gets less product or service for the same price.

Rickards does believe that supply chains can be mended, but this cannot be done through merely remediating the problem. Instead, the supply chain needs to be “rebuilt along new lines.” He believes this new supply chain, which he calls Supply Chain 2.0, will require at least five years and it will not look much like Supply Chain 1.0. He then goes into detail discussing the many causes of the breakdown that led to a backup of cargo outside of the Port of Los Angeles, showing just how many factors were at play in the breakdown. Among many other factors that led to the breakdown are loading and unloading capacity, political moves, and trucking shortages which were exacerbated by both the pandemic and a shortage of young drivers hesitant to enter the field due to the emergence of self-driving trucks.

To describe how the supply chain broke, Rickards says, it was “gradually at first, climaxed by a sudden catastrophic collapse.” He dates the beginning of the breakdown to January 23, 2017 when then President Trump officially withdrew the country from the Trans-Pacific Partnership. This began trade wars, and Trump imposed large tariffs just about a year later primarily aimed at China. Eventually tariffs were implemented by China, the EU, and Canada against the United States. Many of the tariffs did not go into effect immediately, and this caused importers to try to get as many supplies in before the tariffs went into effect, and this began the process that eventually led to where the country was in 2021 with empty shelves.

The trade wars were not the only factor, however. Rickards also blames the constant search for efficiency which ultimately leads to bottlenecks when problems emerge. Trump’s decisions were not the only ones that led to the crisis according to Rickards. He points to numerous choices by the Biden administration, especially vaccine requirements, as contributing to the problem.

Energy was another cause in the supply chain breakdown. As operations scale up, the need for energy scales up “by a factor of five.” Increased energy needs cause problems when shortages occur. They also arise because the increased energy increases either the cost to consumers or the profit margins for producers. In short, Rickards says, “the hidden cost of efficiency is vulnerability.” He believes that the redundancy which efficiency eschews actually serves as insurance and can save businesses from ruin. The current system is complex, and it will collapse in his estimation. Rickards provides an entire chapter on the reasons why the supply chain problems will persist. Some of these reasons are the handling of the pandemic, new green policies, and geo-economics, especially as it pertains to Russia and China.

The Role of Money

The next topic Rickards broaches is that of money and inflation, and he starts out this section with the startling statistic that the US Labor Department in July of 2022 said that the consumer price index rose by 9.1 percent, the highest it had been since November of 1981. Year over year between 2020 and 2021, “gas-



... proper investment will cause increased productivity, which will subdue inflation.”

line prices rose 49.6 percent, natural gas prices rose 24.1 percent, energy prices rose 29.3 percent.” The prices on food and vehicles rose greatly as well. Prices rose not only in the United States but around the world. While inflation was quite high compared to the rest of the 21st century, the rates are not as high as they were for significant portions of the 1970s and 1980s.

The question that Rickards believes people need to consider is if the current inflation is transitory or if it is the beginning of another long inflationary stretch like that that occurred in the 70s and 80s. He lists five causes for the inflation of that time period: Vietnam War and Great Society spending, the Baby Boomers coming of age, the end of the gold standard, the resignation of President Nixon, and the Arab oil embargo. In regards to the response to all of this by Federal Reserve Chairman, Paul Volcker, Rickards says that his policies helped bring inflation down, but it put the economy into a recession.

Rickards discusses velocity as “the first and most important system element.” Velocity refers to the turnover of money. In other words, it measures how quickly people spend their money. Velocity has been collapsing since 2008 because as incomes fall, savings rise and less money is “available for consumption.” He then discusses base effects. Inflation is examined by looking at one month compared to that month in the year prior. An increase in inflation after a year of quite low inflation is called base effect.

Rickards then goes on to list “five factors that may cause higher inflation: deficits, demographics, monetary policy, politics, and supply shocks.” In terms of deficits, Rickards is concerned with the debt to GDP ratio as sometimes countries with a high debt to GDP ratio can quickly move from disinflation to hyperinflation. With regards to demographics, Rickards points to how many countries people are no longer reproducing at a rate to replace those currently alive. This will lead to an aging population that needs to be taken care of. Some say this decrease in population could result in deflations and others say it could result in inflation. Rickards believes it is likely to lead to slow inflation. The third factor that Rickards discusses is monetary policy. While many believe that monetary policy will likely cause short-term inflation, Rickards believes that it could either have no inflationary impact or it could actually lead to disinflation. He believes that the fourth factor, politics, has had an inflationary impact, but this impact could be short-lived. When discussing politics, he goes into detail on the different stimulus packages provided by the government during the pandemic and the effects these packages had.

The final factor he discusses are supply shocks. He gives the example of the Arab oil embargo of the previous century to explain how supply shocks can be so drastic that consumers may

not be able to get oil at the pump. He believes that the pandemic, trade wars, and supply chain breakdown may be causing a new supply side breakdown.

In his next chapter, Rickards discusses the difference between disinflation and deflation. Disinflation occurs when inflation is still occurring but at a slower rate. Deflation occurs when prices actually go down. He claims that both of these “point toward higher real rates, slower growth, and deferred or diminished consumption.” He believes that proper investment will cause increased productivity which will subdue inflation. If investment is not done wisely, there will be an increase in debt-to-GDP which will also subdue inflation. The first will result in a success for all involved whereas the second will result in weaknesses.

Rickards’ book ends discussing some proposals for improving the state of affairs going forward. One of these solutions is for countries to gather together with allies in a College of Nations that works with each other as trusted allies in the supply chain. This would increase prices likely but these prices could also be mitigated with enhanced technology. Key to improved supply chains is also a need for price stability and policy consistency. He says, “The best case is that inflation fades without a monetary policy blunder on the way. That’s a slim reed to lean on.” He does not trust the Fed to make appropriate decisions.

In his book, Rickards presents what he sees as the causes of the current state of affairs with inflation and with the supply chain. He lays the blame not with one particular party or policy as he relates how decisions made by both the current and the previous administration have led to some of these effects. He is quick to say how he believes the handling of the pandemic played a large role in establishing the situation the world is currently facing. Still, he believes there is hope for the future but that it will not be an easy road to get there as some systems will need to be completely rehauled.

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Summary



Microcredit, Barefoot Banking, and the Business Solution for Ending Poverty

A Billion Bootstraps

THE SUMMARY IN BRIEF

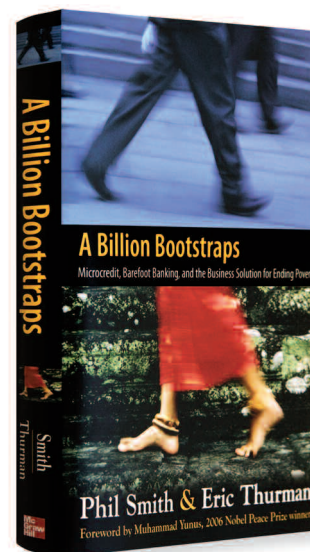
A Billion Bootstraps shows why microcredit is the world's most powerful poverty fighting movement — and an unbeatable investment for your charitable donations. It unearths the roots of the microcredit revolution, revealing how the pioneering work of people such as Dr. Muhammad Yunus — winner of the 2006 Nobel Peace Prize — is giving hope to billions of people. Philanthropist and self-made millionaire Phil Smith and microcredit expert and consultant Eric Thurman provide a riveting narrative that explores how these small loans, arranged by “barefoot bankers,” enable impoverished people to start small businesses, support their families and improve local economies. By paying back their loans instead of simply accepting handouts, men and women around the world are continually giving others the same opportunity to change their futures.

Smith and Thurman also examine why traditional charity programs, while providing short-term relief, often perpetuate the problems they're working to alleviate and how applying investment principles to philanthropy is the key to reversing poverty permanently.

Ordinary people can accelerate the microcredit movement by investing charitable donations in specific programs and then leveraging those contributions so the net cost to lift one person out of poverty is remarkably low. The authors show readers how to get more for their money by donating with a mind-set of an investor and calculating measurable returns — returns that will change lives and societies forever.

IN THIS SUMMARY, YOU WILL LEARN:

- Why many donors are tapping into the power of the microcredit revolution.
- How microloans help poor people around the world expand their businesses, educate their children and improve their communities.
- How to become a better charitable donor and get better results.
- How to identify the best projects to support.
- Why lending programs are an ideal context for delivering social services.



by Phil Smith
and Eric Thurman

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THE COMPLETE SUMMARY: A BILLION BOOTSTRAPS

by Phil Smith and Eric Thurman

The authors: Phil Smith is an active philanthropist who writes and speaks under the banner Practicing Significance. Smith is the former CEO of Prize Energy Corp. and Tide West Oil Co.

Eric Thurman has been a leading expert in international philanthropy for decades. A former CEO of Opportunity International, HOPE International and Geneva Global Inc., he is now CEO of The Protos Fund. He has been profiled in *Forbes*, on CNN and in many other media forums.

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The Power of What Works

After 30 years in the oil and gas industry, Phil Smith earned a fortune when his company was merged out of existence. The owners and managers of his company shared a profit of \$30 million. With the capital earned from that experience and lessons absorbed in how to run a profitable business, Smith went on to be a part of many other successful business ventures.

In 2002, Smith ended his career in the oil and gas industry, leaving as CEO and chairman of the board of a publicly traded company whose investors had received returns of more than three to one in three years. He then chose to begin a new kind of career focused on purposefully living the second half of his life. Wanting to have a direct impact on people's lives, he searched for nonprofit organizations that were financially efficient and where he could make a difference.

In November 2003, while sitting in the Dallas/Fort Worth Airport waiting for his flight to Rome, he read an article in the *Dallas Morning News* titled "What will a \$50 loan buy?" The article explained how Lucy Billingsley, a Dallas real estate developer, organized and motivated several hundred Dallas women to raise money for microloans to poor women in Mexico — and changed their lives. The women in Chiapas were repaying their loans, starting or expanding their businesses and sending their children to school as well.

Billingsley had collected hundreds of thousands of dollars to help the poor using a new idea: *microcredit*. This project was clearly different from a typical charity project dedicated to feeding the hungry, treating the sick and

clothing the naked. This was a project that loaned people the money they needed to help themselves and to create a sustainable future. With capital and sweat equity, poor people can change their lives. Financial "bootstrapping" with small loans is something all of us can benefit from; it has global application.

After Smith returned from his trip, he wanted to find out the nuts and bolts of microcredit and how it works on a practical level. He wanted to know how microcredit works so it could be efficiently applied to new situations, and he wanted to understand why what is working so well in developing countries is not being used to help the poor in developed countries.

Investment Philanthropy

Eric Thurman, a world leader in philanthropy and microcredit, was profiled in an article in *Forbes* called "Contrarian Charity: You want big returns on your investments, so why not on your charitable giving, too?" When Smith found the article during his research, he called Thurman to talk about microcredit and investment philanthropy.

Thurman told Smith that many people share his concerns regarding the fate of the indigent in developed countries, using the rationale that the lives of basket weavers in Uganda are equal in value to those of our next-door neighbors. But, unfortunately, Thurman explained, microcredit, which works so well in developing countries, does not appear to work equally well in developed ones, and he suggested that Smith do the math to enable him to understand why.



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Rebecca S. Clement, Publisher; Sarah T. Dayton, Editor In Chief; Athena Nicolaides, Art and Design; Chris Lauer, Contributing Editor

Summary: A BILLION BOOTSTRAPS

Smith worked through equations honed by microcredit experts and then created his own. They all led to the same conclusion: By focusing their giving dollars on microcredit loans in developing nations instead of on charities in the developed world, givers multiply the impact of their donations by much more than 100 times.

After a dinner with Thurman, Smith applied the same investment principles to philanthropy as in leveraged buyouts, IPOs and hedge funds. He found that the same principles that bring success in the financial world could be applied to helping develop the economies of poor countries anywhere in the world.

Changing the World

Microcredit is well on its way to changing the world. Innovators like Bill and Melinda Gates, and others, including Bill Clinton and Brad Pitt, have discovered that microcredit is a powerful tool that can be used to solve many of humanity's most difficult problems. It is so powerful that the impact of microcredit on poor families and communities around the world already goes far beyond typically held views of what is possible. Microcredit makes common sense, and its impact is measurable both financially and in terms of lives changed.

Learning about microcredit and ways that microcredit organizations can leverage contributions has become Smith's personal passion. He sees how tiny loans can change the destiny of more than a billion of the world's working poor. His mission is to help at least 1 million of them start bootstrapping themselves out of poverty.

With 3 billion people living on less than \$2 per day, Smith knew that he needed to share both the problem and the solution with more people. Dr. Muhammad Yunus and the Grameen Bank won the 2006 Nobel Peace Prize for pioneering work in microcredit. Finally, microcredit is headline news, an idea whose time has come. ●

Beyond the \$900 Billion Black Hole

Eric Thurman's career has included a mix of owning businesses and running enterprises for others, serving as an active donor and managing tens of millions of philanthropic dollars for foundations and individuals. His extensive experience leading philanthropic organizations includes supervising microcredit programs in more than 30 countries and directing grant making for a wide range of programs in 102 nations. He has spent his career at the intersection of business and philanthropy.

This intersection is lightly traveled despite the magnitude of nonprofit activity, which is \$900 billion in capital in motion annually in the United States alone. Charity finances and sound business practices often do not merge naturally. Those signposts that routinely mark the path to success in business are often missing on the charity highway. An example of this contrast between the approaches used in nonprofit versus for-profit business practice is the fact that almost all charitable giving is defined solely by the amount involved; seldom are other factors considered. Any savvy businessperson knows that price alone does not define whether a deal is good. Attention to detail can reveal that a cheap price is not a bargain and, alternatively, that sometimes a higher price can be a better value. Even more significant is that business has reliable ways of determining when a transaction is desirable.

A Better Donor

The discipline of thinking about such details is not nearly as common in the charitable world as in business — and that discipline is badly needed. Following it will make you a better donor and ultimately force charities to achieve better results. The trend of business leaders adopting philanthropy as a top priority has been positive in large part because of the business acumen they bring to their giving. They base their decisions on the results expected and insist on knowing how their donations will be used. Only then do they decide the amount they will give. This is tremendous progress for donors, for charities and for the people they wish to help.

The United States alone has nearly 2 million registered nonprofit organizations, twice as many as 25 years ago. During the past decade, the number of nonprofit organizations grew nearly three times faster than the number of for-profit businesses. By the time you put together all of the donations, dues, fees and government grants, the total budget for U.S. nonprofits tops \$900 billion a year. These nonprofit groups employ more people than the real estate, insurance and finance industries combined. Nine out of 10 U.S. households give to charitable causes.

How can we have a free charitable sector along with quantifiable great results? The answer lies with donors. The most constructive force in philanthropy is intelligent donors. When you give carefully, not only do you help a good cause, but you also encourage progress and accountability among charities.

The biggest problem is lack of meaningful results. A good habit to develop is to think “accountable for results” every time a charity representative or publication says “accountable.”

Summary: A BILLION BOOTSTRAPS

Intelligent Giving

Responsible charities are eager to restore and maintain public trust. Donors can help that occur by following sound giving practices. Invest your giving so that it actually changes lives for the better. Results count most. Businesslike analysis will make you an intelligent giver. Simply follow these three rules:

- **Have a bottom line.** Intelligent givers always have a bottom line — the outcome they expect from their giving — which can be general or specific. Your giving becomes an investment when you ask critical questions about outcomes.
- **Measure success.** The next step is to select one or more indicators of results. Find out how many lives your contribution will directly affect. Press for a simple, specific list of how many people will be leading better lives and in what ways as a direct result of your donation. By measuring results that are a direct consequence of your donation, not the charity's overall budget, you have a much better idea of the effects of your giving.
- **Support what works.** Resist being enticed to donate because of clever new ideas, convincing presentations or winsome fundraisers. A more intelligent way to give is to find a group that has a proven track record and back it in a way that allows the group to take the same benefits to more people.

Identifying Projects

The process of identifying excellent projects to support is not difficult. In every corner of the globe, there are scrappy local groups deeply dedicated to their communities. In many cases, they have delivered successful projects that have rescued children or provided clean water or some other major lifesaving accomplishment with little or no money. Getting behind these unsung heroes and providing the funds to double or triple their impact is an exceptional way to achieve your philanthropic objectives. An added benefit is that the cost to change a life is minimal. ●

Giving Credit Where Credit Is Due

The fundamental premise of microcredit is that people can improve their incomes through hard work if given small loans to strengthen their businesses. This premise has been proven true by millions of borrowers who are now building their tiny businesses, supporting their families and repaying their microloans so that others can have a chance at the one break they need to succeed. These

borrowers are actively changing the futures of their families instead of begging or helplessly waiting for the next installment of charity aid, which may never come.

As a weapon against poverty in developing countries, microcredit is as vital as education, health, human rights and good government. To highlight its importance in eliminating poverty, the United Nations declared 2005 the International Year of Microcredit.

Why does microcredit work so well in developing countries? The economies of developing countries are entirely different from those of developed countries. These economies operate on a much smaller scale, a microscale, compared to the economies of the developed world. What those in the developed world might consider pocket change can represent a doubling of income for impoverished people.

Cash Only

More than half of the world's population operates in a cash-only, informal economy. *The Economist* reported that nearly 60 percent of nonagricultural employment in Latin America and 67 percent in Africa is in the informal sector. In India, nine out of 10 workers are in the informal sector, contributing 60 percent of net domestic product and 70 percent of income. Informal businesses are typically the only viable employment options for the poor.

In developing countries, most poor people do not have access to financial services. Either credit is not available from any source or only from unscrupulous lenders. With just a tiny amount of fair credit, people are able to open and expand businesses by adding inventory or equipment, implementing a competitive advantage or seizing a market opportunity.

Though the income derived from microbusinesses is not large, neither is the cost of living of the individuals who run them. That is why the minor increase in income, which stems from appropriate use of microcredit, can give families the financial boost necessary to increase their standard of living.

Microenterprises

Microenterprises are small-scale versions of the same types of businesses found in developed countries. Twenty hens and a coop constructed from scrap material become a poultry enterprise. A produce store may be a rickety wooden cart piled with mangos picked that morning by the driver or purchased from a local farmer. Hives, bees and a collection of mismatched used jars are a honey

Summary: A BILLION BOOTSTRAPS

factory. A pedal-powered sewing machine is the local equivalent of a clothing factory. An outdoor clay oven is the village bakery. With a microloan providing working capital, these businesses can support families and boost the grass-roots economy for the whole community.

Some of the most crucial benefits of microcredit are far more than financial and cannot be measured on a balance sheet. The true benefits are dignity and self-esteem, along with respect for family and community. Microcredit enables people to become givers, not takers. Microcredit should not be seen as charity but rather as the opportunity poor people need to build a decent life. Through microcredit, donors can shed the old handout mentality and become true partners in progress with the people of the developing world. ●

Barefoot Banking

Mao Zedong's program for public health in China remains a legend. In 1978, a conference of the World Health Organization unanimously passed the Declaration of Alma-Ata praising the Chinese solution for universal health care, a solution that became known as *barefoot doctors*.

In 1965, Chairman Mao announced his plan to provide health care services to rural China using barefoot doctors. They were simply farmers from different agricultural communes who had received a few months of practical medical training. They learned to dispense drugs, set bones, deliver babies and treat wounds and many common diseases. Returning to their homes after the training, they split their time between farming and treating fellow workers. This program brought at least a rudimentary level of health care to all levels of society.

During the nearly three decades that barefoot doctors were on the front line of Chinese medicine, the data show that they measurably improved the health of the nation. According to the *Harvard Public Health Review*, "Between 1952 and 1985, China's average life expectancy rose from 35 to 68 years. Infant mortality plummeted from 200 deaths per 1,000 live births to 40."

Changing Lives

Just as barefoot doctors were vital to bringing basic health care to previously underserved populations in China, a similar approach is now required to address the absence of legitimate financial services for the majority of the world's people. In a parallel to China's barefoot doctors program, microcredit is sometimes referred to as *barefoot banking*.

Barefoot banking may sound quaint, but do not underestimate its importance or power. Microcredit has an impressive record of changing lives. Keep in mind, however, that authority in microcredit rests more with members of the borrowers group than with the loan officers. Peer pressure within groups of borrowers guarantees that everyone pays on time. All financial transactions take place in the open at regular group meetings. This approach ensures mutual accountability and builds trust quickly in communities where corruption and exploitation have long been the norm.

These grass-roots financial institutions are generally referred to as *community* or *village banks*.

The Nuts and Bolts of Community Banking

Barefoot banking operates according to proven, well-documented principles. The following are a few of the guiding principles that are the norm in the microcredit industry:

- *Small loans* increase borrowers' incomes by allowing them to seize business opportunities or supply day-to-day working capital. Depending on the economic level of the country, initial loans usually range between \$50 and \$500.
- *Small groups* of entrepreneurs cross-guarantee one another's loans. This provides a strong incentive to repay. Tight community bonds are forged, and the resulting peer pressure and peer support are more effective than collateral in ensuring loan repayment.
- *Short terms* help people who are new to credit learn how to use it and be responsible. Initial terms of four to six months keep borrowers from becoming complacent and allow the community bank to recycle the money into new loans more often.
- *Frequent payments* create financial discipline and keep the borrowers from falling behind. Making weekly payments is much easier than accumulating larger amounts for monthly payments. Weekly meetings are usually mandatory.
- *Potential future, larger loans* motivate borrowers to pay back their first loans. Graduating up the scale also helps members expand their microbusinesses.

Stability Through Savings

Barefoot banking frequently involves more than loans, just as formal commercial banking does. One additional activity common among microcredit groups is savings. Is it surprising that poor people are avid savers? Savings may take the form of a piglet raised to sell to pay for

Summary: A BILLION BOOTSTRAPS

next year's school fees, or coins accumulated one at a time in a tin box under the bed. Those savings are often the only safety net for the impoverished.

Savings account holders earn interest on their money. Many microcredit providers require small, regular savings deposits along with weekly loan payments. Such compulsory savings are more than collateral on outstanding loans: They help the poor accumulate useful sums of money for business expansion and family needs, such as a bed, a stove or school fees.

Banks Without Walls

Community banks function as banks without walls for the benefit of small groups of borrowers who may meet in a one-room school, someone's shanty home or literally under a tree. Tracking individual accounts is not that difficult, but the task becomes complicated when there are thousands of clients making tiny weekly payments, often less than a dollar at a time. All of this requires supervision by trained credit officers who meet regularly with the group. Typical microcredit workers monitor hundreds of accounts each. Then, at the head office, capable senior managers must maintain up-to-the-minute, accurate summary information to spot and address any problems.

Not many of these bankers for the poor are barefoot anymore, though many of them have nothing more than shoe leather to transport them to borrower meetings. ●

Moving the World

The first way to multiply the power of your money is to use it in an underdeveloped country. The poorer the community, the less money it takes to start or improve a microbusiness capable of supporting a family, and the less it costs to live there. Underdeveloped countries have informal economies where self-employed people face little government regulation or other profit barriers. A street vendor selling homemade tortillas does not require a business permit or a building.

There is no exact formula to determine the total dollar amount in loans it takes to move a family up the poverty ladder. Rather than getting lost in a forest of details, the following rule of thumb works well across a wide spectrum of countries and situations: Whether it is in one loan or a series of loans, the total amount of borrowed funds needed to help lift someone from poverty is roughly equal to the average annual income per capita of the borrower's country. Based on this rule, the total amount of loans would be as low as \$120 in parts of Africa and as high as \$4,460 in Russia.

On a cost basis, the most extraordinary opportunities for changing lives are in the world's poorest countries. With this lever alone, your money in a poor country can be 365 times as powerful as compared to using it in the United States.

The Loan Recycling Lever

Microloans, when properly made, have a typical repayment period of six months or less, and then the money recycles as a new loan. Over the span of a decade, up to 20 microbusinesses are started or strengthened with the amount of just one loan. Therefore, the power of money multiplies approximately 20 times through microcredit compared to one-time charity expenditures.

Multiply the lever of using money in an underdeveloped country (up to 365) by the lever of loan recycling (20), and the result is that you are able to exert as much as 7,300 times more power when you provide microloans in a poor country compared to donating to a humanitarian cause in a developed country. Additional levers can be applied for even larger outcomes.

Now, late-stage microcredit supporters can reap outlandishly high returns for low risk by taking advantage of three decades of investments and hard work by others. Microcredit is capital-starved because few people know about it and understand how and why it works. By providing some of this capital, you can help poor people advance their small businesses with sweat equity and bootstrap loans. With loans, not handouts, they can achieve economic stability and the dignity that stems from solving their own problems.

The financial levers available with microcredit are powerful, and you can move the world by using them. Other levers are the genius of microcredit methods, the dedication of field staff, and the tenacity of poor entrepreneurs. Although world poverty is powerful, these levers are even stronger. ●

Microcredit Plus

The pairing of lending with other services is called "Microcredit Plus," an excellent approach because poverty often involves more than lack of money. While some income-related problems such as hunger simply disappear as families move out of extreme poverty, other problems persist. This is where the "Plus" comes in.

Lending programs are an ideal context for delivering added services because the programs have established trust with the borrowers, opening them to new ideas. Since credit groups gather at regular intervals, it takes

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little, if any, additional expenses to build extra services into those meetings. Health and literacy programs, legal information and even farming tips have all been delivered successfully alongside microcredit. Savings and insurance are among the most common additions to lending programs; they decrease the vulnerability of poor families to emergencies, disasters and unexpected expenses.

Strategic alliances with other organizations are another way microcredit groups add extra features to their lending. Habitat for Humanity partnered with Opportunity International to combat AIDS in sub-Saharan Africa. Through that cooperative arrangement, AIDS orphans worked on Habitat housing projects and learned valuable construction skills. Opportunity International clients also mentored and trained the young people so they were able to use microloans to start their own businesses. Microcredit providers have joined forces with various groups to provide childhood immunizations, malaria prevention, AIDS awareness and a wide array of other services. ●

Beyond Good Intentions

There are reliable ways to connect with microcredit while avoiding the pitfalls. Microcredit is not as simple as sending money and a half-page loan agreement to an entrepreneurial poor person in a faraway country. That may not be legal, and it certainly is not wise.

Giving options cluster under three broad categories. No matter what cause you wish to support, microcredit or anything else, there are only three ways you can channel your resources. Professional fundraisers describe each with the letter T: time, treasure and talent. These are the only items anyone can contribute. Another way to describe these options is that we can give:

- **Our financial resources** — money and credit
- **Our personal resources** — skills, relationships and influence
- **Our lives** — donating hours and possibly even years of our time

In many cases, giving involves a combination of all three. The first way most people participate in microcredit is by giving money. Donors have six options:

1. Give to Grass-roots Organizations. Finding and evaluating the best local providers entails a great deal of research and likely one or more trips to a developing country. You will also find banks unwilling to transfer money to countries that are on government restriction

lists. If you are willing to do the work required to legally surmount difficult barriers, you are positioned to have a wonderful experience witnessing how your contribution is changing lives in a specific place.

2. The MicroCredit Solutions Fund. Geneva Global Inc. brings business-grade due diligence to the analysis of projects in developing countries. Microcredit Plus projects provide loans while simultaneously correcting one or more of the ills aggravated by poverty.

3. Give to an International Organization. Most donors, large and small alike, make qualifying tax-deductible (according to U.S. tax code) contributions to an international microcredit nonprofit organization.

4. Give Your Skills as Well as Your Money. Dallas real estate developer Lucy Billingsley recruited other Dallas women to host breakfasts and coffees to raise money for microloans for women in the Mexican state of Chiapas. They connected with Alternative Solidaria, a local organization they met through its partner, the Grameen Foundation. Connect people who have the capacity to give with microcredit groups that are ready to grow.

5. Give Your Time Along With Everything Else. Find ways to affiliate with the microcredit organizations that can help you meet your goals. Find a place where you can connect with your skills and energy in addition to your donations.

6. Start a Microcredit Program. The learning curve can be steep, and unexpected challenges, such as civil war and hyperinflation, can add exotic complications rarely faced in ordinary business. It can be thrilling to overcome such obstacles. ●

A Thousand Battles, A Thousand Victories

The wealthiest 10 percent of the global population possess 54 percent of the income. The remaining 90 percent of people divide up the remaining 46 percent. Further analysis of poverty statistics shows that 40 percent of the world's entire population lives on less than \$2 per day. There are about 2.5 billion people in that group who struggle to survive on just 5 percent of the world's income. These are the people who desperately need microcredit to improve their circumstances. More than a billion of them have no access to clean drinking water. More than 800 million suffer from severe hunger and malnutrition. Every hour approximately 1,200 children within this group die from preventable diseases.

Summary: A BILLION BOOTSTRAPS

The University of Maryland's Program on International Policy Attitudes conducted a poll in 2001 that found most Americans believe that 24 percent of the federal budget goes to overseas development assistance. In reality, less than 1 percent of the annual U.S. government budget goes to humanitarian foreign aid.

Development Goals

In 2000, the United Nations launched one of its most widely acclaimed initiatives ever: The Millennium Development Goals, or MDG. All 191 U.N. member nations endorsed this plan to halve the number of the people in the world living on less than \$1 a day, halve the proportion of the population suffering from hunger compared to baseline statistics from 1990 and improve the lives of the world's poor in six additional ways. The aim is to reach these goals by 2015.

Everyone's intentions were and are good, but according to the *Millennium Development Goals Report 2006* published by the U.N., the results so far are not very impressive. Parts of Asia show a strong decline in poverty, but extreme poverty in Africa remains virtually unchanged, from 44.6 percent of the people living on less than \$1 per day in 1990 to 44 percent in the latest data. It would seem that, even when the world's nations unite to fight poverty, many of the weapons are blunt. Microcredit succeeds in places where other macro efforts fail. ●

The Best Due Diligence

Making microloans involves many complexities. Sometimes giving out loans directly is not a good idea. Although the concepts of microcredit apply globally, the specifics of how to provide microcredit change dramatically from country to country, and even village to village. It is important to understand a country's political and religious history, its past and current business practices and its cultural differences.

Microcredit organizations in Russia, which must contend with the Russian Mafia or corrupt local governments, face entirely different challenges from, for example, those in Rwanda where some loan officers can barely add or subtract.

Poverty has to be solved one family at a time. These families can eventually have a noticeable, positive effect on their communities. Microcredit has the power to influence entire social and political systems. The ripple effect of microcredit is far greater than experts have ever imagined — on both the borrowers and the lenders. ●

Tough Love Leads to Happy Endings

It is possible to view philanthropy in the same light as investing and to expect that through microcredit you can achieve even better results than with your financial investments. Use your business skills to further your giving goals, not just the goals of the charity organization. Unleash the full power of your donated dollars instead of blindly dispatching your money to a general fund that may accomplish very little. Instead of letting resources snooze inside a foundation or donor-advised fund, find great opportunities and put your contributions to work.

Donor Choices

Keep your mind engaged to make certain you are accomplishing what you intend. If you choose to make your donations with the mind-set of an investor, here are some of the choices you might make:

- Seek charities that offer the *best return* on your investments. Though you might favor a few local charities, the location of the headquarters and the people they serve should not be the primary consideration. Instead, look for an underserved market.
- Require that the returns on your charitable investments be *measurable* and the results reported in a meaningful fashion.
- Even after intense analysis, your *investment style* should guide your decisions. A successful investor has a plan and follows it.
- If a charity does not meet performance expectations, move your investment elsewhere or, in other words, *adjust your portfolio*.

- Pay *management fees commensurate with expected performance*. In charities, actual administrative and fundraising costs are too often 30 percent to 50 percent of the funds raised. As an investor, outside of a brief start-up period, you would find that intolerable.

The Next Step Is Yours

About the only limit to the growth of microcredit and the resulting triumph over poverty is the lack of funding for more microloans. How far this superb solution can reach rests to a large extent in the bank accounts, foundations and donor-advised funds of potential supporters. We have the ability to help billions of the world's poor bootstrap themselves out of poverty, not with charity, but with the partnership of microcredit. ●

· Book 18 of 32 ·

Summary



Ecological Intelligence

How Knowing the Hidden Impacts of What We Buy Can Change Everything

THE SUMMARY IN BRIEF

Daniel Goleman, author of the best-sellers *Emotional Intelligence* and *Primal Leadership* now introduces *Ecological Intelligence* — revealing the hidden environmental consequences of what we make and buy, and how with that knowledge we can drive the essential changes we must make to save our planet and ourselves.

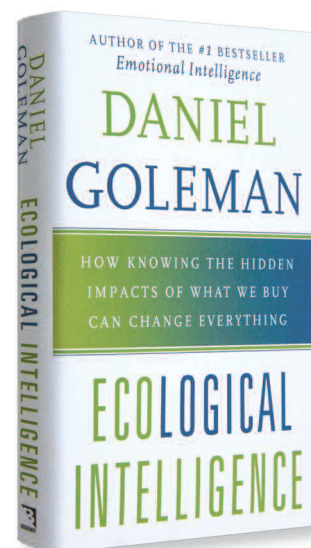
We buy “herbal” shampoos containing industrial chemicals that can threaten our health or contaminate the environment. We dive down to see coral reefs, not realizing an ingredient in our sunscreen feeds a virus that kills the reef. We wear organic cotton T-shirts, but don’t know that the dyes may put factory workers at risk for leukemia. In *Ecological Intelligence*, Goleman reveals why so many of the products that are labeled “green” are a mirage, and he illuminates our wild inconsistencies in response to the ecological crisis.

Drawing on cutting-edge research, Goleman explains why we, as shoppers, are in the dark over the hidden impacts of the goods and services we make and consume — victims of a blackout of information about the detrimental effects of producing, shipping, packaging, distributing and discarding the goods we buy.

What Goleman calls “radical transparency” will enable consumers to make smarter purchasing decisions, and will drive companies to rethink and reform their businesses, ushering in, he claims, a new age of competitive advantage.

IN THIS SUMMARY, YOU WILL LEARN:

- Our world of material abundance comes with a hidden price tag.
- Industrial ecology exists at the cusp where chemistry, physics and engineering meet ecology, and integrates those fields to quantify the impacts on nature of manmade things.
- Radical transparency converts the chains that link every product and its multiple impacts — carbon footprints, chemicals of concern, treatment of workers and the like — into systematic forces that count in sales.
- How making once-hidden data available to all remedies the unfair advantage of sellers over buyers.



by Daniel Goleman

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THE COMPLETE SUMMARY: ECOLOGICAL INTELLIGENCE

by Daniel Goleman

The author: Daniel Goleman is the author of the international best-sellers *Emotional Intelligence*, *Working with Emotional Intelligence* and *Social Intelligence*, and the co-author of the acclaimed business best-seller *Primal Leadership*. He was a science reporter for *The New York Times*, was twice nominated for the Pulitzer Prize and received the American Psychological Association's Lifetime Achievement Award for his media writing.

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The Hidden Price of What We Buy

Our world of material abundance comes with a hidden price tag. We cannot see the extent to which the things we buy and use daily have other kinds of costs — their toll on the planet, on consumer health and on the people whose labor provides us our comforts and necessities. We go through our daily life awash in a sea of things we buy, use and throw away, waste or save. Each of those things has its own history and its own future, backstories and endings largely hidden from our eyes, a web of impacts left along the way from the initial extraction or concoction of its ingredients, during its manufacture and transport, through the subtle consequences of its use in our homes and workplaces, to the day we dispose of it. And yet these unseen impacts of all that stuff may be their most important aspects.

As utilized in yesterday's business environment, today's industrial chemicals and processes made utter sense, but all too many make little sense going forward. Consumers and businesses alike can no longer afford to leave invisible decisions about those chemicals and processes — their ecological consequences — unexamined.

Industrial Ecology

Industrial ecology exists at the cusp where chemistry, physics and engineering meet ecology, and integrates those fields to quantify the impacts on nature of manmade things.

The field includes topics as diverse as estimating CO₂ emissions from every industrial process or analyzing the global flow of phosphorus, to how electronic tagging might streamline the recycling of garbage.

If we knew the hidden impacts of what we buy, sell or

make with the precision of an industrial ecologist, we could become shapers of a more positive future by making decisions better align with our values. All the methods for making that data known to us are already in the pipeline. As this vital knowledge arrives in our hands, we will enter an era of *radical transparency*.

Radical transparency leverages a coming generation of tech applications, where software manipulates massive collections of data and displays them as a simple readout for making decisions. It will introduce an openness about the consequences of the things we make, sell, buy and discard that goes beyond the current comfort zones of most businesses. ●

'Green' Is a Mirage

An industrial engineer's version of the deconstruction of stuff is called Life Cycle Assessment, or LCA, a method that allows us to systematically tear apart any manufactured item into its components and their subsidiary industrial processes, and measure with near-surgical precision their impacts on nature from the beginning of their production through their final disposal.

LCAs had a prosaic start; one of the very first such studies was commissioned by Coca-Cola back in the 1960s to determine the relative merits of plastic and glass bottles and quantify the benefits of recycling. The method slowly spread to other industrial questions; by now a large and growing band of companies with national or international brands deploys the method somewhere along the way to make choices in product design or manufacturing — and many governments use LCAs to regulate those industries.



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Summary: ECOLOGICAL INTELLIGENCE

Nothing Made Industrially Can Be Utterly Green

As one industrial ecologist confided, “The term ‘eco-friendly’ should not ever be used. Anything manufactured is only relatively so.” This shadow side of industry has been overlooked in the value chain concept, which gauges how each step in a product’s life, from extracting materials and manufacturing through distribution, adds to its worth. But the notion of a value chain misses a crucial part of the equation: while it tracks the value added at each step of the way, it ignores the value subtracted by negative impacts.

Seen through the lens of a product’s LCA, that same chain tracks a product’s ecological negatives, quantifying its environmental and public health downsides at each link.

Assessing the pluses and minuses throughout a product’s value chain offers a metric for business decisions that will boost the pluses and lessen the minuses. ●

What We Don’t Know

Try this mind experiment:

1. Imagine an old-fashioned two-tray balance scale, like that held by the classic image of a blindfolded goddess of justice.
2. On one of the trays put the total benefits that accrue from all the recycling, use of green products, and other environmental, public health-minded and socially concerned activities you engage in over a typical month.
3. Now on the other tray place what an industrial ecologist might assess as the harmful impacts of everything else you buy and do over the same month: all the miles you drive in a car, the hidden consequences of producing, transporting, and discarding your groceries, the printer paper you use and everything else.

Unfortunately, for any of us but the most incredibly virtuous, the harmful impacts are enormously greater than the benefits.

Vital Lies, Simple Truths

The Norwegian playwright Henrik Ibsen coined the phrase “vital lie” for the comforting story we tell ourselves that hides a more painful truth. When it comes to the full costs of ecological ignorance in the marketplace, we endorse the vital lie *what we don’t know or can’t see does not matter*.

Every vital lie requires cover stories that paper over the

‘Green’ Is Not What It Seems

Consider the tote bags British fashion designer Anya Hindmarch put out in a limited edition of 20,000. Hindmarch’s inspiration came when she was approached by a charity called “We Are What We Do” — what Hindmarch decided to do was use her fashion platform to raise public awareness about refusing plastic bags in stores. And that it did.

That Hindmarch canvas tote was emblazoned with the slogan “I’m NOT a plastic bag,” a play on the 1929 painting by the Belgian surrealist René Magritte depicting a pipe, below which were the words “Ceci n’est pas une pipe.” (This is not a pipe.) The painting’s title, *The Treachery of Images*, underscores Magritte’s point that the image is not the thing and things are not what they seem.

simple truth. We tell ourselves, “Well, I recycle my newspapers and bottles. Plus I bring my own bags to the store” and feel a bit better for having done our part.

As the saying goes, “When you throw something away, there is no away.” It remains here, on planet Earth. ●

Ecological Intelligence

Ecological refers to an understanding of organisms and their ecosystems, and *intelligence* connotes the capacity to learn from experience and deal effectively with our environment. Ecological intelligence lets us apply what we learn about how human activity impinges on ecosystems so as to do less harm and once again to live sustainably in our niche, which these days includes the entire planet.

To tap into this intelligence, we need to get beyond the thinking that puts mankind outside nature; the fact is we live enmeshed in ecological systems and impact them for better or worse — and they us. All of us need to discover and share among ourselves all the ways this intimate interconnectedness operates, to see the hidden patterns that connect human activity to the larger flow of nature, to understand our true impact on it, and to learn how to do better.

The New Math

Buy a snack-sized bag of Walkers Salt & Vinegar Flavour Potato Crisps — the British version of potato chips — and its label tells you its carbon footprint, 75 grams of carbon emissions (by comparison a full jumbo jet flying from Frankfurt to New York City emits 713,000 grams per passenger). The bag proclaims that Walkers has been working with an outfit called the

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Carbon Trust since 2005 to analyze the carbon footprints of its products and to find ways to reduce them.

To calculate that 75 grams took enormous effort. For starters, researchers from the Carbon Trust calculated how much energy was used when the seeds for its two ingredients, potatoes and sunflower oil, were planted. Then they added in the carbon emitted by the diesel tractors that harvest the potatoes, as well as during their cleaning and chopping, frying and bagging, storing and shipping. They also threw in the greenhouse gases emitted when the bags were printed and the potato crisps packaged. Finally, the carbon accountants factored in what happens when the empty bag gets tossed into a garbage can, including collection and trucking to the dump and burying in a landfill.

There is a need to master a new kind of math that spells out the consequences of our everyday choices and purchases more deeply than ever before. Industrial ecology is the discipline that seeks to master this new math.

How to Boost Our Collective Ecological Intelligence

One way to boost our collective ecological intelligence is to become familiar with a wider range of ways to classify and think about impacts from products. Ideally, we want to understand an item's adverse consequences in three interlocking realms:

1. The *geosphere* (including soil, air, water and, of course, climate)
2. The *biosphere* (our bodies, those of other species and plant life)
3. The *sociosphere* (human concerns, such as conditions for workers) ●

The Information Gap

Consider our present predicament. If you want to buy a given product that's best for the environment, for your health, and for the well-being of those who made it, it's largely impossible to get sound comparative information. One can check cost and, usually, quality. But apart from organic or "eco" brands and labels, shoppers can rarely express a preference for less toxic or more environmentally sound alternatives.

- When the ecological impact of goods remains invisible, merit goes unrewarded.
- Information itself has value: Knowledge translates into market power.
- The essence of transparency lies in conveying information from the informed to the uninformed.

Radical Transparency

Ecological transparency becomes *radical* when its analysis encompasses the entire life cycle of a product and the full range of its consequences at every stage, and presents that information to a buyer in ways that demand little effort.

Radical transparency means tracking every substantial impact of an item from manufacture to disposal — not just its carbon footprint and other environmental costs, but its biological risks, as well as its consequences for those who labored to make it — and summarizing those impacts for shoppers as they are deciding what to purchase.

Full Disclosure

Radical transparency launched its seminal application on April 1, 2008, in what had once been a laser cosmetologist's office above a sushi restaurant on a well-worn stretch of Shattuck Avenue, Berkeley's (Calif.) main commercial thoroughfare. That office building, faced in attractive cobalt blue and green tile, houses GoodGuide, Inc. Its mission is to build tools that "transform how people see and interact with products and companies by delivering comprehensive and rigorous information at the point of purchase," as its official mission statement puts it.

GoodGuide is a "for-benefit" corporation, with a charter stating that its mission is to benefit not just shareholders but stakeholders — in other words, the shopping public. Dara O'Rourke is an industrial ecologist and the visionary behind this project to bring radical transparency to the marketplace in the form of a software innovation, GoodGuide.

GoodGuide surfaces a product's backstory. It can calculate the specific environmental impacts of a product during manufacture, transport, use and disposal.

The Mindful Shopper

As we shop, our perceptual apparatus attunes us to whatever confronts us in the immediate surroundings: the stylishness and cut of that outfit, the rock-bottom sales prices or the tempting aroma wafting our way from that coffee shop. These sensory impressions drive our shopping decisions far more than some vague memory of the latest alarm over global warming, that news story about yet another toxin scare or a grim scene of an Asian sweatshop glimpsed on some website.

Sensory clutter and cognitive fog challenge anyone trying to get shoppers to notice the impacts of what they are about to buy. GoodGuide and programs like it offer a way to pierce this fog, bringing squarely into awareness the actual impacts of what we buy, giving us the crucial opinion at the moment we need it. ●

Twitter and Buzz

Instant messaging methods like Twitter, which lets shoppers send their reactions to friends as they stroll through a store, means a customer ripple can start with a single dissatisfied (or delighted) customer. These digital tools threaten the standard veils that have hidden the raw facts about manufacturing processes, toxicity of ingredients, workers' conditions and the like — for better or worse — from customers' eyes.

Impartiality demands that whoever does an evaluation is someone who has no personal stake in the sale of the product. At some point marketplace transparency systems might well include the post of ombudsman (or an ombudsgroup), an independent authority to whom anyone can appeal a rating that seems unfair or inaccurate.

Fair and Square

These towels have been made under fair labor conditions, in a safe and healthy working environment which is free of discrimination, and where the management has committed to respecting the rights and dignity of workers.

That message, printed under a logo reading **FAIR AND SQUARE**, was placed on towels sold at a trendy Manhattan home furnishings store. It proved to have remarkable sales power. Compared to adjacent towels that lacked this simple information, the Fair and Square batch showed a steady boost in sales over a five-month period. When the labels were switched to comparable towels, the sales advantage — a boost of 11 percent in sales — traveled right along with the label.

Most surprising, when the price of the towels was raised, their sales increased more quickly. The two Harvard University political scientists who conducted the experiment, Michael Hiscox and Nicholas Smyth, conjecture that the higher price tag for the towels lent more credibility to the claim for superior labor standards. The results, they suggest, show a large untapped market for such ethical merchandise.

Of course, this happened at an upscale store; its shoppers fall within the marketing category known in some circles as “Price-Sensitive Affluents,” those who equate a virtuous label with quality, and are willing to pay up to twice an item's price if it matches their concerns.

Motivational Differences

Children today face the specter of drastic disruptions of life from global warming and the other ecological disasters we may have already set in motion.

Older shoppers may not have cell phones, may be too set in their habits, or merely be too lackadaisical as they

shop, to use technologies like the smart bar code. But today's younger generations seem far more motivated to embrace them, growing up in an atmosphere of alarm about the future of their planet that stands to move them more strongly to action. ●

The Virtuous Cycle

Adding hydrogen atoms to cooking oils created saturated fats, gunk patented in 1903 that made baked goodies stay moist longer. The miracle of trans fats lent pastries and cakes a longer shelf life, let pie crusts (and French doughnuts) stay pleasingly crisp yet chewy.

While in 1997, knowledge of trans fat itself — let alone its hazards — was barely beginning to dawn, that awareness grew quickly as a cascade of findings made clear the hazards in eating trans fat. In 2001, the prestigious Institute of Medicine, a branch of the National Academy of Sciences, issued a report confirming that trans fat was strongly associated with heart disease.

Early on, when the FDA began to hold hearings on listing trans fat on products, many companies opposed the proposed labels.

What's most telling is the mechanism that made trans fats vanish. The federal government never banned hydrogenated oils. No one told food companies they had to stop using trans fat. The crucial shift was in the *information available to consumers*. Trans fat stands as a textbook case of the potent market force that comes from full disclosure in labeling the things we buy.

The Multiplier Effect

Sequestered among New Jersey's anonymous landscape of industrial parks squats a vast factory complex dedicated to making bath and body products. A goodly portion of the shampoos in America's stores and beauty salons was born in the immense vats in this factory's mixing room, each vat the size of an upended cargo container — about 18 feet high and 10 feet across. A single vat holds 8,500 gallons, which turns out enough bottles of shampoo to fill a slot on the shelves of every store in a national retail chain.

However the shampoo was made, whatever its ingredients, whatever its contribution to the devalue chain (the ways in which various points in its life cycle have negative ecological impacts), in the logic of the marketplace, all these impacts are rewarded whenever someone buys a single bottle.

In this sense, a single customer switching a brand preference can have vast implications. But the missing piece of the equation here is finding a way to let a company

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know precisely why we decided to buy, or switch from, its brand.

Such an information feedback loop between shoppers' preferences and a business's response to how it does things creates a "virtuous cycle."

A virtuous cycle connects what shoppers decide in the store aisles with what companies need to do to win their business. As businesses respond by making more of the improvements that shoppers want, shoppers can feel empowered by seeing that their ethical choices matter. ●

The Chemical Stew

Conventional wisdom posits a potential bonanza for companies that go green not merely in direct savings on energy costs, but also from the smarter products and processes they innovate that solve ecological problems. But looked at through another lens, the current tide of activity focused on global warming is just the first in a series of such waves likely to wash over businesses in coming years.

Most products marketed today are based on 20th century industrial chemistry. The 21st century will inevitably bring a more fine-grained understanding of how commonly used ingredients interact with human biology. Given the inexorable advance of science, eventually some of those substances will be implicated in processes that lead to disease of one kind or another.

The widespread fears about the heating of the planet are driven by a steady drumbeat of scientific findings, each hitting the media with a new wave of alarm. One inexorable force that stirs these waves is backwash from fast-moving scientific advances. Another is the ever-increasing zones of transparency created by the availability of information.

The Inflammatory Syndrome

If you want to know what industrial chemical compounds Michael Lerner or his wife, Sharyle Patton, carry around in their bodies, just go to the Web page www.bodyburden.org. Lerner and Patton are both active in environmental health, the field that studies how the chemical by-products of industry and commerce impact the human body. They posted their analyses on the Web as part of an awareness-raising campaign.

Lerner, it seems, lugs around relatively high levels of methylmercury, inorganic arsenic and polychlorinated biphenyls (better known as PCBs). These are but a few of the 102 industrial chemicals of 214 assayed by measuring metabolites in his blood and urine.

Patton's body, in addition to these, has relatively high

levels of chlorinated dioxins and organochlorine pesticide residues, plus a generous helping of others that did not show up in her husband's tests.

Medical databases link, at various levels of certainty, each of these compounds with a distinct set of illnesses.

Stepping back and looking at the entire list of 214 industrial chemicals creates the creepy feeling that nothing is safe: toxins waft our way in house dust or air, from water and soil, or by offgassing from a long litany of objects from paint and carpeting to computer consoles and furniture.

Bioaccumulation has become its own corner of medical science, with studies suggesting that virtually everyone alive on this planet harbors a stew of toxic substances. ●

The Amygdala Goes Shopping

Every shampoo contains four basic types of chemicals. The first is surfactants, cleaning agents that strip dirt off hair. But surfactants are harsh and can leave hair dry and brittle, so formulators add a conditioning agent to rectify the pH balance. Foaming agents make it bubbly; fragrances give a shampoo its unique identity. Shampoos can have dozens and dozens of ingredients fine-tuning their unique appeal in these four basic categories. Not all of those ingredients are necessarily benign.

Skin Deep

Skin Deep is a cosmetics hazard-rating website operated by the Environmental Working Group, an outfit that crusades against toxic ingredients in personal care products. The average American woman applies one to two dozen personal care products daily, and Skin Deep tells which of these contain chemicals that might better be kept away from the body's biggest organ, the skin.

From the perspective of neuroscience, Skin Deep caters to the apprehensions of the amygdala, the central node in our brain's radar for danger. These circuits continually scan for anything that might be a threat to us and triggers the fight-flight-freeze reaction that catapults us into a frenzy. When the amygdala goes shopping, it puts us on alert for potential dangers in what we buy.

The very possibility of hazard in a product triggers the brain's most primitive safety strategy: avoid what might be dangerous. The amygdala operates by an emotional logic with a singular decision rule: better safe than sorry.

At present, consumer concerns have relatively little effect on the ingredients or chemicals used in the products we buy. But in a radically transparent marketplace, that equation shifts, allowing shoppers to make more

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informed decisions based on information that previously had been hidden. ●

Tough Questions

With the advent of methods for radical transparency, what the marketplace offers today may become out of sync with what shoppers will want tomorrow. These new approaches to managing information herald a coming flood of data about the heretofore unnoticed consequences of a host of common ingredients in everyday products. Previously successful brands may be in danger of becoming tainted in our minds.

Art Kleiner, editor in chief of *strategy+business*, was posed a hypothetical business scenario:

Let's say in the near future the field of epigenetics, the study of which molecules turn what genes on and off, begins to identify certain industrial chemicals as possible triggers of genes known to be active in specific diseases. Those chemicals happen to be crucial to a wide range of products. What should a company do?

Kleiner rattled off a series of tough questions that skeptical executives would have to answer before considering changing their company's use of such chemicals:

1. Do we care about it?
2. What would we lose if we ignore this?
3. How would we have to change our thinking?
4. What's the harm?
5. What information exists that I need to be aware of?
6. What are the costs of changing?
7. Do we really want to know?
8. If we decide to change, how do we convert our response to fit the cost-benefit calculus?
9. What are the logistics of change?
10. Are the changes worth it?

The subtext of these 10 questions and their answers revolves around values, which dictate strategic priorities.

Ecologically intelligent companies will be proactive: businesses will want to be the first to know about epigenetic data, collaborate with suppliers to make shifts, see marketplace feedback as actionable information, and perceive the change as a business opportunity that will bring added value, not just added costs.

The Ecological Evolution

In 2006, Coca-Cola and its franchisees processed 80 billion gallons of water, some ending up in drinks, but most used in making the drinks. Coca-Cola has set measurable targets for itself toward the goal of ensuring that

by 2010, all wastewater from Coke plants worldwide is returned to the local water supply clean enough to support aquatic life.

In the view of MIT's Peter Senge and his colleagues at the Society for Organizational Learning, that shift to sustainability as a means to create value can be seen in terms of several discrete stages in the evolution of a business, each with its own drivers.

The earliest stages describe the conventional business response, as reflected in the assumptions behind Kleiner's questions. The assumptions include that accommodating to ecological needs will be costly, unnecessary and bad policy.

A more proactive approach begins in the next stage of Senge's model with voluntary compliance; the drivers here often come from the realization that taking environmental measures can save money and improve reputation and brand value.

Beyond this search for savings comes the next level in Senge's progression, integrating sustainability into a company's strategy, typically by discovering a range of ecologically sound business opportunities.

The Perpetual Upgrade

Wherever you live, whatever you do, you are very likely to have something in your home or workplace made by FiberMark, a manufacturer of papers, packaging and a host of related things that permeate the manufacturing universe.

Packaging from FiberMark holds a slot in a vast number of product supply chains, so whenever FiberMark upgrades its methods, all those products share in the ecological benefit.

As LCA expert Gregory Norris observes, "When anyone in your supply chain makes a smart move, it makes your product greener too — as well as the purchases of everyone who buys your product. That ripple effect turns thousands of upstream suppliers into your allies, to the extent any of them make improvements."

Norris has a vision for a way to churn out an endless stream of such ecological upgrades throughout the world of industry and commerce. Earthster is a free, open-source, Web-based program that will offer businesses LCA-driven windows into supply chains and create an online bazaar for upgrades. Earthster seeks to give B2B (business to business) shoppers a way to signal producers about the ecological improvements they want to see in products over their life cycles.

Norris's hope is that Earthster will one day give industrial buyers the kind of information they need to "show

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a metric for how much good we've done in the world — that our choices, for example, have reduced this kind of pollutant by that much.”

The Next Fifty Years

There are literally millions of ways to upgrade our collective ecological footprint. Here ecological intelligence takes the form of rethinking our entire legacy from earlier days, when processes and inventions came online without regard for their impacts. Upgrading this legacy may present the biggest business challenge of the 21st century: We need to reinvent everything, from the most basic platforms in industrial chemistry and manufacturing processes through the entire supply chain and life cycle of products. ●

Second Thoughts

The countries of the Second World — like Brazil, India, Russia and China — harbor the growing new consumer markets whose spending power drives much of the world economy's growth. For billions of shoppers in these economies cost alone will likely prevail as the hallmark of best-selling products.

It may take decades for the first-tier market's desire for impact transparency to reach or permeate these second-tier economies. The market segmentation that separates high-quality/low-impact goods from low-cost/poor-impact ones will likely prevail for decades in these bustling economies. On the other hand, if global retail giants like Wal-Mart apply their huge advantages in seeking ecological gains from their suppliers, the cost equation might change radically.

Getting It Right

Simple ineptness or poor execution may be the greatest threat to the best-intentioned transparency efforts in the marketplace. There are other risks: Radical transparency is itself an untried intervention in a complex system and, as such, may have any number of unintended, even unfortunate, side effects. There are many caveats and cautions.

For one, as some argue, only top-tier brands, which are the most reputation-sensitive, may be affected. Another concern: Misguided good intentions could mean sourcing or other nightmares for companies trying to respond to market shifts.

Doing Well by Doing Good

Throughout history, companies have been able to consume or pollute air, water or land with little to no consequence. The costs — such as damage from

floods and the expense of treating respiratory disease or cleaning toxins from soil — are borne by the general public. Whatever form such abuse of nature's commons takes, the laissez-faire mishandling of any public resource can be seen as unsustainable and ethically unacceptable.

Ethical judgments aside, there has been a practical problem in dealing with this abuse: calculating the actual cost of such damage to nature. But new methodologies now allow the quantification of “natural capital,” the economic value accruing from nature.

Radical transparency holds out the carrot, the promise of business opportunity waiting to be seized. The free market itself could foster an alternative or complementary mechanism for making damage to the commons consequential to a company, through systematically revealing that harm to consumers. And if a company takes steps to compensate the commons for damage done or raises local health and education standards by bringing jobs to poverty-stricken areas, that, too, would be transparent.

Compassionate Consumption

Radical transparency unites what had seemed polarities: the self-interest of a company aligns with the best interests and values of the consumer.

This conceptual sea change reorients capitalism to embrace the public interest, as an arena for competition emerges where ethics, innovation and initiative are dependably rewarded in sales.

A boost in ecological intelligence seems essential for our species to adapt to the singular challenges of these times. Ian McCallum, a South African physician and naturalist, points out that while our planet seems destined in the years ahead for shifts in weather that threaten our fragile niche, the planet itself can continue long after our species has gone. He says we don't have to fix the planet, but rather our relationship to it. “The Earth doesn't need healing. We do.” ●

RECOMMENDED READING LIST

If you liked *Ecological Intelligence*, you'll also like:

1. **The Necessary Revolution** by Peter Senge, et. al. This book focuses on sustainability and the challenge for businesses to invest in new solutions to environmental problems.
2. **Green to Gold** by Daniel C. Esty and Andrew S. Winton. This title shows how companies generate lasting value by building environmental thinking into their business strategies.
3. **Transparency** by Warren Bennis, Daniel Goleman and James O'Toole. This book contains three essays that look at the issue of transparency from different angles.

· Book 19 of 32 ·

Summary



How the New Oil Industry Will Change People, Politics, and Portfolios

Future Energy

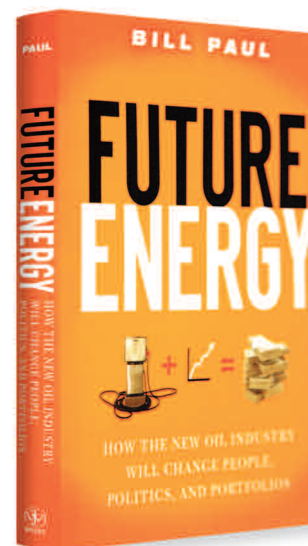
THE SUMMARY IN BRIEF

In America, driving a car or truck is quite possibly our most ubiquitous expression of freedom — freedom of travel, freedom of motion, the freedom of the open road. That freedom, like all other freedoms, comes at a price. Americans are increasingly recognizing the cost of this freedom when they fill their tanks, but the “pain at the pump” is only a fraction of the toll our oil dependence exacts on our economy, our nation’s energy security and our environment. Most of us simply see no alternative.

Help is on the horizon, and might be closer than we think. Bill Paul examines the energy technology revolution that is brewing in America and throughout the world — a revolution that will create a “new” oil industry that holds the promise of energy independence for the United States and other nations. The potential ramifications of this revolution are enormous — moderate prices, a cleaner environment, even a new method of wealth creation. While it will take government programs and legislation to bring these changes, you can keep an eye out for the inventive and disruptive technologies that will bring about the revolution, and the global, corporate, and federal entities that will develop and nurture those technologies. The revolution will take time, but the future is definitely starting right now.

IN THIS SUMMARY, YOU WILL LEARN:

- How factors in America’s relationship with oil are forming a “perfect storm” that can bring about change.
- The key investment sectors in the “new” oil industry.
- Why crude oil will continue to be a vital part of the world’s energy mix for years to come.
- How electricity will become a new transportation fuel.
- Why it’s conceivable that energy efficiency could become a new method of wealth creation.
- What companies made the “100 Companies to Watch” list.



by Bill Paul

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THE COMPLETE SUMMARY: FUTURE ENERGY

by Bill Paul

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The New Oil Industry

In a 2006 newspaper article, a group of economists stated their belief that if gasoline were to reach \$5 a gallon in the United States, “an entire industry would develop aimed at cutting costs and finding new sources of energy that could alter the economy in unforeseen ways.” In truth, this industry is already taking shape, fueled in part by crude oil and gasoline prices that have risen rapidly over the past few years.

This new industry is gaining momentum because of two of the most widespread fears in the world today: the fear of governments everywhere over their lack of energy security, and the fear of people everywhere over the health of the planet, best expressed in the wave of media interest in global warming. Chronically high prices plus pervasive geopolitical risk plus environmental fear equals a recipe for change, for a radical restructuring of the oil industry.

The Perfect Storm for Oil Price Spikes

In addition to rising worldwide demand for oil, the upward pressure on oil prices should be maintained over an extended period by the financial and psychological fallout from a number of confluent conditions such as:

- The rising cost of discovering, extracting, and refining crude oil;
- Increasing reliance on other hydrocarbon sources, such as coal and tar sands, that are more expensive to exploit;
- The growing concentration of America’s critical energy infrastructure in the hurricane-prone Gulf of Mexico;
- The political assessment that the “war on terror” is only in the first round;

- Rising demand in oil-producing countries that effectively reduces the amount of oil available for export; and
- Growing concern that conventional oil production may have peaked, or could soon.

Yet even under these circumstances, it is accepted that, with proper guidance, the new oil industry has the potential to solve many, if not most, of the world’s energy-related problems. Unfortunately, it will take time for these problems to be solved, if we are indeed capable of solving them — perhaps a decade or longer, though a lot depends on political and policy variables. Until that day, even with the world pumping as much crude as it can, it is unlikely we will be cured of our “pain at the pump.”

SLFs and Negaoil

In energy, every winning investment idea is first a winning political idea. While the present-day oil industry has one sector — conventional oil — in the new oil industry, conventional oil will be one of three sectors. The other two will be:

- Substitute liquid fuels (SLFs). This refers to fuels made both from biomass sources and from hydrocarbon sources other than crude oil.
- Efficiency. This refers not only to ways of getting more mileage out of a gallon of gasoline, but also to the use of electricity as a *nonliquid* alternative fuel, a “kilo-watt gasoline” made for vehicles now under development that will be capable of being plugged into an ordinary electrical outlet. Efficiency also refers to something called “negaoil,” an adaptation of a concept found in the electric utility industry called *negawatts*, which is a measurement of electricity not used as a result of efficiency improvements. Negaoil is used to describe the ways in which oil is not used, thanks to improved efficiency.



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Rebecca S. Clement, Publisher; Sarah T. Dayton, Editor In Chief; Athena Nicolaides; Art and Design, Robert J. Smith; Contributing Editor

While the three sectors in the new oil industry will complement one another, they will also need to compete with one another. The trick for government officials everywhere will be to encourage competition without losing the synergism that will come from having all three sectors working together toward the same goal.

Rising Price Potential of Natural Gas

Oil is not the only important fossil fuel whose price could skyrocket; the price of natural gas could do likewise. Looking out to 2010, it is believed natural gas prices will be vulnerable to “super spikes.” Thanks to a very mild winter in 2005–2006, the United States had a plentiful supply of available natural gas in 2006. However, with all of the increased demand from natural gas-fired power plants and with domestic production that has recently tread water, the shock of an extremely cold winter could send U.S. natural gas prices as high as \$15 to \$20 per thousand cubic feet, an amount equal to a \$90 to \$120 barrel of crude oil.

This forecast is important because the prices of oil and gas tend to influence each other. Also, thanks to what is called gas-to-liquids (GTL) technology, natural gas could become an important alternative to crude oil in the production of diesel and gasoline, though not until there is enough natural gas available and the threat of a super spike has been lifted.

What’s the Alternative?

Natural gas is not the only alternative fossil fuel that can be used to make what is often called “synthetic” oil; coal, tar sands and oil shale can be used, too, assuming price and supply conditions are right. Unlike natural gas, there does not appear to be a supply problem with these three. However, due to high extraction and refining costs, the three share the natural gas problem of being an expensive alternative to crude-derived gasoline.

The answers to the world’s oil problems remain at its feet — fuels that can substitute for gasoline made from crude oil, and new technologies that enable less gasoline to be consumed. Substitutes and efficiency are keys to long-term energy solutions.

Oil Consumption Abroad

While everyone tends to focus on the United States, China, and India when it comes to oil demand, they are only part of the world’s rising demand problem. Another important part of it is what is happening in the oil-producing countries. We’re used to thinking of OPEC as a source of oil. But in addition to exporting their oil around the world, OPEC’s members also must satisfy the

oil demands of their own people, which are surging due to expanding populations and subsidized gasoline prices.

It doesn’t take an economist to understand the implication of this rising trend in demand — the more an oil-producing country consumes at home, the less it has available for export, unless it ramps up production. In almost every case, this increased production is simply not possible. ●

Terrorists, Nationalists, and Shock Absorbers

It is said that the odds of a foreign oil disruption happening over the next 10 years are 80 percent. To absorb the oil price shock that would accompany such a disruption, investors should consider having “shock absorbers” in their portfolios. These shock absorbers will not enable investors to beat the odds — for the next five to 10 years, no amount of cushioning will prevent investors from taking a hit should the global flow of oil be interrupted for any length of time. But as the prices of one’s other investments are going down, shock absorbers should be able to hold their own.

How much one invests in shock absorbers depends on the exact nature and timing of the disruptive event, as well as the response to it. The condition of the economy at the time of a disruption is important, as well — if it is weak, the disruption is likely to lead to a recession that damages one’s other investments.

Countries to Keep an Eye On

The three countries that should cause investors to lose the most sleep are the three at the heart of much of our international policy conversation at present:

- **Iraq.** Whatever one’s opinion about whether American soldiers should have been sent to Iraq in the first place, if they leave Iraq in a chaotic state, the oil market will react badly. The U.S. military is the only thing preventing Iraq’s unpredictable neighbor, Iran, from establishing at least partial political dominance over the oil-rich nation.

- **Iran.** Tehran is doubly dangerous because it doesn’t just *want* Iraq’s oil; it *needs* Iraq’s oil. Due to steadily rising domestic demand and a plateau in production, the amount of oil the country has available for export is expected to drop sharply. Also, there may be no bigger geopolitical oil problem in the world today than Iran’s nuclear program. Tehran wants nuclear technology in the form of a bomb in order to cement its role as a global power broker, and it needs nuclear technology in the form of electricity to help offset the plateau in oil production.

• **Saudi Arabia.** Saudi Arabia's oil facilities are among the best-defended pieces of real estate on the planet, thanks in no small part to the United States military. If there is one thing the oil market is sure of, however, it is that it cannot be sure there will not be an attack on Saudi oil installations. It is an all-too-believable scenario that 10 percent of the world's oil supply would be taken off the world market for several months, resulting in an oil spike to \$125 a barrel, a gasoline spike to \$6 or \$7 a gallon, and a stock market crash. It could all happen before the U.S. military and Saudi security forces had time to respond.

As much as America's energy interests are at risk from the tactical threats posed by Iran and terrorism, they are at almost as much strategic risk from anti-U.S. nationalism emanating from countries like Venezuela, Russia and China. The danger here is the potential of a new cold war over energy supplies.

Defense is the Best Offense

While China, Russia and Venezuela can't be forgotten, investors need to stay focused on the danger to their portfolios posed by Iran and terrorism. So what are the best shock-absorbing investments to own?

One seemingly bulletproof investment would be defense stocks. Defense expert Milton Copulos mentions Lockheed Martin and Raytheon and adds that almost any defense company would be a good hedge against an oil price shock.

In 2006, the United States spent roughly \$2.70 per gallon—nearly as much as the summertime price of gasoline—to make sure its imported oil safely reached Americans' gas tanks. This is the hidden cost of America's gasoline, the price we all pay to protect shipping lanes and countries on whom we are increasingly dependent for our black gold.

Until America has licked its addiction to imported oil, defense companies warrant a spot on the list of companies to watch. Additionally, tank operators benefit in a world of pervasive geopolitical risk, in part because their ships can be used as floating storage terminals.

Transportation companies that move not just the oil but also the coal, corn and other energy feedstock will not be strategically important to the development of the new oil industry, but like infrastructure firms, nothing will be possible without them. ●

Substitute Liquid Fuels: Biofuel

Biofuel is really solar power in disguise — if the sun doesn't shine, there's no "bio" in biofuel. Think of it as

stored solar power, and think of solar power as the common denominator between mobile energy (cars and trucks) and stationary energy (homes and businesses). With the latter, the sun's rays are converted into electricity through solar panels and solar roofing shingles.

The Power of Ethanol

The main biofuel in the United States today is ethanol, and most ethanol is made from corn kernels. Corn ethanol is just a part of the first technological step in the development of what should be a global biofuel industry that greatly relieves the strain on crude oil supplies without doing as much environmental damage as driving on straight gasoline.

Ethanol, also known as ethyl alcohol or grain alcohol, is a tasteless, colorless chemical compound that has gone into alcoholic beverages for thousands of years. When blended with unleaded gasoline, ethanol increases the fuel's performance while decreasing harmful emissions. In 2006, all vehicles in the United States could run on a blend of 90 percent gasoline and 10 percent ethanol. About 5 percent of vehicles, called *flex-fuel* vehicles, could run on a blend of 15 percent gasoline to 85 percent ethanol (E85 fuel). U.S. automakers have committed to putting more E85-ready vehicles on the road.

Cellulosic Ethanol

By 2012, corn ethanol sales in the United States could be as much as 10 times higher than they were in 2006 — \$45-\$60 billion, as compared to \$6 billion. Its longer-term outlook, however, is more guarded. By 2012, or sooner, two other biofuels currently in development could challenge corn ethanol's market dominance in the United States. One is cellulosic ethanol and the other is biobutanol.

Cellulosic ethanol is ethanol made from the hard fibrous parts of plant matter. It can be made from wild grasses and from agricultural, wood or even municipal waste products. Unlike corn ethanol, which is made from a food crop, cellulosic ethanol can be made from stuff that has little or no economic value — switchgrass and other wild grasses, corn stalks, wood chips, even garbage.

Cellulosic ethanol comes with one significant problem, however — it cannot be transported through the United States' existing petroleum pipeline.

Biobutanol

Biobutanol is alcohol with a different chemical composition than ethanol that can be made from both grains and cellulose. Biobutanol can be transported through the existing petroleum pipeline.

DuPont and British Petroleum (BP) are currently conducting a project in Great Britain, aimed at raising the yield for the part of the biobutanol production process in which sugars are fermented into alcohol. If they succeed, the cost of producing biobutanol might be lowered to the point that a global production program could take off.

Aside from its aforementioned transportability, biobutanol possesses many attractive attributes:

- It has a higher energy density than ethanol, resulting in better engine performance that translates into better mileage.
- Ordinary vehicles should, without modifications, be able to run on a higher concentration of biobutanol to gasoline than ethanol to gasoline.
- It will be possible to make biobutanol either from grain or cellulose; thus, it will be possible to use food crops like corn up to their optimal point in terms of land use, while simultaneously using wild grasses grown on suboptimal farmland, plus all of the world's organic waste.
- Existing corn ethanol refineries can be retrofitted to make them biobutanol refineries.
- Biobutanol is an oxygenate, which means that it increases the level of oxygen in gasoline, improving combustion, which is good for the environment.

If the Dupont/BP project succeeds, the politics surrounding biobutanol could be fascinating to watch. It could hasten the end of corn ethanol's reign by being a flat-out superior fuel. Major oil companies will also have something to consider. While their initial reaction might be to fight the rise of biobutanol, seeing it as a threat, the more forward-thinking among them will see biobutanol's development for what it will likely be — one of the biggest opportunities ever to come down the road. ●

Substitute Liquid Fuels: Unconventional Fossil Fuels

Unconventional fossil fuels get their name from the fact that while gasoline can be made the conventional way (from the refining of crude oil), it also can be made unconventionally, from other fossil fuel sources. Tar sands, coal and oil shale all have hydrocarbons, just in solid form. These three, and also natural gas, can be turned into what may be called synthetic oil through processes that have long been considered too expensive to compete with crude oil.

An Unconventional Future?

It takes a lot of money (hundreds of millions or even billions of dollars per project) and really long lead times (5 to 10 years or longer) to build the infrastructure required for a new unconventional oil industry, such as tar sands. To justify the time and expense, tar sands and the other unconventional oils must be considered economically viable not just for a few years, but for a few decades or longer. The fact is, at least two out of the three solid fossil fuels oils — tar sands and coal — definitely have a future in the world, and the third, oil shale, eventually may too, in spite of obvious inefficiencies in extraction and refinement. What remains unclear is exactly how long of a future.

Why do they *definitely* have a future? Energy security is one of biofuel's selling points. But until scientists figure out things like how to genetically engineer microbes to increase productivity, synthetic gasoline will trump biogasoline as a “secure” transportation fuel. A case can be made that if a nation were to rely too heavily on biofuel, it would put itself in danger of using so much of its agricultural land to grow crops for energy that it would have to import more food, thereby risking becoming food insecure in order to become energy secure. No politician is going to be willing to take that risk.

Defense to the Rescue

When one considers how much the United States spends to ensure imported oil reaches its shores, it's easy to recognize that gasoline made from American coal or oil shale reserves — or from tar sands found in Canada — is not just an important way to boost the national security of the United States. Relatively speaking, it's also a financial bargain. Given the “war on terror” and the general state of the world today, the U.S. Department of Defense (DoD) is primed to spur the development of domestically available unconventional fossil fuels.

The military brass are said to be emphasizing alternatives that employ so-called Fischer-Tropsch (FT) technology, which uses a chemical reaction to convert carbon monoxide and hydrogen into liquid hydrocarbons after the gases have been generated by partial oxidation of coal or wood-based fuels. The same process can be used to directly convert natural gas into liquid hydrocarbons.

One especially active area of military research is synthetic jet fuel. The Air Force's ambitious goal is to have 50 percent of its aviation fuel come from alternative sources by 2016. It is interested in acquiring 100 million gallons of synthetic jet fuel by 2008. Initially, the Air

Summary: FUTURE ENERGY

Force is working with natural gas but has said that long term, it will use coal.

A point that investors should note is that the DoD could eventually use this sort of fuel in all branches of the military.

Coal — Hope for the Future?

Coal is rapidly becoming the world's "everyman" fuel, the resource probably best able to compensate for tightening supplies of the conventional oil and natural gas the world has long depended on to keep the wheels turning in many vitally important global industries such as plastics and chemicals.

One of the greatest governmental challenges of the next half-century will be figuring out how to use coal without poisoning the environment. It's a challenge that includes tar sands and oil shale. Given the urgency of the situation, it is hard to believe how slowly Washington is proceeding on a project to demonstrate that coal can be used cleanly to generate electricity. At present, the United States has no requirements for controlling carbon emissions from fossil fuel sources, the Bush administration having opted for a voluntary approach that environmentalists say will be devastating because it will permit an entire new generation of coal-fired power plants to be built without carbon capture technology.

Instead, companies such as General Electric have taken the lead in clean development, transport and storage of carbon byproducts. The timing of these efforts is significant — globally today, fossil-fuel power generation accounts for roughly 40 percent of man-made carbon dioxide emissions. When a Chinese-led global CTL industry kicks into gear sometime in the next decade, those emissions from coal could get even worse. ●

The Power of Efficiency

Depending on whom you ask, in 2006 plug-in hybrid automotive technology either was ready to go immediately, close to a breakthrough that would make it ready, or still in need of considerable development.

There was, however, a common thread — that plug-in hybrids *are coming*. There appear to be any number of companies in the running to develop a PHEV40, a plug-in hybrid electric vehicle that can go the first 40 miles on electricity before having to switch over to a liquid fuel. However, plug-in advocates have had to fight the perception that people generally drive long distances on a daily basis. Citing federal and other statistics, plug-in proponents have argued that four out of five personal automobiles on the road travel 50 miles a day or less.

Such statistics, on the surface, seem to underestimate the number of miles the average car travels on a daily basis in at least some of America's fast-growing cities, like Phoenix and Atlanta. It also may not give sufficient weight to the growing number of commuters who regularly travel 90 minutes or more each way to get to and from work.

Regardless, plug-in hybrid vehicles have the potential to make it possible for people to not use gasoline.

In the absence of a clear and coherent government policy for incorporating plug-ins (not to mention biofuel) into America's transportation system, there could be more frequent oil price gyrations as traders face the new uncertainty of trying to predict how much gasoline Americans are going to consume in their cars and trucks, versus how much electricity and how much cellulose and grains. Planning must extend to global commodities markets, for in the new oil industry, there will be unprecedented linkage between agricultural and energy commodities. ●

Every Drop of Oil We Can Get Is Important

In 2005, the world used 30 billion barrels of oil and 5 billion new barrels were found. Compare that with 1964, when 48 billion barrels were found and only 15 billion were used. According to energy investment analyst Charley Maxwell, 1964 was the best year in terms of the ratio of oil discovered versus oil consumed. The two lines crossed in 1988 at 23 billion barrels, and ever since then the world has been using more oil than it has replaced through new discoveries.

Don't expect new oil field technology to save the day. While there have been many major breakthroughs over the last 35 years, when you add them up, they have not been enough to keep supply comfortably ahead of demand. However, oil field technology could make a difference in how much more oil the world might be able to recover.

Enhanced Oil Recovery

The two basic technologies involved in enhanced oil recovery (EOR) have been around for many years. One approach uses thermal heat to thin heavy oil, so that it flows more easily to the surface. The other, more widely used approach employs primarily carbon dioxide to force "stranded" oil to the surface. This technique makes it technically possible to recover an estimated 89 billion barrels of stranded oil in the United States. It should be noted that these are *potential* reserves.

Moreover, historically EOR has been hampered by its relatively high cost. Indeed, however much more oil might be pushed up by EOR, it takes so much energy to

do the job that it doesn't take very long before the cost of recovering the oil is equal to the value of the oil itself.

Other Drilling Frontiers

The Gulf of Mexico, Africa and Brazil, considered the "Golden Triangle," are the primary sites for deepwater drilling, or drilling in wells located in more than 1,000 feet of water. As more explorers go down farther in search of oil (the technical limit in the Gulf of Mexico is said to be around 12,000 feet), the cost of deepwater drilling keeps increasing. By one estimate, the average day-rate on deepwater units in the Gulf of Mexico capable of drilling in water depths of 6,000 feet or deeper increased 118 percent in the second quarter of 2006.

Deepwater is not the only frontier that is going to be explored to a much greater degree in the new oil industry. The areas north of the Arctic Circle are becoming more accessible as global warming shrinks the polar ice cap. It is easier to get at what, by some estimates, could be as much as 25 percent of the remaining oil and natural gas reserves. It is also a controversial area, due to environmentalists' objections and the question of who owns what with Russia, Canada, Norway, the United States and others all trying to stake their claims. ●

The New Oil Economy?

America has two energy futures from which to choose — one a future of limitations, the other a future of possibilities. As much as the present-day oil industry is a drain on the overall economy, the new oil industry could be a stimulant. Eliminate some of the hidden cost of gasoline, and you would free up billions of dollars a year that the government could spend on other priorities.

If people were willing to accept a new layer of government bureaucracy in their lives, the new oil industry just might be able to reduce energy consumption across the board — natural gas and electricity, as well as oil, at home and on the road — and do so while putting money in people's pockets.

For the new oil industry to pay off over the next 10 to 20 years to the fullest extent possible for nations and investors alike, the public needs to feel in the driver's seat. People must be able to literally take something to the bank.

The TGR System

Martin Feldstein, noted scholar and CEO of the National Bureau of Economic Research, has suggested creating a system he calls *tradable gasoline rights* (TGRs). In his system:

- Every adult would get a TGR debit card, using it in combination with money to pay for gasoline. Businesses that use trucks would also get allotments. A gallon of gas would cost one TGR.

- The government would determine the total number of gallons consumed by the nation per year and would give out that total number of TGRs.

- These rights would be tradable — people with more TGRs than they need could sell the excess, while those who want more than their allocation would have to buy extra TGRs.

- The gasoline companies would act as clearing houses for these trades, using their pumps. Banks could also trade TGRs for cash. Individuals could buy and sell TGRs among themselves by letting others use their card.

- The market price of a TGR would depend on the number distributed by the government. The smaller the number of TGRs, the greater the price of each TGR.

- TGRs could be distributed in a way that actually raises the income of a majority of households while giving everyone an incentive to reduce gasoline consumption. In a way, TGRs would put monetary value on gasoline not used—on negaoil.

The TGR idea is not as outrageous as it might at first sound. In Great Britain, ideas are already being discussed for what some have described as a "carbon credit card" system, under which the government would give everyone a carbon allotment. People whose carbon footprint exceeded their allotment (by driving a gas-guzzling vehicle, for example) would have to buy points from people who kept their footprint to a minimum. Both the British and TGR approach cut pollution and encourage conservation.

Given the global nature of energy, there is every reason to believe that TGRs would not only work, but also become a global phenomenon.

Final Thoughts

Major oil companies may not want to change, but change in the form of new technology has started to be thrust upon them.

Conventional oil production — crude oil — will continue to be a vital part of the world's energy mix for years to come. But it will be one of a number of sectors that will need to both compete with and complement one another. It will be the job of government to come up with a strategy that does that; that hits the trifecta of energy security and environmental friendliness at a reasonable price. It will be the task of investors to follow the new oil industry where technology and politics take it. ●

Summary: FUTURE ENERGY

100 Companies to Watch

Here are 100 companies (plus two overall businesses) that have great potential for influence in the “new” oil industry.

Category 1: Biobutanol

Technology

- Dupont

Category 2: Ethanol and Biodiesel Technology

- Ceres
- Dyadic International
- Genencor International
- Imperium Renewables
- Iogen
- Neste Oil
- Novozymes
- SunOpta

Category 3: Battery Technology

- A123 Systems
- Altair Nanotechnologies
- EESor
- Johnson Controls
- Valence Technology

Category 4: Automotive Efficiency

- Toyota
- Honda
- Volkswagen

Category 5: Investment Bankers

- British Petroleum
- Chevron
- Exxon/Mobil
- Shell
- Goldman Sachs
- Lehman
- JP Morgan
- Merrill Lynch

Category 6: Coal Technology

- GreatPoint Energy
- Rentech
- Saso
- Syntroleum

Category 7: Synthetic Oil and LNG Providers

- Arch
- Canadian Natural Resources
- CONSOL
- EnCana
- Peabody
 - Suncor
- Woodside Petroleum

Category 8: Biofuel Production

- Aventine Renewable Energy
- Abengoa
- Archer Daniels Midland
- Dynamotive Energy Systems
- Pacific Ethanol
- VeraSun Energy

Category 9:

Infrastructure Providers

- ABB
- AMCOL International
- Cheniere
- Chicago Bridge & Iron
- Daewoo Shipbuilding
- Diamond Offshore Drilling
- ENSCO
- Fluor
- Foster Wheeler
- General Electric
- GlobalSantaFe
- Grand Prideco
- Halliburton
- Hydril
- Hyundai Heavy Industries
- Jacobs Engineering
- McDermott
- Samsung Heavy Industries
- Schlumberger
- Shaw Group
- Smith International
- Tetra Technologies
- Todco
- Transocean
- Weatherford International

Category 10:

Transportation Providers

- Burlington Northern
- Canadian National

- Canadian Pacific
- CSX
- Frontline
- Norfolk Southern
- OMI Corporation
- Overseas Shipholding
- Teekay
- Union Pacific

Category 11: Oil Producers

- Apache
- Anadarko Petroleum
- EOG Resources
- Imperial Oil
- Lukoil
- Petrobras
- Talisman Energy

Category 12: Alternative Transportation Providers

- Flexcar
- Tesla Motors
- Zipcar
- ZAP

Category 13: Consumer Information Providers

- Alternative Energy Store
- CalCars.org
- Google
- Home Depot
- Lowe's
- Wireless providers (any)

Category 14: Nonliquid Fuel Providers

- Constellation Energy
- Exelon
- Nanosolar
- NRG
- PSEG
- Sharp
- Suntech Power Holdings

Category 15: Defense Companies

- None stand out above the rest, but all should do well.

Note: this list is presented for information purposes only.

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Summary



Predictably Irrational

The Hidden Forces That Shape Our Decisions

THE SUMMARY IN BRIEF

When it comes to making decisions in our lives, we think we're in control. We think we're making smart, rational choices. But are we?

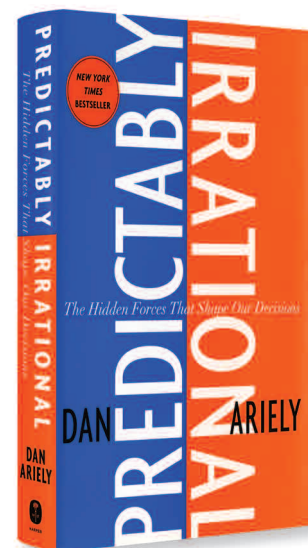
In a series of illuminating, often-surprising experiments, Duke psychologist and behavioral economist Dan Ariely refutes the common assumption that we behave in fundamentally rational ways. Blending everyday experience with groundbreaking research, *Predictably Irrational* explains how expectations, emotions, social norms and other invisible, seemingly illogical forces skew our reasoning abilities.

Not only do we make astonishingly simple mistakes every day, but we make the same *types* of mistakes, and we make them over and over. We consistently overpay, underestimate and procrastinate. We fail to understand the profound effects of our emotions on what we want, and we overvalue what we already own. Yet these misguided behaviors are neither random nor senseless. They're systematic and predictable — making us *predictably* irrational.

Predictably Irrational explains how to break through systematic patterns of thought to make better decisions. It also changes the way we interact with the world — one small decision at a time.

IN THIS SUMMARY, YOU WILL LEARN:

- Why we splurge on a meal but cut coupons to save cents on a can of soup.
- Why everything is relative, even when it shouldn't be.
- Why options distract us from our main objective.
- Why our headaches persist after taking a one-cent aspirin but disappear after taking a 50-cent aspirin.
- Why we are dishonest and what we can do about it.
- Why dealing with cash makes us more honest.



by Dan Ariely

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THE COMPLETE SUMMARY: PREDICTABLY IRRATIONAL

by Dan Ariely

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Introduction

We are not only irrational, but *predictably irrational* — our irrationality happens the same way, again and again. Whether we are acting as consumers, businesspeople or policy makers, understanding how we are predictably irrational provides a starting point for improving our decision making and changing the way we live for the better.

Life is complex, with multiple forces simultaneously exerting their influences on us, and this complexity makes it difficult to figure out exactly how each of these forces shapes our behavior. Social scientists approach such complex problems by carrying out experiments. For social scientists, experiments are like microscopes or strobe lights. They help us slow human behavior to a frame-by-frame narration of events, isolate individual forces, and examine those forces carefully and in more detail. They let us test directly and unambiguously what makes us tick.

Think about the experiments as illustrations of general principles, providing insight into how we think and how we make decisions — not only in the context of the particular experiment but, by extrapolation, in many contexts of life.

On top of that, try to consider whether the principles revealed in these experiments might make your life better or worse, and more important, what you could do differently, given your new understanding of human nature. This is where the real adventure lies. ●

The Truth About Relativity

Here is an example of the problem of relativity from a

study conducted by two brilliant researchers, Amos Tversky and Daniel Kahneman.

Suppose you have two errands to run today. The first is to buy a new pen, and the second is to buy a suit for work. At an office supply store, you find a nice pen for \$25. You are set to buy it when you remember that the same pen is on sale for \$18 at another store 15 minutes away. What would you do? Do you decide to take the 15-minute trip to save the \$7? Most people faced with this dilemma say they would take the trip to save the \$7.

Now you are on your second task: You're shopping for your suit. You find a luxurious gray pinstripe suit for \$455 and decide to buy it, but then another customer whispers in your ear that the exact same suit is on sale for only \$448 at another store just 15 minutes away. Do you make this second 15-minute trip? In this case, most people say that they would not.

But what is going on here? Is 15 minutes of your time worth \$7, or isn't it? In reality, of course, \$7 is \$7 — no matter how you count it. The only question you should ask yourself in these cases is whether the trip across town, and the 15 extra minutes it would take, is worth the extra \$7 you would save. Whether the amount from which this \$7 will be saved is \$10 or \$10,000 should be irrelevant. But this is not how we view our financial decisions.

This is the problem of relativity — we look at our decisions in a relative way and compare them locally to the available alternative. We compare the relative advantage of the cheap pen with the expensive one, and this contrast makes it obvious to us that we should spend the extra time to save the \$7. At the same time, the relative advantage of the cheaper suit is very small, so we spend the extra \$7.



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This is also why it is so easy for a person to add \$200 to a \$5,000 catering bill for a soup course, when the same person will clip coupons to save 25 cents on a \$1 can of condensed soup. Similarly, we find it easy to spend \$3,000 to upgrade to leather seats when we buy a new \$25,000 car but difficult to spend the same amount on a new leather sofa (even though we know we will spend more time at home on the sofa than in the car). Yet if we just thought about this from a broader perspective, we could better assess what we could do with the \$3,000 that we are considering spending on upgrading the car seats. Would we perhaps be better off spending it on books, clothes or a vacation? Thinking broadly like this is not easy, because making relative judgments is the natural way we think. Can you get a handle on it?

The more we have, the more we want. And the only cure is to break the cycle of relativity. ●

The Fallacy of Supply and Demand

Traditional economics assumes that prices of products in the market are determined by a balance between two forces: production at each price (supply) and the desires of those with purchasing power at each price (demand). The price at which these two forces meet determines the prices in the marketplace.

This is an elegant idea, but it depends on the central assumption that the two forces are independent and that together they produce the market price. The results of many recent experiments challenge these assumptions.

First, according to the standard economic framework, consumers' willingness to pay is one of the two inputs that determine market prices (this is the demand). But as those experiments demonstrate, what consumers are willing to pay can easily be manipulated, and this means that consumers don't, in fact, have a good handle on their own preferences and the prices they are willing to pay for different goods and experiences.

Second, whereas the standard economic framework assumes that the forces of supply and demand are independent, the anchoring manipulations suggest that they are, in fact, dependent. In the real world, anchoring comes from manufacturer's suggested retail prices (MSRPs), advertised prices, promotions, product introductions, etc. — all of which are supply-side variables. It seems then that instead of consumers' willingness to pay influencing market prices, the causality is somewhat reversed, and it is market prices themselves that influence consumers' willingness to pay. What this means is

The End of Cash?

The days of cash are coming to a close. Profits from credit cards in the United States rose from \$9 billion in 1996 to a record \$27 billion in 2004. The question, therefore, is how we can control our tendency to cheat when we are brought to our senses only by the sight of cash — and what we can do now that cash is going away.

that demand is not, in fact, a completely separate force from supply, and the prices in the marketplace are not rational or optimal. ●

The Cost of Zero Cost

It's no secret that getting something for free feels very good. Zero is not just another price, it turns out. Zero is an emotional hot button — a source of irrational excitement. Would you buy something if it were discounted from 50 cents to 20 cents? Maybe. Would you buy it if it were discounted from 50 cents to two cents? Maybe. Would you grab it if it were discounted from 50 cents to zero? You bet!

When choosing between two products, we often overreact to the free one. We might opt for a FREE! checking account (with no benefits attached) rather than one that costs \$5 a month. But if the \$5 checking account includes free traveler's checks, online billing, etc., and the FREE! one doesn't, we may end up spending more for this package of services with the FREE! account than with the \$5 account. Similarly, we might choose a mortgage with no closing costs but with interest rates and fees that are off the wall, and we might get a product we don't really want simply because it comes with a free gift.

Zero is not just another discount. Zero is a different place. The difference between two cents and one cent is small. But the difference between one cent and zero is huge!

If you are in business, and understand that, you can do some marvelous things. Want to draw a crowd? Make something FREE! Want to sell more products? Make part of the purchase FREE!

Similarly, we can use FREE! to drive social policy. Want people to drive electric cars? Don't just lower the registration and inspection fees — eliminate them so that you have created FREE! In the same way, if health is your concern, focus on early detection as a way to eliminate the progression of severe illnesses. Want people

Summary: PREDICTABLY IRRATIONAL

to do the right thing — in terms of getting regular colonoscopies, mammograms, cholesterol checks, diabetes checks and such? Don't just decrease the cost (by decreasing the co-pay). Make these critical tests FREE!

It's certainly counterintuitive in these times of budget cutbacks to make something FREE! But when we stop to think about it, FREE! can have a great deal of power, and it makes a lot of sense. ●

The Cost of Social Norms

If companies want to benefit from the advantages of social norms, they need to do a better job of cultivating those norms. Medical benefits, and in particular comprehensive medical coverage, are among the best ways a company can express its side of the social exchange. But what are many companies doing? They are demanding high deductibles in their insurance plans and at the same time are reducing the scope of benefits. Simply put, they are undermining the social contract between the company and the employees and replacing it with market norms. As companies tilt the board, and employees slide from social norms to the realm of market norms, can we blame them for jumping ship when a better offer appears? It's really no surprise that "corporate loyalty," in terms of the loyalty of employees to their companies, has become an oxymoron.

If corporations started thinking in terms of social norms, they would realize that these norms build loyalty and — more important — make people want to extend themselves to the degree that corporations need today: to be flexible, concerned and willing to pitch in. That's what a social relationship delivers.

Social Norms in the Workplace

This question of social norms in the workplace is one we should be thinking about frequently. America's productivity depends increasingly on the talent and efforts of its workers. Could it be that we are driving business from the realm of social norms into market norms? Are workers thinking in terms of money, rather than the social values of productivity, loyalty and trust?

At some level, we all know the answers. We understand, for instance, that a salary alone will not motivate people to risk their lives. Police officers, firefighters, soldiers — they don't die for their weekly pay. It's the social norms — pride in their profession and a sense of duty — that will motivate them to give up their lives and health. ●

The Influence of Arousal

Looking from an emotional state to a non-emotional state (and the other way around) is difficult. It's not always possible; and it can be painful. But to make informed decisions we need to somehow experience and understand the emotional state we will be in at the other side of the experience. Learning how to bridge this gap is essential to making some of the important decisions of our lives.

We need to explore the two sides of ourselves; we need to understand the cold state and the hot state; we need to see how the gap between the hot and cold states benefits our lives and where it leads us astray.

What do the experiments suggest? That our models of human behavior need to be rethought. Perhaps there is no such thing as a fully integrated human being. We may, in fact, be an agglomeration of multiple selves. Although there is nothing much we can do to get our Dr. Jekyll to fully appreciate the strength of our Mr. Hyde, perhaps just being aware that we are prone to making the wrong decisions when gripped by intense emotion may help us apply our knowledge of our "Hyde" selves to our daily activities. ●

The Problem of Procrastination and Self-Control

Although almost everyone has problems with procrastination, those who recognize and admit their weakness are in a better position to utilize available tools for pre-commitment and, by doing so, help themselves overcome it.

Resisting temptation and instilling self-control are general human goals, and repeatedly failing to achieve them is a source of much of our misery. When we look around, we see people trying their best to do the right thing, whether they are dieters vowing to avoid a tempting dessert tray or families vowing to spend less and save more. The struggle for control is all around us. We see it in books and magazines. Radio and television airwaves are choked with messages of self-improvement and help.

And yet, for all this electronic chatter and focus in print, we find ourselves again and again in the same predicament as many students — failing over and over to reach our long-term goals. Why? Because without pre-commitments, we keep on falling for temptation.

An Opportunity to Commit

What's the alternative? Of course, barking orders,

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while very effective, may not always be feasible or desirable. What's a good compromise? It seems that the best course might be to give people an opportunity to commit upfront to their preferred path of action. This approach might not be as effective as the dictatorial treatment, but it can help push us in the right direction (perhaps even more so if we train people to do it and give them experience in setting their own deadlines).

What's the bottom line? We have problems with self-control, related to immediate and delayed gratification — no doubt there. But each of the problems we face has potential self-control mechanisms as well. If we can't save from our paycheck, we can take advantage of our employer's automatic deduction option; if we don't have the will to exercise regularly alone, we can make an appointment to exercise in the company of our friends. These are the tools that we can commit to in advance, and they may help us be the kind of people we want to be. ●

The High Price of Ownership

Ownership pervades our lives and, in a strange way, shapes many of the things we do. Adam Smith wrote, "Every man [and woman] ... lives by exchanging, or becomes in some measure a merchant, and the society itself grows to be what is properly a commercial society."

Much of our life story can be told by describing the ebb and flow of our particular possessions — what we get and what we give up. We buy clothes and food, automobiles and homes, for instance. And we sell things as well — homes and cars and, in the course of our careers, our time.

Ownership also has peculiarities. For one, the more work you put into something, the more ownership you begin to feel for it. Think about the last time you assembled some furniture. Figuring out which piece goes where and which screw fits into which hole boosts the feeling of ownership.

Another peculiarity is that we can begin to feel ownership even before we own something. "Virtual ownership," of course, is one mainstay of the advertising industry. We see a happy couple driving down the California coastline in a BMW convertible, and we imagine ourselves there. We get a catalog of hiking clothing from Patagonia, see a polyester fleece pullover and — poof — we start thinking of it as ours. The trap is set, and we willingly walk in. We become partial owners even before we own anything.

Ownership is not limited to material things. It can also apply to points of view. Once we take ownership of an

idea — whether it's about politics or sports — what do we do? We love it perhaps more than we should. We prize it more than it is worth. And most frequently, we have trouble letting go of it because we can't stand the idea of its loss. What are we left with then? An ideology — rigid and unyielding.

There is no known cure for the ills of ownership. As Adam Smith said, it is woven into our lives. But being aware of it might help. Everywhere around us is the temptation to improve the quality of our lives by buying a larger home, a second car, a new dishwasher, a lawn mower and so on. But once we change our possessions, we have a very hard time going back down.

A Change in Perspective

Ownership simply changes our perspective. Suddenly, moving backward to our pre-ownership state is a loss, one that we cannot abide. One approach is to try to view all transactions (particularly large ones) as if you were a non-owner, putting some distance between yourself and the item of interest. ●

Keeping Doors Open

Running helter-skelter to keep doors from closing is a fool's game. It will not only wear out our emotions but also wear out our wallets. What we need is to consciously start closing some of our doors. Small doors, of course, are rather easy to close. We can easily strike names off our holiday card lists or omit tae kwon do from our daughter's string of activities.

But the bigger doors (or those that seem bigger) are harder to close. Doors that just might lead to a new career or to a better job might be hard to close. Doors that are tied to our dreams are also hard to close. So are relationships with certain people — even if they seem to be going nowhere.

The Importance of Shutting Doors

We have an irrational compulsion to keep doors open. It's just the way we're wired. But that doesn't mean we shouldn't try to close them.

We need to drop out of committees that are a waste of our time and stop sending holiday cards to people who have moved on to other lives and friends. We need to determine whether we really have time to watch basketball and play both golf and tennis and keep our family together; perhaps we should put some of these sports behind us. We ought to shut these doors because they draw energy and commitment away from the doors that should be left open, and because they drive us crazy. ●

The Effect of Expectations

Suppose you're a fan of the Philadelphia Eagles and you're watching a football game with a friend who grew up in New York City and is a rabid fan of the Giants.

An Eagles wide receiver near the corner of the end zone dives for the ball and makes a spectacular catch. But wait. Did the receiver get both of his feet in? It looks close on the Jumbotron so the booth calls down for a review. You turn to your friend and say, "Look at that! What a great catch!" Your friend scowls. "That was completely out! I can't believe the ref didn't see it!"

What just happened? Was your friend the Giants fan just experiencing wishful thinking? Was he deceiving himself? Worse, was he lying? Or had his loyalty to his team — and his anticipation of its win — completely, truly and deeply clouded his judgment?

Expectations can influence nearly every aspect of our lives.

Expectations enable us to make sense of a conversation in a noisy room, despite the loss of a word here and there, and likewise to be able to read text messages on our cell phones despite the fact that some of the words are scrambled. And although expectations can make us look foolish from time to time, they are also very powerful and useful.

Expectations also shape stereotypes. A stereotype, after all, is a way of categorizing information, in the hope of predicting experiences. The brain cannot start from scratch at every new situation. It must build on what it has seen before.

The Influence of Biased Processes

So what about the two football fans and the game-winning pass? Although both friends were watching the same game, they were doing so through markedly different lenses. One saw the pass as in bounds. The other saw it as out. In sports, such arguments are not particularly damaging — in fact, they can be part of the fun. The problem is that these same biased processes can influence how we experience other aspects of our world. These biased processes are, in fact, a major source of escalation in almost every conflict, whether Israeli-Palestinian, American-Iraqi, Serbian-Croatian or Indian-Pakistani.

In all these conflicts, individuals from both sides can read similar history books and even have the same facts taught to them, yet it is very unusual to find individuals who would agree about who started the conflict, who is to blame, who should make the next concession, etc. In such matters, our investment in our beliefs is much

stronger than any affiliation to sport teams, and so we hold on to these beliefs tenaciously. Thus the likelihood of agreement about "the facts" becomes smaller and smaller as personal investment in the problem grows. This is clearly disturbing.

But there's reason for hope. If we acknowledge that we are trapped within our perspective, which partially blinds us to the truth, we may be able to accept the idea that conflicts generally require a neutral third party — who has not been tainted with expectations — to set down the rules and regulations. Of course, accepting the word of a third party is not easy and not always possible. But when it is possible, it can yield substantial benefits. And for that reason, we must continue to try. ●

The Power of Price

Can the price of a drug affect our response to it? Does an expensive drug make us feel better than a cheaper drug does?

Imagine that you're taking part in an experiment to test the efficacy of a new painkiller called Veladone-Rx. (The actual experiment involved about 100 adult Bostonians, but for now we'll let you take their place.)

You arrive at the MIT Media Lab in the morning. Taya Leary, a young woman wearing a crisp business suit, greets you warmly, with a hint of a Russian accent. A photo ID identifies Taya as a representative of Vel Pharmaceuticals. She invites you to spend a moment reading a brochure about Veladone-Rx. "Veladone is an exciting new medication in the opioid family," you read. "Clinical studies show that over 92 percent of patients receiving Veladone in double-blind controlled studies reported significant pain relief within only 10 minutes, and that pain relief lasted up to eight hours." And how much does it cost? According to the brochure, \$2.50 for a single dose.

Once you finish reading the brochure, Taya calls in Rebecca Waber and leaves the room. Rebecca then hooks you up to a complicated machine. This is an electrical shock generator, she explains, and it is how we will test your perception and tolerance of pain.

She administers a set of charges that fluctuate randomly in intensity: Some are very painful and some merely irritating. Following each one, you are asked to record, using the computer in front of you, the amount of pain you felt.

When this part of the torture ends, you look up. Rebecca is standing before you with a Veladone capsule in one hand and a cup of water in the other. "It will

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take about 15 minutes for the drug to reach its maximal effect,” she says.

Fifteen minutes later you’re hooked up to the machine again, and the shocks begin. The pain doesn’t feel nearly as bad.

Indeed, that’s what most participants found. Almost all of them reported less pain when they experienced the electrical shocks under the influence of Veladone. Very interesting — considering that Veladone was just a capsule of vitamin C.

Price and the Placebo Effect

From this experiment, we saw that our capsule did have a placebo effect. But suppose we priced the Veladone differently. Suppose we discounted the price of the capsule of Veladone-Rx from \$2.50 to just 10 cents. Would our participants react differently?

In our next test, we changed the brochure, scratching out the original price (\$2.50 per pill) and inserting a new discount price of 10 cents. Did this change our participants’ reaction? Indeed. At \$2.50 almost all our participants experienced pain relief from the pill. But when the price was dropped to 10 cents, only half of them did.

Moreover, it turns out that this relationship between price and placebo effect was not the same for all participants, and the effect was particularly pronounced for people who had more experience with recent pain. In other words, for people who had experienced more pain, and thus depended more on pain medications, the relationship was more pronounced: They got even less benefit when the price was discounted. When it comes to medicines, then, we learned that you get what you pay for. Price can change the experience. ●

The Context of Our Character

Adam Smith reminded us that honesty really is the best policy, especially in business.

What can we do to keep our country honest? We can read the Bible, the Koran or whatever reflects our values, perhaps. We can revive professional standards. We can sign our names to promises that we will act with integrity. Another path is to first recognize that when we get into situations where our personal financial benefit stands in opposition to our moral standards, we are able to “bend” reality, see the world in terms compatible with our selfish interest and become dishonest. What is the answer, then? If we recognize this weakness, we can try to avoid such situations from the outset. We can prohibit physicians from ordering tests that would bene-

fit them financially, we can prohibit accountants and auditors from functioning as consultants to the same companies, we can bar members of Congress from setting their own salaries, and so on.

We have learned that given a chance, many people cheat. But what’s really odd is that we don’t understand what causes people to cheat more or less. For example, when we asked students in another experiment to predict if people would cheat more for tokens (that could later be converted into money) than for cash, the students predicted that the amount of cheating would be the same. After all, they explained, the tokens represented real money and the tokens were exchanged within seconds for actual cash. And so, they predicted, our participants would treat the tokens as real cash.

But how wrong they were! They didn’t see how fast we can rationalize our dishonesty when it is one step away from cash. Of course, their blindness is ours as well. Perhaps it’s why so much cheating goes on, why Jeff Skilling (former president of Enron), Bernie Ebbers (former CEO of WorldCom) and the entire roster of executives who have been prosecuted in recent years let themselves, and their companies, slide down the slope.

All of us are vulnerable to this weakness. Think about all the insurance fraud that goes on. It is estimated that when consumers report losses on their homes and cars, they creatively stretch their claims by about 10 percent.

When We Deal With Cash

Isn’t cash strange? When we deal with money, we are primed to think about our actions as if we had just signed an honor code (which we found out reduces the tendency to cheat). Money is a clear unit of exchange. It’s hard to say that a dime is not a dime, or a buck isn’t a buck. But look at the latitude we have with nonmonetary exchanges. There’s always a convenient rationale. We can take a pencil from work, a Coke from the fridge — we can even backdate our stock options — and find a story to explain it all. We can be dishonest without thinking of ourselves as dishonest. We can steal while our conscience is apparently fast asleep.

How can we fix this? We could label each item in the supply cabinet with a price, for instance, or use wording that explains stocks and stock options clearly in terms of their monetary value. But in the larger context, we need to wake up to the connection between nonmonetary currency and our tendency to cheat. We need to recognize that once cash is a step away, we will cheat by a factor bigger than we could ever imagine. ●

Beer and Free Lunches

Does the sequential process of taking orders at a pub (asking each person in turn to state his or her order) influence the choices that the people sitting around the table ultimately make? In other words, are the patrons influenced by the selections of others around them?

Would the patrons sitting around a table intentionally choose beers that were different from or the same as the choices of those ordering before them? And finally, would those influenced by the choices of those ordering before them be better or worse off in terms of how much they enjoyed their beer?

To get to the bottom of the sudsy barrel of questions that they thought of at the Carolina Brewery, Jonathan Levav (a professor at Columbia) and author Dan Ariely decided to plunge in — metaphorically, of course.

Ordering Out Loud vs. Privately

What happened? They found that when people order out loud in sequence, they choose differently from when they order in private. When ordering sequentially (publicly), they order more types of beer per table — in essence opting for higher variety.

Overall, those who made their choices out loud, in the standard way that food is ordered at restaurants, were not as happy with their selections as those who made their choices privately, without taking others' opinions into consideration. There was, however, one very important exception: The first person to order beer in the group that made its decisions out loud was *de facto* in the same condition as the people who expressed their opinion privately, since he or she was unencumbered, in choosing, by other people's choices. Accordingly, they found that the first person to order beer in the sequential group was the happiest of his or her group and just as happy as those who chose their beers in private.

From this experiment, you can see that a bit of simple life advice — a free lunch — comes out of this research. First, when you go to a restaurant, it's a good idea to plan your order before the waiter approaches you, and stick to it. Being swayed by what other people choose might lead you to choose a worse alternative.

If you're afraid that you might be swayed anyway, a useful strategy is to announce your order to the table before the waiter comes. That way, you have staked a claim to your order, and it's less likely that the other people around the table will think you are not unique, even if someone else orders the same dish before you get your chance. But the best option is to order first.

The Perception of Power

One main lesson from the research is that we are pawns in a game whose forces we largely fail to comprehend. We usually think of ourselves as sitting in the driver's seat, with ultimate control over the decisions we make and the direction our life takes, but alas, this perception has more to do with our desires — with how we want to view ourselves — than with reality.

Many forces (emotions, relativity, social norms, etc.) influence our behavior. And while these influences exert a lot of power over our behavior, our natural tendency is to vastly underestimate or completely ignore this power. These influences have an effect on us not because we lack knowledge, lack practice or are weak-minded. On the contrary, they repeatedly affect experts as well as novices in systematic and predictable ways. The resulting mistakes are simply how we go about our lives, how we “do business.” They are a part of us.

The Way We Make Decisions

Our visual and decision environments are filtered to us courtesy of our eyes, our ears, our senses of smell and touch, and the master of it all, our brain. By the time we comprehend and digest information, it is not necessarily a true reflection of reality. Instead, it is our representation of reality, and this is the input we base our decisions on. In essence we are limited to the tools nature has given us, and the natural way in which we make decisions is limited by the quality and accuracy of these tools.

A second main lesson is that although irrationality is commonplace, it does not necessarily mean that we are helpless. Once we understand when and where we may make erroneous decisions, we can try to be more vigilant, force ourselves to think differently about these decisions or use technology to overcome our inherent shortcomings. This is also where businesses and policy makers could revise their thinking and consider how to design their policies and products so as to provide free lunches. ●

RECOMMENDED READING LIST

If you liked *Predictably Irrational*, you'll also like:

1. **The Upside of Irrationality** by Dan Ariely. Focusing on our behaviors at work and in relationships, Ariely offers new insights about what really motivates us on the job, how unwise actions can become long-term habits, and more.
2. **Buyology** by Martin Lindstrom. What truly influences our decisions in today's message-cluttered world? Lindstrom presents the astonishing findings from his groundbreaking neuromarketing study.
3. **Multipliers** by Liz Wiseman with Greg McKeown. Are you a genius or a genius maker? Learn how to become a multiplier of talent and people.

· Book 21 of 32 ·

Summary



Where They Will Be Fought And How They Will Be Won **The Coming China Wars**

THE SUMMARY IN BRIEF

China's breakneck industrialization is placing it on a collision course with the entire world. Tomorrow's China Wars will be fought over everything from decent jobs, livable wages and leading-edge technologies to strategic resources such as oil, copper and steel ... even food, water and air.

In this summary, best-selling author Peter Navarro previews all of these potential conflicts — and reveals the urgent, radical decisions that must be made to avoid catastrophe.

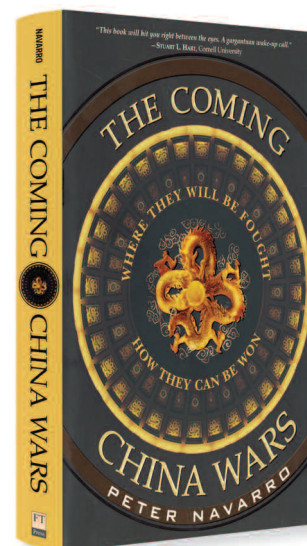
You'll discover China's shocking role in the drug trade and how its mega-dam projects are displacing millions of rural peasants. You'll learn how China uses foreign aid and the promise of capital investment to leverage one-sided "joint ventures" for massive resource extradition operations, and how the country's environmental pollution serves as a deadly catalyst for an explosion of diseases.

Navarro also reveals how China has become the world's most ruthless imperialist, how it is promoting global environmental disaster and how this nuclear superpower and pirate nation may be spiraling toward internal chaos.

The Coming China Wars is not just about how China's emergence as the world's "factory floor" is affecting you and your pocketbook; it is also about the larger view of the eight major China Wars already well underway and the urgency to understand the complexities of their economic origins in order to achieve peaceful resolution.

IN THIS SUMMARY, YOU WILL LEARN:

- The real story behind China's "weapons of mass production."
- How China's counterfeit drugs and products can literally kill you.
- How China's fouling of its air and water represents a source of competitive economic advantage that is helping to put millions of people out of work.
- The reasons for the coming U.S./China showdown over oil.
- The urgency to understand the high stakes of the China Wars.



by Peter Navarro

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How to Fight — and Win!

THE COMPLETE SUMMARY: THE COMING CHINA WARS

by Peter Navarro

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Introduction

The best of economic times for China are fast becoming the worst of times for the rest of the world. China's "cowboy capitalism" and amoral foreign policies are triggering a whole range of economic, financial, environmental, political and military tsunamis that threaten to engulf us — as well as the Chinese people. The ever-growing dangers lay in a model of rapid, unsustainable economic growth, coupled with a wanton disregard for both human life and intellectual property.

There are eight major China Wars already well underway:

1. The Not-So-Swashbuckling Piracy Wars. China has become the world's largest pirate nation.

2. The 21st Century Opium Wars. China has emerged as one of the world's biggest dope dealers.

3. The Air-Pollution and Global-Warming Wars. China has been dubiously crowned as the most polluted nation on Earth.

4. The 'Blood for Oil' Wars. China has emerged as the world's second-largest petroleum consumer behind only the United States.

5. The New Imperialist Wars. After unwitting countries are driven ever deeper into China's debt, China's imperialistic quid pro quo is the rapid extraction of the country's raw materials.

6. The Damnable Dam and Water Wars. Upstream, China is constructing a phalanx of mega-dams on the Mekong River despite the strong protests of the downstream countries of Cambodia, Laos, Thailand and Vietnam.

7. China's Wars From Within. Over the past decade, the number of protests and riots in China has risen to

nearly 100,000 annually.

8. China's Ticking Time Bombs. China is now facing a pension crisis. It is also a nation getting increasingly sick. Environmental pollution serves as a deadly catalyst for an explosion of myriad cancers and an epidemic of respiratory and heart diseases.

The radical remedies and reforms that will be required to avoid the chaos, casualties and hardships of the Coming China Wars — both within China and beyond its borders — will never occur unless we gain a much better understanding of the basic economic forces driving these political, financial, energy and environmental conflicts. Hopefully, a better understanding of the complexities of the economic origins of the Coming China Wars will help lead to their peaceful resolution. ●

The 'China Price' and Weapons of Mass Production

China's hyper-rate of economic growth is export-driven, and the ability of the Chinese to conquer one export market after another derives from their ability to set the so-called "China Price."

The China Price refers to the fact that Chinese manufacturers can undercut significantly the prices offered by foreign competitors over a wide range of products and services. Today, as a result of the China Price, China produces more than 70 percent of the world's DVDs and toys; more than half of its bikes, cameras, shoes and telephones; and more than a third of its air conditioners, color TVs, computer monitors, luggage and microwave ovens. The country



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Rebecca S. Clement, Publisher; Sarah T. Dayton, Editor In Chief; Joanne Merenda, Graphic Designer; Chris Lauer, Contributing Editor

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has established dominant market positions in everything from furniture, refrigerators, and washing machines to jeans and underwear.

Nine 'Drivers' of the China Price

How has China been able to emerge as the world's "factory floor"? The answer lies in China's primary "weapon of mass production" — the China Price. The nine major economic "drivers" of the China Price are:

- **Low-wage, high-quality work by a highly disciplined, educated and nonunion work force**
- **Minimal worker health and safety regulations**
- **Lax environmental regulations and enforcement**
- **The supercharging, catalytic role of foreign direct investment (FDI)**
- **A highly efficient form of industrial organization known as "network clustering"**
- **An elaborate, government-sanctioned system of counterfeiting and piracy**
- **A chronically undervalued, "beggar thy neighbor" currency**
- **Massive government subsidies to numerous targeted industries**
- **"Great Wall" protectionist trade barriers, particularly for "infant industries."**

Of the nine key economic drivers, only one — network clustering — is truly legitimate from the perspective of a global economic system that is supposed to be based on free and fair trade. Each of the other eight China Price drivers violates one or more of the many "rules of the trading road" that have been established by organizations such as the World Trade Organization and treaties such as the General Agreement on Tariffs and Trade.

Unprecedented Export-Driven Economic Growth

By engaging in unfair trade policies and by wielding its primary "weapon of mass production," the China Price, China enjoys unprecedented rates of export-driven economic growth — and is trouncing the competition in global markets. In the process, China is effectively sowing the economic seeds of the Coming China Wars with the rest of the world. And, in the worst "wars from within" scenario, China is also setting itself up for its own environmental, political and social destruction. ●

Significant Safety Issues:

One of the biggest and most lucrative sectors of China's knock-off economy is that of replacement auto parts. Chinese pirates account for 70 percent of all counterfeit auto parts in the world, and more than half of all Chinese vehicles contain counterfeit components.

There are significant safety issues for an industry that depends on equipment reliability. In some cases, the quality and appearance of the fake auto parts is so good that it is difficult to distinguish between a fake and original product. In many other cases, the parts are of such poor quality they are doomed to early and often dangerous failure. As reported in *Automotive News*, some of the "many horror stories" include "brake linings made of compressed grass, sawdust or cardboard; transmission fluid made of cheap oil that is dyed; and oil filters that use rags for the filter element."

China's Counterfeit Economy and Not-So-Swashbuckling Pirates

Piracy refers to the unauthorized production, distribution or use of a good or service. The goal of a pirate is to create a look-alike "knock-off" that can be sold to a customer as such.

Counterfeiting ups the piracy ante by pawning off pirated products as those of the real, branding corporation. Thus, a golf club that looks just like a Callaway driver but has a name like "Hallaway" is a pirated knock-off, whereas a knock-off sold as a "Callaway" club is a counterfeit.

The World Customs Organization estimates that counterfeiting accounts for fully 5 percent to 7 percent of global merchandise trade and represents the equivalent in lost sales of around \$500 billion. Such counterfeiting costs the pharmaceutical industry alone close to \$50 billion a year, the auto industry more than \$10 billion annually and the software and entertainment industries billions more.

China is the largest pirate nation on the planet. As worldwide production of counterfeit goods has leaped by 1,700 percent since 1993, China accounts for two-thirds of the world's pirated and counterfeited goods and fully 80 percent of all counterfeit goods seized at U.S. borders.

The 'Get Tough on Pirates' Shell Game

Every year, the Chinese government increases the number of raids it conducts, and every year Chinese

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counterfeiting and piracy grows ever larger. Behind this phony “get tough on pirates” shell game is a system of laws and regulations that, through the fundamental laws of economics, encourages rather than deters the tens of millions of Chinese pirates. In doing so, this system of government-sanctioned piracy blatantly violates the rules of the World Trade Organization and many other treaties and agreements.

One major problem is that the fines the Chinese government imposes on counterfeiters and pirates are absurdly small.

A second major problem is that most cases are handled by administrative enforcement bodies rather than by the criminal justice system. The enforcement powers of many of the relevant agencies are limited to confiscating the fakes and imposing monetary fines rather than imposing any jail terms.

A third problem is that in China’s relatively young free-market economy, there is a lack of adequate resources and training for criminal enforcement and intellectual-property protection. ●

Killing Us (And Them) Softly With Their Coal

As an example of the severity of China’s self-inflicted air-pollution crisis, it would be hard to top the northeast city of Benxi — one of the 20 largest cities in China. At one point, this heavy-industry center, which burns roughly 7 million tons of coal per year and produces more steel per capita than any other city in China, literally disappeared from satellite images because of the dense cloud of haze and soot that enveloped it.

China’s extremely lax environmental regulations and weak enforcement allow Chinese manufacturers to produce at an unfair cost advantage over competitors. China’s wanton fouling of its air and water thus represents an important source of competitive economic advantage that is helping to put millions of people out of work and depressing wages in other countries.

China’s prodigious pollution is now spewing well beyond its environmentally porous borders. Some of the fallout is regional — such as increased acid rain in neighboring Japan, Korea and Taiwan. Some of China’s environmental fallout is global — such as an increase in a particularly virulent brand of Chinese smog known as “chog” reaching as far away as Canada and the United States. Some of the effects of the China Air-Pollution Wars are long range and more

speculative, such as an increase in coastal flooding and hurricanes that may result from China’s contributions to global warming.

High-Sulfur, Low-Quality Coal

At the root of many of China’s air-quality problems is its heavy dependence on relatively high-sulfur, low-quality coal for everything from electricity generation and industrial production to cooking and space heating in the home. China relies on coal for almost 75 percent of its energy needs. The result of this heavy coal dependence, coupled with a woeful lack of pollution-control technologies, is that China’s air-quality problem is a different one from that of developed countries such as the United States and Germany in at least three ways.

First, unlike in the United States, Germany or Japan, where sophisticated pollution-control technologies are deployed, much of what Chinese power plants and factories spew in the air is not just sulfur dioxide but also a high percentage of fine particulate matter, the most damaging airborne pollutant.

Second, small cities in China are no better off than large cities in terms of ambient air quality because small cities are as likely as large cities to depend on coal in both their residential and commercial sectors.

Third, unlike the developed world where the automobile is the single-largest source of air pollution, China’s current problem is primarily a “stationary source” one. These stationary sources range from large coal-fired power plants in huge factory towns to small coal-fired stoves and heaters in peasant homes. ●

The ‘Blood For Oil’ Wars — The Sum of All Chinese Fears

On the economic front, China’s rapidly increasing oil demand is creating persistent and significant oil price shocks and increasing volatility in the world’s oil markets. These shocks destabilize the global economy.

On the foreign-policy front, China’s oil thirst is accelerating the global arms race and the further spread of weapons of mass destruction — from long-range, inter-continental ballistic missiles to the nuclear warheads that ride atop them.

Finally, on the “hot-war” front, the China Oil Wars may also spill over into a dangerous array of ugly military confrontations. One possible trigger may be the discovery of large oil reserves in the South and East China Seas. China has been engaged in long-term territorial

The Mongolian Grapes of Wrath:

China is one of the most desert-plagued nations on Earth. Fully one-fourth of its land mass, primarily in the northwestern part of the country, is desiccated dust. Within another 20 years, some experts predict that almost 40 percent of China's land will have been ground into sand.

Today, roughly 1,500 square miles of Chinese real estate are being lost to desertification annually and that number continues to rise despite massive efforts of the central government to contain it. According to the China Meteorological Administration, the frequency of the sand and dust storms that represent the environmental fallout from it is also increasing.

China's overcultivation, overgrazing and deforestation are the three major contributors to its desertification. China is also draining dry its lakes, streams, rivers and groundwater aquifers. To the extent that this has created water shortages in the desert areas, even more topsoil has shriveled into dust.

disputes with Japan, Indonesia, the Philippines, Vietnam and other neighbors in these areas, and has already used military might to seize several islands in dispute and assert its claims.

'Shopping' China's U.N. Veto

One of the most potent weapons in the China Wars is China's ability to veto any U.N. Security Council resolution. China's top business and political leaders regularly "shop" China's U.N. veto to countries with which they seek to strengthen ties. China's activities in the Sudan provide a chilling example of the kind of crass Chinese commercialism that is being shopped under the U.N. banner of peace and humanitarianism.

China has given the Sudan a complete package of economic and diplomatic incentives in exchange for access to its oil reserves. A key part of that incentives package has been China's brazen willingness to use its diplomatic power and permanent veto in the United Nations to protect Sudan from U.N. sanctions. During Sudan's campaign of genocide in its Darfur region, China repeatedly thwarted U.N. attempts to stop the ongoing rape, massacre and systematic starvation of non-Arab Sudanese at the hands of Arab Janjaweed militia forces armed and controlled by the Sudanese government. According to estimates by the World Health Organization and the United Nations, this "ethnic cleansing" has led to the

deaths of several hundred thousand people and the displacement of almost 2 million refugees. ●

The 'New Imperialist' Wars and Weapons of Mass Construction

Throughout Africa, Latin America and Asia, China is using the Trojan horse of a "South-South" message that allies China in a workers' coalition with other developing countries against "northern hemisphere" imperialists such as the United States, France, Russia and Great Britain. Under the cover of this South-South diplomacy, China is deploying a potent mix of state-subsidized capital, managerial expertise and skilled labor, and rapidly gaining economic control of a lion's share of the world's metals, minerals, raw materials and agricultural resources.

The unwitting developed countries now ensnared in China's South-South imperialistic web are starting to have an increasingly rude and painful awakening. At the root of China's new imperialism is an economic appetite for resources and raw materials that is voracious.

The China Wars for Minerals and Raw Materials

In choosing to be the "factory floor" of the world, China has hitched its star to a heavy manufacturing model that, in less than three short decades, has transformed the country from a quiet agricultural backwater into one of the world's largest consumers of metals, minerals, lumber and other raw materials.

Pursuing its heavy manufacturing model, China has already overtaken the United States and Japan as the world's largest steel consumer. It is the largest buyer of copper, the second-largest buyer of iron ore, and the third-largest buyer of alumina, which is used in smelters to produce aluminum.

Massive Resource Extradition Operations

China's strategy for securing supplies of all these various production inputs is to gain as tight physical control of these resources as possible. The way China gains ownership control is by first ingratiating itself to foreign governments and then encircling the country's economy with virtually every imperialistic strategy.

China is using foreign aid and the promise of capital investment to leverage one-sided "joint ventures" for massive resource extradition operations. In the process, it systematically strips nations of their raw materials and natural resources while recovering the costs of these resources and materials by dumping cheap finished goods

Summary: THE COMING CHINA WARS

into these same countries — often driving out local indigenous labor and driving up the local unemployment rate. This scenario is playing out with chilling effectiveness, particularly in Africa and Latin America. ●

The 21st Century Opium Wars

No single country plays more of a key role than China in the global production, transportation and distribution of all four illegal hard drugs — cocaine, heroin, methamphetamine and Ecstasy — and their “precursor chemicals.” Consider the following:

- China annually produces more than 100,000 metric tons of acetic anhydride, with much of this precursor chemical diverted to transform the poppies of the Golden Triangle and Golden Crescent into pure “China white” and the more pedestrian “Afghan heroin.”
- China is the world’s second-largest producer of potassium permanganate, the key precursor chemical used in the oxidation and separation process to turn the coca leaves of South America into cocaine.
- China and India are the world’s largest producers of bulk and synthetic ephedrine: a key precursor used in methamphetamine labs.
- China is emerging as a highly efficient production center for “finished goods” — including heroin, Ecstasy and speed.
- China’s banking system is becoming an important hub for global money laundering.

Imperialism with a Taiwanese Twist:

In Latin America, as in Africa, China is pursuing its imperialistic agenda with a Taiwanese twist. Almost half of the remaining 25 countries that now diplomatically recognize Taiwan are in Latin America, and China is aiming to pick off each of them with promises of lavish aid.

One of the first defectors since the onslaught of China’s Latin America offensive was the tiny island of Grenada. The triggering event for Grenada cutting Taiwan loose was the donation by China of \$50,000 to a hurricane relief fund. This money promptly found its way not into Red Cross coffers where it was supposed to go but rather into the “pockets of Grenadian Prime Minister Keith Mitchell’s government,” according to the *Taiwan Times*.

China’s rapidly emerging role as the world’s “factory floor” for precursor chemicals and, increasingly, as a hard-drug producer in its own right has come despite apparently sincere and severe attempts by the central government to control the trade. China’s failure, however, to curb its drug trade portends great conflict with other nations. ●

The Damnable Dam Wars and Drums Along The Mekong

At more than 85,000 dams and counting, Chinese leaders boast of having the tallest dams, the largest by reservoir capacity, the dam with the highest ship lift, and the most powerful electricity producer. From arch dams, earthen dams and gravity dams to cascade and concrete-faced rockfill dams, China has it all.

If ever there were a double-edged sword, a large-dam strategy would be it. On the beneficial edge of that sword, large dams generate significant amounts of cheap electricity. Among other positive uses, they store water when there is a surplus for use in irrigation during times of scarcity and protect arable land from flood and erosion.

On the other far more costly and dangerous edge of the sword, large dams are quite capable over time of destroying the very waters they harness as well as the agricultural lands they are trying to improve. Because dams tend to slow down river flows, they decrease the ability of rivers to rejuvenate and cleanse themselves of pollutants naturally. They interfere with, and often destroy, natural habitats and fish reproduction. The reservoirs created by large dams displace significant population segments when they inundate villages and towns.

Perhaps the worst aspect of large dams is their relatively short useful shelf life. As silt builds up behind a dam and the reservoir becomes shallower and shallower, less electricity is generated, less water for irrigation is stored and flood control becomes increasingly more difficult.

Most environmentalists now believe that large dams often represent an unacceptable risk, particularly over the long term. China’s leadership is hip-deep in the construction of an ever-larger and larger set of dam projects. These projects will be built on one of the most highly polluted and heavily dammed set of river basins in the world. The result of this dam strategy is a set of great risks not just for the Chinese people but for all of China’s downstream neighbors. ●

The Bread and Water Wars

Much of China's fresh water in its rivers, lakes, streams and wells is simply too polluted to use in irrigation, much less for drinking, and this pollution contributes greatly to a growing water scarcity problem. Here are a few statistics:

- Seventy percent of China's seven major rivers are severely polluted.
- Eighty percent of China's rivers fail to meet standards for fishing.
- Ninety percent of China's cities and 75 percent of its lakes suffer from water pollution, and 700 million Chinese "have access to drinking water of a quality below World Health Organization standards."
- Almost half of China's total population is exposed to contaminated water supplies and one in three countryside dwellers lacks access to safe drinking water.
- Liver and stomach cancers related to water pollution are among the leading causes of death in the countryside.
- All of China's coastal waters are moderately to highly polluted.

The pollution is caused not just by massive industrial dumping and indiscriminate industrial burning of toxic wastes: An avalanche of excess fertilizer and pesticide runoff and a mountain of animal and human waste stand equally tall as culprits. ●

China's Wars From Within

Economic reforms and industry privatization in China have created a "reserve army of the unemployed" numbering more than 100 million. The Chinese countryside has become both a slave-labor camp and a dumping ground for every imaginable air and water pollutant, while the rural peasantry is being sucked dry by government tax collectors. China's aggressive dam projects have displaced more than 2 million rural peasants.

As part of the long march of "progress," corrupt local government officials seize land on behalf of developers, pocket the monies that are supposed to compensate villagers, and then enlist local gangsters to quell protests. In the big cities, wages that go callously unpaid to poor migrant workers number in the staggering billions of dollars. Unpaid construction workers leap to their deaths in protest.

Industrial Burning and Dumping

China's manufacturers not only flood the world with low-cost products, they flood China's waterways with pollution. The worst industries include paper and pulp, food, chemicals, textiles, tanning and mining.

The most common toxic pollutants being unleashed by the indiscriminate burning of industrial waste and wanton industrial dumping include dioxins, solvents and PCBs; various metals such as mercury, lead and copper; and highly persistent pesticides ranging from chlordane and mirex to DDT.

Protests, Riots and Strikes

For all of these reasons, none of the Coming China Wars outside China's borders are likely to be as sudden, wrenching and violent as the wars from within. Hundreds of thousands of skirmishes have already been fought. Over the past decade, the number of protests and riots has risen almost exponentially to nearly 100,000 annually, with both their scope and scale increasing. What is perhaps most alarming to the Chinese government about these protests, riots and strikes is the diversity of causes and their broad geographic sweep. Consider this sampling of major confrontations over the past several years:

- In Xianyang City, more than 6,000 workers strike after a textile factory is privatized and the new owner seeks to fire and then rehire them as "inexperienced workers" at lower wages and "without accrued retirement or medical benefits."
- In metropolitan Shenzhen, factory workers producing audio speaker parts take two of their Hong Kong bosses hostage out of fear that the bankrupt company will not pay them back wages. In a separate incident, hundreds of workers clash with security guards and police during a protest against layoffs at an electronics company.
- In the city of Chizhou, a student on a bicycle collides with the sedan of a wealthy businessman whose bodyguards kick and beat the student. Fueled by cell phones and instant messaging, this turns into a "rich versus poor" conflict involving more than 10,000 people, the smashing of the sedan and a police car, and the looting of a supermarket owned by another wealthy businessman. ●

Of 'Bloodheads,' Gray Dragons, and Other 'Ticking Time Bombs'

China is a nation rapidly graying. Looming dead ahead is a pension crisis the severity of which will make the Social Security woes of equally graying countries such as the United States, Japan and Germany look like strolls through the park.

China is also a nation that is getting increasingly sick. Environ-mental pollution is proving to be an all too deadly catalyst for an explosion of a myriad of cancers and an epidemic of respiratory and heart diseases. This rapid rise in ill health is coming precisely when China's once-vaunted public health-care system has totally unraveled under the weight of China's ongoing privatization of social services and a host of other sweeping economic reforms.

HIV/AIDS Epidemic

Adding to the extreme pressures on China's health-care system now comes an HIV/AIDS epidemic that many experts believe will become the worst in the world. This is an epidemic that began with the worst HIV/AIDS blood-donor scandal on the planet. It is now being rapidly fueled by rampant and rising intravenous drug use, a late-blooming sexual revolution, and the re-emergence of China's once-infamous flesh trade.

For all these reasons, time is running out on the Communist Party, and perhaps even the Chinese economic miracle. Any one of these ticking time bombs — pension deficits, a shredded health-care net, and an impending HIV/AIDS catastrophe — is capable of triggering severe bouts of economic, social and political instability. Taken together with the various wars from within, these ticking time bombs threaten to trigger what ultimately the Chinese fear most — chaos or luan. ●

How To Fight — And Win! — The Coming China Wars

If all the major stakeholders in the Coming China Wars come to understand the high stakes involved, appropriate steps can be taken, all of which are difficult. What is missing from the current political and policy calculus is any real sense of urgency about this mission.

Many of the policy prescriptions to fight the Coming China Wars are straightforward. They have been discussed in numerous policy circles and featured in debates and

negotiations in the U.S. Congress, both Asian and European parliaments, and bilateral negotiations between the Chinese and many other countries.

For example, consider the problem of rampant Chinese counterfeiting and piracy. The obvious “hard line” policy here is for the United States, the countries of Europe, and other nations to adopt a “zero-tolerance” policy toward intellectual property theft. Countries that violate this policy should be held to full account in bodies such as the World Trade Organization and punished.

All policy prescriptions require the economic and political will to stand up to China, along with the military might to back up the prescriptions. The policies also, in many cases, entail significant short-run economic costs. For example, raising global environmental standards will raise the cost of manufacturing goods, tightening border security puts further pressure on an already strained budget, and reducing oil dependence would require a fairly massive industrial realignment.

Political Will

In less than a decade, China has vaulted to the top of the U.S. creditor heap and will soon surpass Japan as the single largest holder of U.S. debt. As China acquires more U.S. securities, it has an increasing ability to destabilize U.S. financial markets and plunge the United States into recession. All China has to do to send U.S. interest rates and inflation soaring is to stop buying new U.S. government securities. If China wants to trigger a crash in the U.S. stock and bond markets — say, to back off the United States from protectionist tariffs — all China need do is start dumping large amounts of its current U.S. holdings.

The United States will never be able to credibly and effectively challenge China until it gets its own house in order. Every U.S. citizen — as well as consumers and voters around the world — will have to understand the real and dangerous hidden costs that are embedded in the purchase of cheap Chinese goods.

Military War Triggers

Several possible “hot” military war triggers — including China's tensions with Taiwan, its competition with Japan and its support of North Korea — together with the various cold economic wars previously mentioned add up to one of the most dangerous situations the world has ever faced. We must move forward with the facts in hand and with all due speed toward the common goal of resolving the many differences both peacefully and prosperously. ●

· Book 22 of 32 ·

Summary



Exposing Why the Rich Are Rich, the Poor Are Poor
— and Why You Can Never Buy a Decent Used Car!

The Undercover Economist

THE SUMMARY IN BRIEF

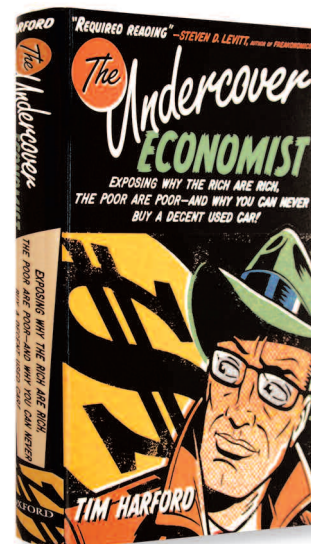
The Undercover Economist is an engaging guide to how economists view the world and the economic principles lurking behind daily events, explaining things from traffic jams to high coffee prices. Economist Tim Harford reveals the intricate economic games of negotiations, contests of strength and battles of wits that shape our day-to-day lives, often without our knowing it. He explores some of today's biggest controversies including, the gap between the rich and the poor, the high cost of health care and why some industries can have high profits for innocent reasons, while in other industries high profits are the result of sinister schemes.

Starting from a point familiar to us all, a \$2.55 cappuccino at Starbucks, the *Undercover Economist* uses detective work to discover the economic reasons behind Starbucks' prices. In the process, the principles of "strength from scarcity," perfect markets (and the World of Truth), globalization and the impact of immigration are all examined and explained.

In the end, economics is like engineering; it will tell you how things work and what is likely to happen if you change them. But dig deeper and it is about people and about the choices they make. Economic growth is about a better life for individuals — more choice, less fear, less toil and hardship. This is what makes understanding economic principles and concepts so important.

IN THIS SUMMARY, YOU WILL LEARN:

- Bargaining strength comes from scarcity.
- Strategies used to make us pay more.
- Why economic problems arise and how to patch them up.
- Economic decisions that have side effects on bystanders.
- The effect of missing information.
- Market failure vs. government failure.
- Using game theory to make decisions.



by Tim Harford

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THE COMPLETE SUMMARY: THE UNDERCOVER ECONOMIST

by Tim Harford

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Who Pays For Your Coffee?

The long commute on public transportation is a commonplace experience of life in major cities around the world, but whether in New York, Tokyo or Prague, it will look surprisingly familiar. Every morning, sleep-deprived travelers struggle to get through the human traffic and get to their desks just before their bosses. The one place many harried commuters will detour is a Starbucks, always conveniently located within yards of the exits of major subway stations around the world.

A Starbucks' coffee is hardly cheap at \$2.55 for a tall cappuccino but, like many people stopping at that café, no one cares to waste time trying to save a few pennies by searching out a cheaper coffee at 8:30 in the morning. There is a huge demand for the most convenient coffee possible and that makes the location of the coffee bar crucial.

The nice margin (the markup is estimated to be around 150 percent) that Starbucks makes is due neither to the quality of the coffee nor to its smiling staff: it's location, location, location. So why is nobody next door undercutting Starbucks? Other coffee bar chains are not eager to pay much for a space next to 10 other coffee bars, so the landlord gets the most advantage out of an exclusive agreement. There are an unlimited number of potential coffee bars and a limited number of attractive sites — and that means the landlords have the upper hand. The landlord who owns a single prime coffee-bar site should be able to dictate the terms and force one of them to pay rent which consumes almost all their expected profits. The successful company will expect some profit but not much.

Strength from Scarcity

The lessons of an economics book published in 1817 help explain not just the modern coffee bar, but much of the modern world itself. The author, David Ricardo, was an enthusiastic economist who longed to understand what had happened to Britain's economy during the then-recent Napoleonic wars. The price of wheat had rocketed and so had rents on agricultural land, and Ricardo wanted to know why.

The first lesson is that the person in possession of the desired resource — the landlord in this case — does not always have as much power as one would assume.

Bargaining strength comes through scarcity: When settlers are scarce and meadows are not, landlords have no bargaining power.

The second lesson that follows from that is if relative scarcity shifts from one person to another, bargaining shifts as well. If more farmers come to town and meadowland becomes scarce, suddenly the landlords have acquired real bargaining power. That means that the landlords will be able to raise their rents by an amount that allows the farmers to earn the same, farming on meadows and paying rent or farming on inferior scrubland rent free. If the difference in productivity of the two types of land is five bushels of grain a year, then the rent will also be five bushels a year. If the landlord charges more, the tenant farmer will leave to farm scrubland.

The simplicity of the coffee bar and farming stories emphasizes the underlying reality that sometimes relative scarcity and bargaining strength really do change quickly, and with profound effects on people's lives. We often complain about the symptoms — the high cost of buying a cup of coffee or a house; but the symptoms cannot



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be treated without understanding the patterns of scarcity that underlie them. It is the economist's job to shine a spotlight on the underlying process.

'Marginal' Land is of Central Importance

The shifts in bargaining power don't stop there. For example, if new farmers keep arriving, they will eventually cultivate not only the meadowland but also all the scrubland, and new farmers will settle for grassland, which is even less productive than scrubland. The rent on meadowland therefore, will always be equal to the difference in grain yield between meadowland and whatever land is available rent-free to new farmers. Economists call this other land "marginal" land because it is at the margin between being cultivated and not being cultivated (economists think about decisions at the margin a lot). It's important to note that there is no absolute value: everything is relative to that marginal land.

From Meadows Back to Coffee Kiosks

Ricardo's story illustrates that two things determine the rent on prime locations like meadowland: the difference in agricultural productivity between meadows and marginal land, and the importance of agricultural productivity itself. Meadows command high dollar rents only if the grain they help produce is also valuable. Applying this to coffee bar locations means landlords will command high rents only if customers will pay high prices for coffee. Rush-hour customers are so desperate for caffeine and in such a hurry that they are practically price-blind. For coffee bars, cheaper rent is no compensation for the loss of a flood of price-blind customers.

Portable Models

Nearly two hundred years ago, Ricardo produced insights that illuminate our understanding today. Economics is partly about modeling, about articulating basic principles and patterns that operate behind seemingly complex subjects like the rent on farms or coffee bars.

Ricardo's model is useful for discussing the relationship between scarcity and bargaining strength, which ultimately explains much of the world around us. If applied correctly, it shows that environmental legislation can dramatically affect income distribution. It explains why some industries naturally have high profits, while in other industries high profits are a sure sign of collusion. It even manages to explain why educated people object to immigration by other educated people, while the working classes complain about immigration by other unskilled workers.

Different Reasons for High Rent — Are We Being Ripped Off?

In Ricardo's terms there are two reasons why rents might be high: that good land is worth paying a high price because the grain it produces is valuable, and it's worth paying a lot for good land because the alternatives that should be available are not. Now the question becomes How can we tell the difference between things that are expensive because they are naturally scarce, and things that are expensive because of artificial means, such as legislation, regulation or foul play?

In the real world there are lots of reasons why potential new companies cannot enter a market and compete. Sometimes the consumers are to blame because they will deal only with established companies. More frequently, firms themselves lobby their governments asking to be protected from competition, and many governments grant monopoly licenses, or are highly restrictive of entry into "sensitive" industries like banking, farming or telecommunications. Whatever the reason, the effect is the same: Established companies, free of competition, enjoy high profits.

Landlords and executives are not the only people who like to avoid competition and who like to enjoy monopoly rents. Trade unions, lobby groups, people studying for a professional qualification and even national governments like them too. Economists call this type of behavior "creating rents" and "rent-seeking."

And Now for Something Controversial — Immigration

Immigration has always been an emotive issue for America. Well-educated workers with jobs requiring skill and training, along with businessmen in need of cheap labor, tend to welcome immigration as part of an enriching process. Poorly educated workers tend to reject any further immigration by unskilled immigrants on the grounds that "they steal our jobs." Who gets to enjoy the proceeds depends on whose abilities are scarce.

The facts support the application of Ricardo's theory to immigration. Skilled immigrants lower the wages of skilled natives and unskilled immigrants lower the wages of unskilled natives. In the UK, the salaries of nurses in the National Health Service have been kept low by the influx of 30,000 foreign nurses; immigrants in the UK are nearly 50 percent more likely than natives to have a university degree. In contrast, in the United States, which takes in a far higher percentage of low-skilled immigrants than the UK does, it is unskilled wages that have stayed low. The income of unskilled workers has not improved in 30 years. ●

What Supermarkets Don't Want You To Know

Any well-run business will seek to charge each customer the maximum price he'd be willing to pay — and they do. There is nothing Machiavellian about that. The problem for any company is to find ways to smoke out customers who are less sensitive about price. There are three common strategies for finding customers who are cavalier about price.

- “First degree price discrimination” or “unique target” is a strategy to evaluate each customer as an individual and charge according to how much he or she is willing to pay.
- “Group target” strategy offers different prices to members of distinct groups. It often seems reasonable because people in groups who pay more are usually people who can afford more.
- “Self-incrimination” strategy is to persuade some customers into confessing that they are not sensitive to price. To do this, a company has to sell products that are at least slightly different from each other, in different quantities, with different features or at different locations. Because the comparison is not exact, you never quite know whether the firm is using a price-targeting trick or merely passing on added costs.

Supermarkets have turned price-targeting into an art, using an automated process to “unique target” individual customers. For instance, supermarkets accumulate evidence of what you're willing to pay by giving you “discount cards,” which are needed to take advantage of sale prices. In return for getting a lower price, you allow the stores to keep records of what you buy, and then in turn offer you coupons for discounts on products.

When technology allows, firms with scarcity power may use highly sophisticated methods to target customers. It's no secret anymore that Internet retailers such as Amazon can identify each customer by putting a tracing device called a “cookie” on your computer. Each customer can have an identity tag, and price labels can change according to who was looking at them.

Of course, this “unique target” approach is unpopular. In Amazon's case, customers started to realize that if they deleted the cookies on their computers, they were offered different, often lower prices. There was an outcry against this and Amazon promised not to do it anymore.

When Price-Targeting is a Good Thing and When It is a Bad Thing

Whenever price-targeting fails to expand the number of sales and merely moves products from people who value them more to people who value them less, it will definitely be less efficient than a uniform price. An example would be HIV/AIDS drugs. If there is not an expansion in the number of sales, the drugs will be sold at a uniform high price to the people who value them the most (the rich), while the poor will not get the drug.

Whenever price-targeting opens up a new market without affecting the old market, it will definitely be more efficient than a uniform price. An example would be to expand HIV/AIDS drugs sales by supplying the drug to poor countries at a lesser price but continue sales at the higher price to the rich countries.

If the situation is such that a change could make at least one person better off, and nobody worse off, then the current situation is inefficient, or in everyday language, it could be better. If, on the other hand, the current situation is that every change that could make at least one person better off will also make somebody else worse off, then the current situation is efficient; it doesn't mean the situation can't be improved, it's just that there is no costless way to improve it. ●

Perfect Markets and the 'World of Truth'

There's a basic truth incorporated into any system of prices that comes from the fact that stores and consumers do not have to buy or sell at a given price — they can always opt out. In a free market, people don't buy things that are worth less to them than the asking price. The reason is simple: Nobody is forcing them to, which means that most transactions that happen in a free market improve efficiency, because they make both parties better off — or at least not worse off — and don't harm anyone else. This free choice produces information about a consumer's priorities and preferences, and when millions of consumers make choices, market prices aggregate the priorities and preferences of us all.

What is the result of a set of perfectly competitive markets interconnected like this?

- Companies are making things the right way.
- Companies are making the right things.
- Things are being made in the right proportions.
- Things are going to the right people.

Yet any modern democracy provides goods, like police

Summary: THE UNDERCOVER ECONOMIST

service and schools, outside the market system. Nonmarket systems have their advantages (you wouldn't want to have to shop for a police force, for instance), but they also lose something important: information about wants, needs and desires, and about inconveniences and costs. Sometimes the loss of information is worthwhile because it is offset by gains in equality or stability. But sometimes the loss of information can leave an economy and a society floundering in waste and confusion. We need a way to make our economies both efficient and fair.

A young economist with a great desire for social justice named Kenneth Arrow came up with a Nobel Prize solution that proved that not only are all perfect markets efficient, all efficient outcomes can be achieved using a competitive market, by adjusting the starting position.

Arrow demonstrated that in a world of perfect markets, the only thing needed to ensure both fairness and efficiency is a "head start" strategy: a program of appropriate lump-sum taxes and subsidies that puts everyone on equal footing. The perfect markets then find every possible opportunity to make everybody better off from their revised starting points. The question is, can this be done in practice? ●

Crosstown Traffic

In any of the world's great cities, vehicles seriously damage the happiness of innocent bystanders. They cause severe air pollution and congestion. Because each driver who gets into his car is creating misery for other people, the free market cannot deliver a solution to the problem of traffic. Drivers do not offer compensation for the cost they inflict on other people.

What matters more for congestion is the price drivers pay at the margin; or, to put it another way, the price drivers pay to make one extra trip. Cars don't cause much pollution or congestion, after all: Car *trips* are the problem.

The idea of an externality charge (for inconvenience inflicted on bystanders) is not to discourage everyone from doing anything that might inconvenience anyone else; it is to get them to take into account the inconvenience they cause to others. It must reflect the cost of the externality — but no more.

Two Objections to Externality Charges

A charge for externalities is effectively a government tax, and thus controversial. The two objections are:

- The externality charge is an unfair tax aimed at a disadvantaged group.

- After the externality charge has been imposed, the rich will still be able to do whatever it was that was objectionable.

In answer to the charge that externality charges are unfairly redistributive: They are not aimed at poor people but at voluntary activities. If you decide to stop causing trouble for others, you don't have to pay. ●

The Inside Story

The United States system makes it voluntary to buy insurance, and premiums are linked to risk, not to income. These market-based principles are beloved by Americans. But a recent survey revealed that only 17 percent of respondents in the United States were content with their health-care system. The superficial reasons given were: The system is hugely expensive, very bureaucratic and extremely patchy. However, the same survey reports that only 25 percent of the British are happy with their system, a government-sponsored National Health Service, which offers health care to all citizens, and is almost completely free. This suggests that when market failure and government failure are both present, the choice is often between the lesser of two evils.

The overwhelming problem for the U.S. privatized, insurance-based system is that the insurance company tends to make a lot of choices, and it produces a "moral hazard" (compensation to people when bad things happen is apt to make them careless). It is a case where the markets work poorly because inside (imperfect) information eats away at the insurance by driving away low-risk customers and forcing premiums to rise. The overwhelming problem in a government provided system (British) is that the government makes the choices, and resources are rationed by political processes.

A better alternative is to have a market-based system without insurance where the patient makes the choices. Here the problem is that the patient also has to pay for unpredictable and potentially catastrophic health-care costs. What is needed is a solution that could fix health care without sacrificing the ability of patients to decide how much they value their own health.

Fixing Health Care with Keyhole Economics

Keyhole surgery techniques allow surgeons to operate without making large incisions. Economists often advocate a similar strategy when trying to fix a policy problem: Target the problem as closely as possible rather than attempting something more drastic.

Keyhole economics first identifies the specific market failures, which in this case fall into three categories, plus

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issues of fairness:

- Scarcity power
- Externalities
- Imperfect information.

The keyhole solutions would be:

- Some light-touch regulatory oversight to prevent the exploitation of scarcity power, coupled with focused subsidies to boost inoculation programs.
- Ensure widespread availability of information and give patients an opportunity to use this information (compel patients to pay for many of their costs, thus providing incentive to make informed choices, but leave the most severe costs to the government or insurance).
- Ensure fairness by tackling the general problem of poverty using redistributive taxes. ●

Rational Insanity

Economists work by studying rational behavior, but the more rational the behavior of stock-market investors, the more erratic the behavior of the stock market becomes. Here's why: Rational people would buy shares today if it was obvious that they would go up tomorrow, and sell them if it was obvious that they would fall. But that means that if investors really are rational, there won't be any predictable share movements at all. All the predictability would be sucked out of the stock market very quickly because all trends would be anticipated. The only thing that is left is unpredictable news. Mathematicians call the behavior "a random walk" — equally likely on any day to rise as to fall.

Shares are called shares because they give you a right to have a share in the profits of a real company. In the long run the share price has to reflect that. Economists can help work out what the fundamental value of the share is:

- If the price of the share is lower than the fundamental value, that tells you that the share is cheap and you should make money buying it.
- In the long run, share prices have to reflect the fundamental profits of companies.
- At the extreme, even if a good-value share stays undervalued forever, you should still make money holding it and pocketing the dividends.
- In the short-run, share prices should also reflect the fundamental prospects of the company.

Thinking Sensibly About Scarcity

Many Internet and technology fans argue that the

Internet is "transforming everything;" that we are in an economic revolution, and therefore shares should be very valuable. However, this premise is wrong. Share price should rise only if economic transformation increases the degree to which organizations control scarce resources.

For example, the gaggle of dot-com pretenders all had businesses that could have been duplicated at minimal cost in a matter of months, and it was that fact alone that should have made it clear that their shares were really worth next to nothing. It did not matter whether the economy was changing, because the economy will never change so much that companies with no scarcity power become highly profitable. ●

The Men Who Knew the Value of Nothing

Since the 1990s, governments across the world have been selling the rights (licenses) to use wavelengths of radio spectrum to telecom companies. With limited amounts of spectrum available (scarcity), there is money to be made. The problems the governments faced were:

- How to price the spectrum licenses to obtain the maximum amounts for the valuable public assets.
- How to ensure the licenses were sold to companies that would use them to deliver quality services at the lowest price.
- How to attract plenty of serious telecom bidders.
- How to accomplish the sale of licenses so as to maintain public confidence in the process (and not embarrass government officials).

Mathematician John von Neumann founded a system known as "game theory." A game, to a game theorist, is any activity in which your prediction of what another person will do affects what you decide to do. The game of poker could be analyzed using game theory, for example.

Using the mathematical model of game theory, economists argued that the allocation of public assets, from the right to drill oil to the right to use radio spectrum, ought to be determined by auction. The auction forces each bidder to tell the truth about his own estimate of the license's value. At the same time, the auction broadcasts the collective view to all the bidders, so they can update their own opinions accordingly.

In the early years, government auctions produced spectacular disasters like New Zealand's auction of radio spectrum in 1990, which was perceived to have sold public assets too cheaply. But with each auction, the process was improved. In the spring of 2000, the

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world watched as the United Kingdom's auction of five spectrum licenses resulted in a highly competitive and successful auction that raised £22.5 billion for the government, and became the biggest auction in modern history.

Critics of the auction argued that:

- Because the telecoms had paid so much for the licenses, they would charge consumers very high prices.
- The telecom industry was crippled by the government's charging such outrageous sums for the licenses.

In response to the first point, economists point out that any firm will charge customers more if their expenses are high; however, their ability to do this is limited by their scarcity power. Consumers do not have to purchase services from telecoms.

In response to the second criticism, it is noted that the most seriously afflicted telecom firms did not win a license — they are mostly U.S. firms who did not participate in the auction or troubled cable companies who withdrew from the auction without spending anything. The license winners, such as Vodafone, remain successful firms. ●

Why Poor Countries Are Poor

Economists used to think that the economic wealth of a country came from a combination of man-made resources, human resources and technological resources. Obviously, then, poor countries grew into rich countries by investing money in physical resources and by improving human and technological resources with education and technology transfer programs. Rich countries don't gain much from further investment: This is called "diminishing returns." For instance, a few roads in a poor country can open up whole new areas for trade; in a rich country, a few more roads just relieve a little congestion. So the theory was that the poorer countries, with investments in infrastructure and education should catch up quickly.

However, it became evident something was not right. Many poor countries are not growing faster than rich ones; in fact, they are growing more slowly or getting poorer.

Over the past 10 years or so, economists working on development issues have converged on the theory that "institutions matter." Government banditry, widespread waste and oppressive regulations designed to make it eas-

ier to extract bribes: All are elements of what are dysfunctional institutions that are a key explanation of poverty in developing countries.

Many poor countries with dysfunctional institutions create a topsy-turvy world in which it's in most people's interest to take action that directly or indirectly damages everyone else. The incentives to create wealth in any way at all are turned on their heads. The rot starts with government but it afflicts the entire society.

Is There a Chance for Development?

These problems cannot be fixed overnight. But there are some simple reforms, which — with a modicum of political will — would move poor countries in the right direction:

- Cut red tape by allowing small businesses to be legally established.
- Legal reforms are necessary; even a single minister with his head and heart in the right place can make a difference.
- Enlist the world economy for help — a small country cannot survive without the world economy. ●

Globalization

The most visible manifestation of the world's increasing economic interdependence is the availability of foreign products in familiar settings. It is both a blessing and a curse: A blessing because it becomes possible to enjoy a wider variety of treats in the place where you were born. It is a curse because you find that foreign places look a little too familiar.

However, economic and cultural integration will take a long time. Furthermore, new ideas and new technologies are always arriving.

Globalization will never homogenize what we have, not while new ideas are always appearing and adding fresh ingredients to the slowly turning blender of economic integration. Those who fear a terrible global sameness must remember that new ideas, welcome or unwelcome, will always arise faster than they can be mixed in.

Contrary to popular belief, it is simply not possible for trade to destroy all of our jobs and for us to import everything from abroad and export nothing. If we did, we would have nothing to buy the imports with. For there to be trade at all, somebody in America must be making something to sell to the outside world. The same is true for every country.

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Globalization is Green

The link between trade and environmental damage does not stand up to close scrutiny. The facts are:

- Foreign investment in rich countries is far more likely to go into polluting industries than foreign investment in poor countries.
- Foreign investment in polluting industries is the fastest growing segment of foreign investment coming into the United States while foreign investment in clean industries is the fastest growing segment of American investments abroad.
- An indicator of the environmental performance of foreign investment in poor countries, as measured in air pollution data, shows that as foreign investment improves the economy, urban air pollution is reduced. ●

How China Grew Rich

For most of the twentieth century, China was a poor country. In 1949, when the People's Republic of China came into being, the world's largest country was torn by civil war and ruled by a communist dictatorship. In the late 1950s, millions of people died in a famine induced by the failed policies of the government. In the 1960s, the university system was destroyed by the Cultural Revolution, when millions of educated citizens were forcibly relocated to work in the countryside. After all this, how did China become the greatest economic success story in history?

In 1976, after many crimes against his own people, Chairman Mao died. Just five years later, the change in China's economy was incredible. Agricultural output for example, had grown by 40 percent. Why? Because Mao's successor, Deng Xiaoping and his allies, brought the "world of truth" into Chinese agriculture.

Partly by accident, partly by benign neglect and partly by design, Deng introduced reforms that liberated agriculture. Those who had good ideas, good luck and who worked hard, prospered. Bad ideas were quickly abandoned. Good ones spread rapidly. Farmers grew more cash crops and devoted less effort to crops that were difficult to grow; all of this was the unsurprising result of introducing a price system. China had begun to travel along the so-called capitalist road.

Where successful agricultural reforms had paved the way, more complex and far-reaching reforms of the whole economy were to follow. Fifteen years after Deng

came to power, returns on investment had quadrupled. How was this achieved?

Growing Out of the Plan

— Entry and Scarcity Power

The Chinese reformers needed to encourage entry and limit scarcity without resorting to a dangerously unpredictable strategy of rapid liberalization. They took steps to improve the performances of the state sector, introduce new public sector companies as competitors, gradually foster a private sector and slowly open up to international competition.

The Chinese economic miracle was not really about privatization. What mattered was not who owned the companies, but that the companies were forced to compete in a relatively free market, driving down scarcity power and bringing in the information and incentives of the world of truth.

The effect of all this was to reduce waste, give Chinese customers better return for their money and make China a potential player on world markets. Scarcity power disappeared.

China and the World

Foreign investment has been a major factor in keeping China's reforms on track. Not only did foreign firms bring capital, and expertise and connections to the world economy, they also continued the competitive process by competing with China's domestic firms, driving them toward improved efficiency.

Does the Economy Matter?

China is not rich — yet. But it is heading in that direction fast. With economic growth comes tremendous upheaval; it is not easy to be part of a revolution. Chinese people are confused; many are unemployed or dislocated from today's modern China, and migration has torn families apart.

Conditions in factories are terrible. Employees are badly paid and work long shifts under dubious safety conditions.

In spite of this, economists like Paul Krugman, Martin Wolf and Jagdish Bhagwati have repeatedly argued that Chinese sweatshops are better than the horrors that came before them, and a step on the road to something better.

In the end, economics is about people. And economic growth is about a better life for individuals — more choice, less fear, less toil and less hardship. ●

· Book 23 of 32 ·

The Elephant and the Dragon



The Elephant and the Dragon

The Rise of India and China and What It Means for All of Us

THE SUMMARY IN BRIEF

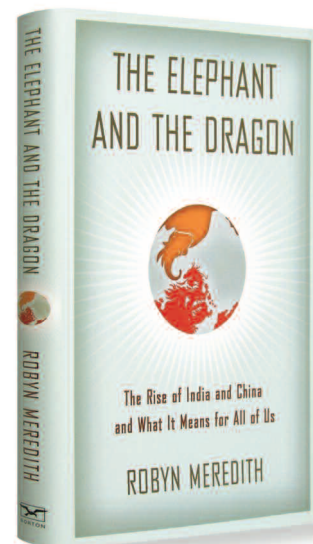
The Elephant and the Dragon explores the earth-tilting emergence of India and China on the world stage and provides an essential guide to understanding how these countries are reshaping our world.

By bringing the global economy to India and China — both by hiring Indians and Chinese and by selling products to them — Western companies are changing the face of the world economy and thus the way we live, those of us in the East as well as those of us in the West. The ability to connect cheap workers in India and China with the modern technology and infrastructure of the global economy is not just changing the lives of workers worldwide. It is not merely changing companies' fortunes. It is also changing the very way business is done.

Robyn Meredith examines the looming shadows of Gandhi and Mao that help explain not just the past but also how the future is unfolding for India and China. She breaks new ground, outlining how Americans can understand the vast changes coming and can thrive in the age of *The Elephant and the Dragon*.

IN THIS SUMMARY, YOU WILL LEARN:

- How a tidal wave of change is headed for American shores as we enter an era defined by labor unbound from geographic borders.
- How to embrace the startling shifts in how — and where — nearly everything we buy is made.
- How to cut through the alarmist hype surrounding globalization, offshoring and layoffs and untangle the complex web of business, politics and culture that entwines India, China and the West.
- How our world is being shaped by the rise of India and China.



by Robyn Meredith

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THE COMPLETE SUMMARY: THE ELEPHANT AND THE DRAGON

by Robyn Meredith

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Tectonic Economics

This is the story of how India and China are changing their destinies and, with that, changing the world's. As they move from the ranks of developing-world countries toward superpower status, India's slow-but-steady approach contrasts with China's rocketlike rise. In plenty of other ways, India and China are as opposite as Gandhi and Mao. India is democratic, and China is authoritarian. Capitalist India is often anti-business, and communist China is unusually pro-business.

Chaotic India is a riot of bright colors, a cacophonous nation with 30 different languages. Even India's nationwide time zone mystifies: It is a half-hour off from those elsewhere in the world, so at noon in New York it is 9:30 at night in Bombay.

China seems more straightforward: The national language is Mandarin Chinese, clocks line up with the rest of the world's and — no doubt about it — the Communist Party runs the country.

Transformations

The two countries have one thing in common: Their transformations — and the ways they will transform the globe — are as stunning as any the world has seen since America itself emerged onto the world economic stage.

The impact can be seen from the falling prices on Wal-Mart's shelves, the rising prices at local gas stations, the shrinking size of many American paychecks, even in the air we breathe. It can be heard in the voices on the end of tech-support phone calls. It is noticeable from the way freighters float low in the waters of the South China Sea because they are so heavily loaded with goods flowing out of new Chinese factories. Most plainly, it can be seen in the raw numbers: India and China have become the fastest-growing big economies on the planet.

Vast Changes

The ability to connect with those Asian workers with the click of a computer mouse has changed the way the world does business. Millions of jobs are moving across the world to Indian and Chinese workers who are willing to do the same work as Westerners — even specialized, white-collar work — for drastically lower pay. Westerners in many professions are suddenly finding they can no longer expect to be paid 10 times more than those in the developing world for the same work.

Even highly paid U.S. and European workers now face long-distance competition for jobs: India and China each add more college graduates to their work forces annually than are produced by the United States and Europe combined.

Yet the rise of India and China is about much more than jobs moving overseas: It is about a major shift in post-Cold War geopolitics, about quenching a growing thirst for oil and about massive environmental change. This is tectonic economics: The rise of India and China has caused the entire earth's economic and political landscape to shift before our eyes. ●

Where Mao Meets the Middle Class

In 1949, Chairman Mao announced the formation of the People's Republic of China to the world. He wasted no time in transforming the nation into his personal vision of an egalitarian communist utopia.

In 1955, Mao collectivized farming. Farmers were no longer allowed to own land or privately to buy and sell what they produced unless they had grown it on small, private plots. In just a few years, production fell by 40 percent in a land that historically had been engaged in a



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Rebecca S. Clement, Publisher; Sarah T. Dayton, Editor in Chief; Chris Lauer, Senior Editor; Christine Wright, Senior Graphic Designer

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constant struggle to produce enough food.

Mao's policies created a nationwide famine in which between 30 and 40 million people starved to death between 1959 and 1962.

Leadership Change

Mao died in 1976 and economic reformer Deng Xiaoping emerged as China's leader. When Deng took the helm from the man Chinese called "the great helmsman," 80 percent of the Chinese population was still made up of tragically poor peasants living on collective farms. The agrarian reform that Deng instigated shuffled China's planned economy toward a market economy.

It is hard to believe that as recently as 1992, the same China that Westerners fear will soon dominate the world economy was still issuing ration coupons to its citizens. Middle-class families now own televisions, live in new apartments and even pay to send their children to private schools. People have traded in their bicycles for motorcycles or even cars, some made by those same Western firms that once dreamed of selling to China's masses.

China's Growing GNP

There is now a Starbucks coffee shop on the Great Wall of China, and McDonald's has signed a deal with Sinopec, the huge Chinese gas station chain, to build drive-through restaurants along China's new roads. Over the past quarter century, China's gross domestic product has grown an average of 9.6 percent a year, a staggering figure. By contrast, over the same 25 years, India's GDP has grown by 5.7 percent and the far larger and more mature U.S. economy by 3 percent.

The architect of Singapore's remarkably fast rise from poverty-stricken backwater to developed country said he is in awe of the breakneck development of China. "I go there every year, and I'm astonished each time at the speed," said Lee Kuan Yew. In a few years, 100 million Chinese, a population greater than any European nation's, will have middle-class purchasing power. Modern China has arrived. ●

From the Spinning Wheel to the Fiber-Optic Wire

India has been haunted by two lingering ghosts of the postcolonial period — Mahatma Gandhi's anti-industrialization tenets and Jawaharlal Nehru's socialism, which together caused India to withdraw from the world economy after winning its freedom from Britain in 1947.

Admired around the world for his advocacy of nonviolence and for his moral insistence on helping the poor, Mahatma Gandhi supported policies that were meant to ensure India's economic independence from the industrialized West. He advocated traditional means of production, symbolized by his own daily use of a wooden spinning wheel, and asked Indians to stop wearing imported clothing and using imported goods, as a revolt against economic ties to a colonial power.

Rejoining the World Economy

Several decades later, in 2003, Prime Minister Atal Bihari Vajpayee of India told his Chinese hosts in Beijing, "We are the two most populous countries in the world and we have the two fastest-growing economies in the world — yours faster than ours." At last, there was consensus among India's national leaders that rejoining the world economy as China had done was in India's best interest — a historic turn for a post-colonial nation that had so long preferred self-reliance.

The Indian government plans to spend an astonishing \$150 billion on infrastructure between 2005 and 2010: \$50 billion on the decrepit airports, ports and roads; \$75 billion on power plants to bring electricity to 125,000 villages and to keep the lights on elsewhere; and \$25 billion for telecommunications. The combined sum is more than India has ever spent.

Steel

India and China have both won a marathon of sorts, one measured in metal. Steel was so important to Mao that he starved his people while trying to produce more of it than Britain. Now that China has repudiated Mao's policies, it manufactures nearly four times more steel than any other country in the world. Many Indians viewed being self-sufficient in steel as critical to the nation's ability to win independence.

In January 2007, the once anemic Tata Steel bought the former British Steel. Today India makes three times as much steel as its former colonial master, the United Kingdom. ●

Made by America in China

China amounts to a double dream for Western companies — corporate one-stop-shopping for both cost cuts and revenue growth. The first dream is that companies can use China's cheap labor to make just about any of the goods that fill shelves, catalogs and online shopping carts back in the United States and Europe.

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The second dream is that when a billion Chinese see their incomes rise as a result of the new, better-paying jobs, they can finally afford to buy Western goods sold in China.

Winners and Losers

Even though Chinese workers have been the big winners overall because their incomes have risen, they have few rights and little recourse to fair courts, so it is easy for unscrupulous, newly capitalist bosses to take advantage of them.

China's army of migrant workers, the tens of millions who pour from the countryside into the cities hoping to find work, are particularly powerless and often wind up as construction workers or factory hands. Just 6 percent of construction workers, the very heart of the Chinese development miracle, are paid on time each month, according to Qiao Jian, head of the labor union department at the China Institute of Industrial Relations.

American Jobs

The other big losers from the shift of the global economy to China are American workers whose jobs have been moved to China, and they are hard to count because the rise of China is creating some jobs in America at the same time it eliminates others. Just as the effect of China's strong economic growth on America is more complex than it appears at first glance, so is the effect on American jobs.

The bulk of China job gains have come from factory work, and most Americans no longer work in factories but in the service industries. Yet they, too, have reason to worry. Increasingly, American companies and other multinationals are hiring Chinese workers to do white-collar work.

Designed and Engineered in China

As factories move to China, products that are built in China are increasingly designed and engineered there as well. This is partly at the insistence of the Chinese government, which has asked foreign companies to create research and development facilities, not just factories.

Western companies have hired hundreds of thousands of Chinese engineers and office workers, creating China's first modern middle-class work force. In this next stage of development, the Chinese government is once again setting the nation up to prosper in world markets by using low wages to entice foreign companies to employ — and thus train — its skilled work force, not just its factory workers. ●

The Internet's Spice Route

India's more than 100 million English speakers — about twice as many as live in the United Kingdom itself — are attracting millions of new jobs, propelling its once crumbling economy into the 21st century. In the process, middle-class Americans and Britons are growing increasingly worried that their jobs will be moved from Boston to Bangalore, or from Manchester to Mumbai.

The fears of these Western workers are justified. More than a million white-collar, service-industry jobs have already moved to India, and more are on the way. As many as 300,000 American jobs each year will move overseas for the next 30 years — 9 million jobs in all, estimates the McKinsey Global Institute, McKinsey & Co.'s economics think tank.

The World's Back Office

On behalf of foreign companies, Indians answer phone calls, write computer code and increasingly take on far more sophisticated tasks — from accounting to investment banking — that previously were performed strictly in corporate offices across America and Europe. As China has famously become the factory to the world, India is becoming the world's back office.

The birth of the remote back office has turbocharged the Indian economy, reorganizing the way business is done in India and around the world and spreading India fever among foreign companies. Fueled by gold rush dreams of massive profits through cost-cutting, international companies are rushing into India, and they will leave in their wake millions of white-collar workers in the West, all of whom will need to find new jobs and some of whom will have to find new careers.

Intel has already hired 2,900 Indian workers. Of the world's 500 largest companies, 400 send middle-class work to India, up from 150 in 2000.

The new practice of moving white-collar work overseas is called off-shoring, and it put long-ignored India on the map as a market for foreign companies.

Opposite Approaches

China's government-planned development has turned it into the factory to the world and is in the process of transforming it, like India, into a powerful magnet for foreign companies' white-collar work. India, meanwhile, is finally following China's example, first attracting back-office jobs and more recently getting foreign companies interested in opening factories. The two nations have taken opposite approaches, but they share one important trait: They are the fastest-growing big economies in the world.

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Because each is growing about three times as fast as the United States and Japan and far faster than Europe, India and China represent the unavoidable future for companies around the world. The two emerging-market giants are the only places where most big companies can grow rapidly, their only hope for adding vast numbers of new customers, and thus for pleasing stockholders and corporate boards. ●

The Disassembly Line

The way the world does business has changed because what Americans and Europeans buy on store shelves is flowing down a new kind of assembly line, one that stretches back and forth between disparate countries around the world.

Ten years ago, this indirect, pinball-like path from factory to customer was not an option. But during the 1990s, companies began searching for the lowest-cost place to make each component of their products. At the same time, sophisticated technology made reality of what had once been a logistical pipe dream: creating a seamless connection between multiple factories, sometimes in multiple countries. Cost-cutting efforts combined with powerful new technology allowed companies to change the way they build most consumer products.

Henry Ford

The last time a manufacturing revolution of this magnitude occurred was in the early 20th century, when Henry Ford revolutionized the business world by popularizing the assembly line. He brought into one place all the materials and components needed to make a car, lined up workers and had each of them manufacture and install one piece until they had cooperated to make a car.

In the 21st century, everything has changed. Henry Ford's assembly line was shattered into a thousand pieces and scattered around the world. The new system — call it a disassembly line — is the result of companies rushing to break up their products into specialized subassemblies to drive down costs, ratchet up quality and reduce the time it takes to get the product to market. The manufacturing process is so different from that of the last century that the term “assembly line” has been replaced by the phrase “supply chain.”

How It Works

Here's how today's disassembly line works: A clothing company like J.C. Penney Co. might order 100,000 copies of a shirt. First, it might buy yarn from a Korean producer, then ship the yarn to Taiwan to be dyed and woven into cloth. The clothing company might order

buttons from a specialized Japanese company with a factory in China, but ship the buttons plus the freshly woven cloth to Thailand to be cut and sewn into a shirt. Because fashions change quickly and the store would want the shirt on its shelves as soon as possible, the cloth and buttons might be sent to five different Thai factories so that each could rush to finish and ship 20,000 shirts, completing the 100,000-piece order faster than if one factory produced the entire lot.

Five weeks after they are ordered, identical shirts can be found on store shelves halfway around the world. It may sound needlessly complicated, but this shipping frenzy pays for itself as it means fewer remaindered goods, which occur if the shirts hit store shelves after fickle customers have moved on to newer fashions.

The Backbone of Globalization

The disassembly line is the backbone of globalization. The ability to fragment the assembly line and stretch it across the world has dramatically changed the roles of companies and their workers. The disassembly line has let companies become extremely efficient, by building each piece of a finished good in the country where it is cheapest, then moving the part on to the next factory in line. This approach also allows each company to focus on what it does most productively, driving down prices for consumers around the world and spreading jobs across the globe. ●

India's Cultural Revolution

To visit Infosys' Bangalore headquarters is to see not just the newly emerging India but also the entire global economy on the move. Outside the gates of the complex, barefoot children walk to school on the noisy, traffic-choked streets. But inside the guarded gates is an idealized re-creation of an American college campus. Infosys' office buildings sit quietly among grassy expanses bisected by sidewalks and peppered with basketball and volleyball courts. There's a Domino's pizza restaurant and a giant parking deck. Back when the Infosys campus was built in 1994, most workers rode buses or motorcycles. A decade later, new cars are replacing two-wheeled transport.

India's Economic Reforms

As India's economic reforms bring even greater prosperity, some of the profits from the newly flush Indian customers go to Indian businesses and some go to Western companies. The prosperity of Indian technology companies and their workers has indirectly created 3 million Indian jobs outside the industry, some in construction and some through employees' increased spend-

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ing at restaurants, nightclubs and shops. Indian airlines and hotels are packed as business travel booms and as more Indians can afford to fly instead of ride trains.

To move its economic development forward, India must come to grips with the nation's enduring post-colonial aversion to connection to the world economy, and it must put in place policies that encourage Indian and foreign companies to hire in India.

Out of Poverty

The Indian government must convince voters that the changes it uses to spur economic development will bring them gains — something that is sometimes easier to see from a distance. It must make the case that building new roads will create hundreds of thousands of construction jobs for the poor even as it displaces some from their homes.

If India fails to fully unleash its economy while it has the attention of investors from around the world, it will pay a heavy price in prosperity both today and when its young population becomes a working-age behemoth in need of jobs. India must move past the on-again, off-again reforms that slow its economic rise or risk missing a historic chance to propel hundreds of millions of people out of poverty. ●

Revolution by Dinner Party

Hung Huang is China's answer to Oprah Winfrey. She publishes women's magazines; writes one of China's most popular blogs; penned a juicy, best-selling autobiography; and even had her own TV talk show. She — and her surroundings — captures just how much China

has changed in a single generation. After growing up in Beijing and then graduating from Vassar College, she returned to her hometown to find China in the midst of a metamorphosis.

Hung, currently the CEO of China Interactive Media Group, lives in a vast loft apartment that could have been plucked from downtown Manhattan and deposited in Beijing's art gallery neighborhood intact, complete with towering ceilings and contemporary artwork. The art doubles as political commentary: Adorning the exposed brick wall in the dining room is a neon sign with foot-high, red Chinese characters. "Revolution is a dinner party," it proclaims. Indeed. Mao defended the hardship his hungry subjects faced by declaring, "Revolution is not a dinner party." Today, with China in the midst of another kind of Cultural Revolution, it is.

China's New Approach

Mao's Cultural Revolution devastated the nation, crushing its intellectual, scientific and artistic capabilities, eliminating China's education system and ruining its economy. When Mao died in 1976, he left behind a nation of penniless peasants. Now that his Communist Party has done an about-face, gradually rejoining the world economy, moving toward a market economy and taking the nation through an industrial revolution, incomes are rising and the once quashed spirit of the Chinese is reappearing.

Already China's new approach has lifted more than 100 million people out of poverty, and average incomes have doubled in a decade. Hundreds of millions of lives have been altered as China's economy modernizes.

The world's big companies may have come to China to sell to a billion new customers or to search for low-pay laborers, but despite their motives, their presence has brought incalculable changes to the everyday lives of the millions of Chinese who work for them.

Already there are 14 million Chinese earning more than \$12,500 a year. The disposable income of that elite group stands at \$61 billion a year.

Rising Incomes

However stratified, incomes are rising quickly across the board. Today 77 percent of urban Chinese live on less than \$3,100 a year; by 2025, just 10 percent will earn that little. By then, urban Chinese will spend \$2.5 trillion a year, almost as much as Japanese now spend in what is today one of the world's biggest consumer markets.

By 2011, a large wave of 290 million Chinese is expected to reach the lower-middle class, earning

China's Consumer Market

As incomes rise, China is emerging as a giant consumer market, and companies' attempts to reach it are changing core traditions in China.

Tom Doctoroff, CEO of Greater China for the J. Walter Thompson advertising agency, has marketed some of America's most prominent brands to Chinese buyers. He likens the setting to America in the 1950s, long before TiVo let TV viewers skip commercials. People in China believe what they see on their new televisions. And commercials using the sophisticated production techniques common in the West can be far more eye-catching than the stuffy, censored programming of China's state-run TV stations. China's TV viewers are more impressionable than jaded American and European viewers, and that naïveté is helping Western companies sell to the Chinese.

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between \$3,100 and \$5,000 a year. By 2025, about 520 million Chinese should have reached the upper-middle class, earning between \$5,000 and \$12,300 a year. The combined disposable income of that group is expected then to reach \$1.6 trillion. ●

Geopolitics Mixed With Oil and Water

After a century-long hiatus, India and China are moving back toward their historic equilibrium in the global economy, and that is producing tectonic shifts in economics as well as in geopolitics. The prevalence of made-in-China goods on American store shelves is evidence that truly global trade is again flourishing. India's service exports are not as visible, but India, too, is clearly returning to its former important role. "Both countries are on the way to reclaiming their rightful places in the world economy," India's Prime Minister Manmohan Singh stated in 2006.

Until the late 19th century, China and India remained the world's two largest economies, according to Angus Maddison, the distinguished economic historian. But protectionism and the world wars intervened, then India and China shut themselves off from the world, and by 2003 India and China together accounted for just 20 percent of the global economy, despite their vast populations.

China's economy will grow larger than the long-reigning United States' again by 2030, at which point India will have the third-largest economy, Maddison predicts. In 2030, India and China combined will account for 28 percent of the world's economic input, up from 18 percent in 2001. Although Americans will remain far richer per person, the U.S. economy by 2030 will have declined in relative terms from 21 percent of the global economy to 18 percent.

Three Big Issues

But as India and China rejoin the global economy, three big issues, besides jobs, are coming to the forefront. First, as the two giant nations go through industrial revolutions, their appetites for natural resources are skyrocketing.

The new demand is leading to higher world prices. Their growing thirst for petroleum, along with newfound economic strength, is causing shifts in political alliances around the world. In addition, now that both nations are richer and have new technology, both are quickly modernizing their militaries, causing

Energy Needs

Westerners fear job losses as China and India ascend, but the most troubling element of their industrial revolutions may instead lie in their soaring energy needs.

The rise in the consumption of natural resources in Asia is significant because of the sheer numbers of people involved: There are a combined 600 million Americans and Europeans but more than a billion Chinese *and* a billion Indians. India's oil consumption has doubled since 1992, and China's has doubled since 1994. China already consumes more coal and steel than any other nation, including the United States. Demand has dramatically driven up the world prices of a range of commodities, from aluminum to oil to zinc. As India and China race back toward their former prominent roles in the global economy, their economic successes don't just create and destroy jobs around the world; they impact the natural world too.

powerful shifts in geopolitics not seen since the end of the Cold War.

Finally, as India and China industrialize, their already dire pollution is worsening. The result is blackened air and water for them, along with danger for the world's environment.

Growing More Connected

As the Indian and Chinese economies grow and take hold of a larger slice of the global economic pie, both are growing more connected to the rest of the world, not more estranged from it. Disagreements between nations are no longer disputes about economic models — communism versus capitalism. Capitalism decisively won the Cold War debate, and that has helped hundreds of millions of Indians and Chinese prosper by ushering in the globalization era that has created so many jobs and bettered so many lives in developing countries.

So far, the increased trade has drawn nations closer together, even to the point of answering each other's e-mails and phone calls. The whole world has a stake in keeping vibrant worldwide trade going, rather than giving in to the temptation to try to protect jobs at home instead of letting them flow freely around the world. The geopolitical shifts are enormous, but the economic developments may force even bigger adjustments — not only for India and China but also for the West. ●

Summary: THE ELEPHANT AND THE DRAGON

A Catalyst for Competitiveness

Some individual Americans are feeling the squeeze from India and China, but collectively, Americans are benefiting.

The re-emergence of these Asian giants and the vast increase in global trade that has ensued mean that ever-lower prices are offsetting what could otherwise feel like a falling standard of living for middle-class Americans. Consumers are the big winners. Call it the Wal-Mart paradox. By buying from factories in China, India and other low-wage countries, Wal-Mart has brought Americans almost irresistibly low prices — sometimes for goods no one knew were needed. Wal-Mart and stores like it have allowed Americans to keep their closets — sometimes even their garages — overflowing, encouraging Americans to spend and spend on mostly foreign-made goods.

For those with stable jobs, the widespread availability of ever-shrinking prices lessens the pain of paychecks that have stagnated. Wal-Mart has become such a big player nationwide that it has helped set a “China price” for goods supplied to its stores (and their competitors), and that pressure has helped push companies to close factories in the United States and buy from low-wage factories overseas. The paradox is that Wal-Mart’s success — and its eager shoppers — has led to job losses in the United States, even as it has eased the pain of adjustment for American factory workers who lose their jobs.

Back to Basics

In readying for a storm of competition, America must return to basics. The most critical building block is education. Federal, state and local governments — and the individuals who elect them — will be catastrophically irresponsible unless they insist on dramatically improved education, starting with elementary school. Despite years of hand-wringing and despite higher spending than that of other industrialized nations, America’s schools threaten to leave the nation less competitive in global labor markets.

A barrage of test scores shows that American students are already far behind the world’s academic leaders. When those American children grow up and start working, they will not have the skills to compete with better-educated foreign counterparts, much less to earn wages 10 times higher.

Business leaders — the ones busy hiring Indian and Chinese college graduates — warn that judging by America’s current education efforts, the nation is already falling behind. “The competitiveness of the U.S. work force depends on a strong educational foundation, par-

ticularly in the math and science skills required to succeed in the information technology industry,” says Craig R. Barrett, chairman of Intel Corp. “We need to raise our sights and not tolerate the mediocrity we already have.”

Expect Change

The stakes are high: Without dramatic changes, standards of living could fall as more white-collar as well as blue-collar jobs move overseas to hungrier, harder-working, lower-paid Indians and Chinese. Americans should expect change and embrace it, rather than expect to work in the same job for an entire career like the previous generation. Americans must be ready for disruption and willing to undergo retraining to upgrade their skills and to be ready to change careers to jump on new job opportunities when they arrive.

There is one thing impossible for any company to move overseas and difficult for other nations to duplicate: America’s essentially scrappy culture of thinking of, funding and bringing to market new ideas and ventures — its people’s inventive, can-do mindset. Despite the coming turmoil, Americans should not assume the worst, but ready themselves to embrace the new opportunities that will come along, even though experts cannot say what they will be. Americans are flexible and creative, are risk-takers, are the world’s optimists and are at their best as underdogs.

Americans in a New World

“Americans like to compete,” says Intel’s Chairman Craig Barrett. “It is a fundamental strength and national characteristic that we have.” The United States is the world’s largest, strongest, most resilient economy by good measure. Americans must embrace that and walk tall into the ways of a new world shaped by the rise of India and China.

If inward-facing India and communist China can transform themselves and face the world, so can the United States of America. ●

RECOMMENDED READING LIST

If you liked *The Elephant and the Dragon*, you’ll also like:

1. ***The Coming China Wars* by Peter Navarro** The updated and expanded version is still a “call to action” to increase awareness of the world’s growing China Problem for which economic and political actions are long overdue.
2. ***The Next Global Stage* by Kenichi Ohmae** Legendary business strategist Kenichi Ohmae synthesizes today’s emerging trends into a coherent view of the global economy of the future and describes the implications.
3. ***World Out of Balance* by Paul A. Laudicina** In order to seize the many opportunities available in this changing world, companies must develop a structured and dynamic process for reading the signs of change.

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The Extreme Future



The Extreme Future

The Top Trends That Will Reshape the World for the Next 5, 10, and 20 Years

THE SUMMARY IN BRIEF

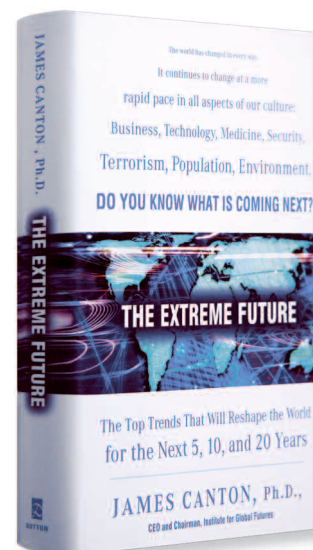
Are you interested in the future of your industry? Where your future customers may come from? What about your current career — or your next one? If so, *The Extreme Future* will offer the insights that may help you derive the answers. The world continues to walk the fine line between light and darkness. Innovation and medical advances are met with equal fervor by invasions of privacy and increasing ecological and terrorist threats. The sheer velocity of change can overwhelm most individuals, but renowned futurist James Canton, Ph.D., is on the front line of the fight to understand tomorrow.

This is not only a book for business leaders. Understanding and preparing for the future — and learning to use the tools that make that possible — is a responsibility we all share, for the sake of our own interests as well as society's.

Canton charts a course to steer you through the volatile changes that lie ahead. *The Extreme Future* is the essential guide for what's next and how to navigate the trends that will shape the future of business, markets and society. He challenges us that with the right information about future trends, it is possible to navigate the Extreme Future.

IN THIS SUMMARY, YOU WILL LEARN:

- How climate change and new energy demands will reshape the planet.
- How shifting population trends will transform the workforce.
- How radical innovation trends will create personal wealth and competitive advantage.
- How astounding medical advances will radically enhance people's lives.
- How dangerous terrorism trends will threaten the individual and society.
- How the rise of China will bring on a new global power struggle.



by James Canton, Ph.D.

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THE COMPLETE SUMMARY: THE EXTREME FUTURE

by James Canton, Ph.D.

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Welcome to the Extreme Future

The future of our lives, of our work, of our businesses — and most of all, the future of our world — depends on us gaining a new understanding of the dizzying changes that lie ahead. Events such as the mapping of the human genome, the end of the Cold War, the rise of China, the Internet, globalization, existing and potential epidemics, and “weird” science contribute heavily to the need to find new ways to understand the future. We face a new future in which uncertainty reigns supreme.

When there is no future vision, there is nothing to work toward creating. The lack of a goal to work toward will result in failure. This is a starting point for nations, organizations and individuals. Consider John F. Kennedy's challenge to go to the moon, Ronald Reagan's “tear down this wall” call for an end to a divided Germany, Martin Luther King Jr.'s dream of racial equality and Gandhi's nonviolent liberation movement. As different as these men were, as different as their stated goals were, all had one thing in common: a clearly articulated future vision and a sense of the trends of the day that enabled this future to become reality.

It is not just one force, one trend, but the convergence of trends that create the future. This convergent thinking is central to making better forecasts. ●

Fueling the Future

Several years ago, a former Saudi oil minister issued what has since become an oft-quoted prophecy: “The Stone Age did not end for lack of stone, and the Oil Age will end long before the world runs out of oil.” It

was a lament, an acknowledgment that a day of reckoning was coming that would change the global balance of wealth and power. A fluke of geology had made the vast emptiness of the Saudi desert the No. 1 source of the most important commodity on earth. But the good times would not, and could not, last forever, and he knew it.

The Myth of Abundance

The United States imports about 12 million barrels of oil a day, or roughly 60 percent of the oil it consumes. In 1970, dependence on imported oil was just 21.5 percent of U.S. consumption. The U.S. is the world's No. 1 oil consumer, using more than 26 percent of the world's oil. Japan and China, the next two leading consumers, together account for 13 percent.

Roughly 11 percent of global oil production is devoted purely to providing gasoline for cars and trucks on American soil. America spends more than \$25 billion a year on Persian Gulf oil. At the same time, the United States possesses only about 3 percent of proven reserves (opening the Arctic National Wildlife Refuge to drilling would increase that by just a fraction of 1 percent). Already, you can see just how close the ties are between oil — especially foreign oil — and what we consider the American way of life.

Looking ahead, world oil consumption is likely to rise by 50 percent by 2020, and the United States is projected to play a leading role in that anticipated increase. If you consider the needs of fast-growing, oil-hungry countries such as China and India, as well as the other emerging developing countries in Asia and Latin America, what you have is an unsustainable energy world.



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Postindustrial dilemma

The lack of energy to fuel transportation, health care, business, communications or manufacturing would have a devastating effect. The absence of an adequate, cost-effective, abundant supply of energy would doom a society in the developed world for certain. Social stability and growth are linked to a pipeline of abundant energy.

It is in the interest of all nations — developed and developing alike — to pursue energy security. Energy for the developing world may be vital to future economic prosperity, poverty reduction and, perhaps, democracy. Energy enables the freedoms and individual self-reliance that are the foundation of a democratic society. The world needs affordable, abundant, nonpolluting, renewable sources of energy to sustain life, support growth, and maintain or improve quality of life.

The U.S. economy's GDP growth is about 4 percent per year. The Eurozone is at 2.5 percent. China alone is growing at almost 10 percent a year. Governments in China and elsewhere are today locking up future oil reserves in the ground. The Chinese have contracted with the South Americans and Africans for future oil supplies reaching deep into the 21st century. They are defending against Japanese rights to oil-potential deposits in the seas. They are scouring the planet from Australia to Ecuador for all commodities, especially energy-related ones. The energy wars are here, but not everyone has noticed.

Fueling a Prosperous World

If we can't fix the coming energy shortage with existing technology and resources, then we need to identify new forms of energy, since no one would seriously suggest that we roll back the advances in society. In fact, quite the opposite is true. Developing nations need reliable and cost-effective energy to defeat poverty, install democracy, develop the middle class and grow commerce.

The Europeans and the Japanese have invested wisely for energy-independent futures based on nuclear technology and alternative energy sources such as wind. Alternative energy in Germany alone accounts for more than 12 percent of overall energy.

The U.S. — despite having invested heavily in nuclear energy — was never able to deal with the negative public perception about it. Nuclear energy accounts for less than 8 percent of all U.S. energy consumption.

Based on current production and consumption technologies and trends, we as a civilization — not just as a nation — do not have the existing or projected energy

Five Things Everyone Needs to Know About Energy

- The era of cheap oil is over.
- Alternative energy, though promising, is not ready to produce adequate supply.
- We need to invest quickly in new energy sources.
- We need to learn to conserve energy.
- Energy is a national security issue.

resources and production means that we will need to sustain growth, security, quality of life and productivity by 2040 — and possibly sooner.

Even if we were to start feverishly building nuclear reactors, solar and wind farms, hydroelectric plants and other renewable energy sources, we still would not be able to meet the rapidly expanding energy demands in 30 years. ●

Finding Prosperity: The Innovation Economy

Dinosaurs that once ruled the earth weren't replaced by creatures larger or more fierce. They were succeeded by creatures more nimble, more able to adapt, more capable of evolving — in sum, more innovative — at a time of rapid, radical change. This story illustrates a future we all face, one in which we will need to evolve, be nimble and be adaptive, or face individual, economic and even societal extinction.

The coming innovation economy will herald an age of rapid, dramatic change, one in which ideas that create value, offer solutions and fulfill needs will thrive. Innovation will be the prime source of productivity, prosperity, competition and potentially even peace. Innovation will be recognized as an empowering force that will drive individual prosperity and global competition.

An economy is a collective measure of the production, distribution and commerce in a given area, from a small village to a state to a nation to the entire planet. It is the result of the productivity of workers and organizations. An economy is also about the flow of ideas, capital markets, talent and growth.

That textbook definition will be rewritten in the Extreme Future. The new definition will reflect the fact that 21st-century economies will survive and prosper

The Next Workforce

Most organizations and nations are still asleep, unaware that there are problems brewing, convinced that any shortages in talent will be short-lived. Denial runs deep, because no one likes change. The reality is that these are not temporary changes but massive dislocations that will force companies without people resources to move, sell, merge or go out of business.

only if they embrace innovation. If they do, if the individuals within them understand and capitalize on innovation, they will come to enjoy shares of the greatest prosperity generator the world has ever known. ●

Help Wanted: The Future of the Workforce

One challenge has the potential to enhance or destroy the future of the U.S. economy: preparing for the next workforce and the coming talent war. This is a vitally important Extreme Future trend that will affect generations of citizens and corporations, as well as the nation's influence around the world. As a result, it must be addressed soon.

America's workforce is changing in fundamental ways. Today, there are more than 1 million high-tech jobs that are not filled. This shortage is not just about people, but a lack of skills. Companies in the innovation economy, those on the front lines such as Apple, Intel and Microsoft, have gone offshore to conduct research and new product development because they cannot get the same talent here. Talent, skilled human capital, innovative, high-tech-savvy people independent of any nation will be the lifeblood of the future organization.

There are clear actions the nation should take, starting today, to offset the coming challenges, such as remedying the massive dysfunction of the U.S. education system. At the same time, some trends are inevitable, such as lower birth rates, and so we will simply have to prepare to confront them in the Extreme Future workforce.

Population Changes: Changes in population will bring more women into the workforce, along with older workers and more culturally diverse workers. By 2025, one in every three new employees will be female. Also, lower birthrates in the U.S. will mean fewer workers will be available, unless immigration is accelerated. This

trend will accelerate outsourcing as talent — independent of geography — will become the most valued asset to corporations.

According to the U.S. Bureau of Labor Statistics, the U.S. workforce will lose the skills and knowledge of 46 million college-educated baby boomers, who will retire over the next 20 years. They are not being replaced, at least not domestically. This will become a crisis, not just in the U.S. but in Europe as well. Unless we drastically open the doors to immigration to offset low birth rates and low productivity, quality of life will decline.

Those new workers are going to be faced with added burdens. In 1950, there were seven working-age people for every elderly person in the United States, but census figures show that by 2030, there will be only three.

Globalization Changes: The increased skills of foreign workers and the stability of their home countries will be key drivers of U.S. productivity as businesses look to the global workforce for services and solutions they cannot get at home. Outsourcing, which is both cost-effective and holds a competitive advantage, will become a main component of U.S. business. Increased skills of foreign workers, some with skills even more advanced than those of U.S. workers, will drive this trend in the future.

Innovation Changes: Jobs in the future will require even more advanced skills, higher education and more sophisticated high-tech training. Having an innovation-savvy workforce will be the central factor that will drive future growth and success in business and society. Yet without significant upgrades to the U.S. education system, our workforce will not be innovation-savvy.

Ninety-seven percent of our youth hope to go to college: 63 percent actually enroll, but only 30 percent actually receive a bachelor's degree, according to the U.S. Department of Labor. Even worse, employers estimate that 39 percent of their current workforce and 26 percent of new hires will have basic skills deficiencies, according to the Bureau of Labor Statistics.

Competitiveness Changes: Compared with education systems in other nations, U.S. schools are not preparing the future workforce adequately to compete in the global economy. The U.S. remains below more than 20 other nations in math and science scores, which points to a dangerous future for the U.S. workforce.

The United States ranked 28th of 40 countries in math and 18th in reading, according to the Organisation for Economic Cooperation and Development. With jobs

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requiring more complex skills like math, science and technology, Americans may lack the skills necessary to compete in the future global workforce. ●

Outliving the Future: Longevity Medicine

The largest global marketplace in the near future will be shaped by longevity medicine, offering a variety of anti-aging and health-enhancement products. Everyone who wants to live longer — and can afford it — will be able to stay healthy.

The ability to extend healthy life will have earthshaking societal, political, financial, environmental and individual consequences. Destinies and futures will be enhanced and broken. Careers and relationships will be shaped and chosen. Longevity medicine is not just about the future of health care; it is about a personal and social transformation in culture that will define how individuals will live, work and interact.

Not all of the choices enabled by longevity medicine will seem fair, morally right or even desirable by all people. There are dangerous decisions ahead that will raise fundamental questions about the nature of humanity and human evolution.

Life Extension

Just as the 76 million baby boomers, those born between 1946 and 1964, have redefined every aspect of culture, from media to technology to sports, so too will they redefine health care, making it about life extension and human enhancement so that they can extend their power, their influence and themselves into the future by living longer and healthier. This is a critical motivation for the most affluent demographic group on the planet. What appears at first to be a narcissistic desire for survival will actually set into motion a (mostly) constructive future.

If you consider this life extension trend in context with the need for society to keep the highly skilled boomers employed in the future workforce longer, you begin to see the larger social issues at play. Longevity medicine will lead not just to longer lives, but to longer, more productive workers. In a future at risk of depopulation due to lower birth rates, longevity medicine will become a much needed social entitlement.

As people live not just longer, but with replenished capacities and even higher performance, the world we live in will change in dramatic ways. Think about this for a moment. How different would your life be if you

believed you had not just 60 or 70 years to live with diminishing capacity in old age, but 125 years, with the vitality of a much younger person along with the wisdom of experience? ●

Tomorrow's Climate

There is abundant evidence that climate change and environmental threats present a real and present danger to life as we know it on the planet. If we do not fix these problems, the safety, health and survival of the world's population is at stake. Some climate change may be irreversible. Fundamental challenges such as clean water, food, health care, transportation and commerce are directly linked to climate.

The idea that individual lifestyles are actually making the climate change is not readily accepted, but it is true. The discrete, seemingly unconnected actions of 6 billion people are leading us every day toward or away from environmental disaster that may signal the end of civilization.

Global Warming Is Real

The rate of temperature warming and rising sea levels will continue into the 22nd century. This is not good. One can simply calculate the risks to life, health and society caused by this increased warming in the future to get an idea of what is in store without fast, sustainable global management of the environment. To date, too little has been done, and we are running out of time.

A United Nations-sponsored report called the Millennium Ecosystem Assessment emphasized that approximately 60 percent of the ecosystem services that support life on earth were at serious risk of being damaged by pollution, overuse and mismanagement. This includes ecosystems essential to human life such as water, agriculture, fisheries and air. The lack of sustainable management of the climate is at the core of what is missing and what will increase risks in the future.

As we move into the future, radical shifts in the environment due to natural causes, industrial pollution, overpopulation and lifestyle will alter the relative stability we have enjoyed, unless significant action is taken now. ●

Cultures in Collision: The Future of Globalization

Globalization is about a new synthesis of ideas, trade, communications and collaboration that should promote future global prosperity, freedom and opportunity. As a force of modern civilization, it may overcome the issues

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and barriers that create division, conflict and inequities. This new integration of trade, innovation and progress may incite more democracy and freedoms, or it may confuse and complicate a wondering world, suspicious of globalization's risks and unaware of its potential.

Globalization is still very much unraveling and will remain in a state of flux for the next 50 years. Will it become a force for global progress, collaboration and cultural understanding, or will it be hijacked by forces opposed to these values? Our future will be defined by our deepening understanding of other cultures, nations and diverse ideas.

Battle for the Future

In its crudest sense, globalization is either going to be the most successful revolution to accelerate global democracy, free trade and open markets, or it will victimize the poor nations of the world.

The resistance forces of globalization fear that the West continues to move forward with global dreams of free trade and democratic reforms — without including poor nations at the table. The organized global terrorist networks are counting on globalization to provide support for their dreams of global destabilization, which would allow them to continue to lure new recruits in poor nations, raise funds via criminal actions such as drug trafficking and commit acts of terror in the name of those who are being left out of the globalization game.

This is the Achilles' heel of globalization advocates. Unless we find a way to bring the rest of the world on board fast, globalization will fail or drive a 100-year stake into the heart of liberal reforms, open markets and, most importantly, peace and security. This is perhaps the greatest challenge facing our civilization today. People without a future are the most dangerous people in the world. They will do anything to get a future — or to destroy those who they believe are robbing them of that future.

Poverty Will Kill Globalization

Poor countries are generally weak in law enforcement. Without the competence to meet their citizens' basic needs, they are easy prey for extreme religious groups and terrorists. They also become havens for international crime. ●

Securing the Future

In the Extreme Future, there will be two sets of threats, traditional and asymmetric, that will defy logic, create social havoc and alter our world. Traditional risks

are what we might expect — a nuclear or bioterror attack, for instance. Asymmetric risks are what we don't expect, which might be an attack at a mall, a bioagent released into the water supply, a suicide bomber at the Stock Exchange or an Ebola-carrying passenger entering the land. Asymmetric risks, such as flying airplanes into buildings, redefine the risk landscape and will challenge us to think differently.

The risks we will face in the future will be new, complicated, serious, widespread and extreme. These risks to our life, health, society and even our sense of what it is to be human will frustrate our capacity to manage the future. This may be one of the greatest challenges we as a civilization have ever had to face.

The Double-Edged Sword of Innovation

As much as we hail the coming innovations, there is a dark side of innovation. The innovations that will provide greater competitive advantage, improved education, prosperous commerce, increased quality of health care and a higher standard of living might also be used to annihilate civilization as we know it. Think of the Internet used as an e-mail and propaganda tool by terrorists, or computers used to plan attacks and manage networks of people, or biotech used to make weapons.

Privacy for Sale

We don't give much thought to the many eyes watching us, the video cameras following us, the databases monitoring our every behavior. But this invasion of privacy will seem tame as we step into the Extreme Future, where others will watch every act, every behavior, every association, every interest, every transaction and every communication.

If one threat will encroach on our personal liberties more than others, it will be the assault on our privacy brought about by the convergence of technology and social policy amid the insecurity of the future. George Orwell's nightmarish vision of the future, expressed in *1984*, might seem like a golden age of liberty. ●

Invisible War: The Future of the Individual

In the future, there will likely be a more collaborative relationship between nations, even nations of differing ideologies and political systems. Relations between the U.S. and China will be similar to dealings between the U.S. and Europe, which have shared interests yet remain different in many ways. What will emerge in the future is a collaboration of cultures, ideas and economies.

China has been changing because of this influence, transforming itself into a market economy that perhaps will be the largest in the world by 2040. Market economies are associated with democratic societies, those that respect individual freedoms and rule of law, those that guarantee free elections and a free press.

Clearly, the fate of the individual needs to be protected — not just in China, but throughout a world influenced by two large superpowers such as China and the U.S. The Chinese political model of today, with limited individual rights, will not be the same model in 2040 or even before that. As prosperity increases, China's population will demand more parity with the people of democratic societies. The age-old dance between the individual and government will persist, but it will take new forms as it meets new threats and confronts new challenges.

Subtle Risks

Democracies won't long survive, or be authentic democracies, if they are not dedicated to protecting the rights of the individual for the long term. If the individual is at risk, then democracy as a viable system for society is at risk. There will be dangerous seductions and subtle risks we may not even recognize until after they have appeared. We must be on guard today to keep these costs from being incurred tomorrow.

Some of these ideas will seem dangerous — and they are. Today's individual is at risk from external forces as innocent as advertising, as intrusive as censorship and as deceptive as pharmacology. Clever, seductive, always-on technology, without democracy and in the wrong hands, will be used to manipulate ideas, fabricate knowledge and even design reality. The individual will be the target. Information will be manipulated. Technology will be used to change what we think, what we do and, most dangerously, what we believe. We must guard against the information engineering of our reality. This is one of the most dangerous risks individuals face in the future.

The individual has always been at risk from the forces of ideology, government and religion. The battle between the freedoms and rights of the individual and attempts at control by government, religion and ideology has been ongoing for as long as civilization has existed.

The risk to the individual will continue into the future, in part from technology but also from old-fashioned politics. An ideal future would be one in which the goal of every government would be to empower the individual to enjoy freedom, prosperity and human rights. But increasingly, the tyranny of radical theocrats and despots reminds us that the very idea of individual freedom is anathema to many world leaders.

The Invisible War

Most people don't even know that a war against individual rights has already occurred. We in the developed nations of the world may face more complex, long-term challenges to our individual freedoms, such as brain implants, drugs, censorship and limits on media choice, but individuals in developing nations that are less than democratic will be vastly more at risk.

For example, consider these questions and the implications for free choice:

- What if you did not have unfettered access to the Internet?
- What if you did not have access to quality education?
- What if you lived in a society that did not offer free elections?
- What if you lived where there was no free press and all the news you read or saw on television was controlled by the government?

In the U.S., these questions seem unrealistic. But more than 75 percent of the world — that's more than 4 billion people — doesn't have access to the Internet, phone service, clean water, regular meals, free elections, or quality education and health care.

The developed world uses 90 percent of the world's resources — water, food, energy and capital. Isn't it realistic that the other citizens of the planet, the remaining 4 billion, might be angry about this? There is something off base when so many have such limited access to the total resources of the world. We must consider this when trying to grapple with global conflict, terrorism and the future. This is not just about fundamentalism. There is a legitimate argument here, one that suggests that better sharing of resources would reduce tensions between ideologies and cultures.

Trading Rights for Security

The real threat to individual rights will emerge silently and over time. It will be the creeping insecurity caused by more identity crime, more terrorism, and even more economic downturns or disruptions. The real threat will come in the form of a deal with the devil, in which we will trade our individual rights and freedoms for more security. We will scare ourselves into giving away our rights unless we are very careful and remain vigilant for danger signals. The manufacturing of "rational" fear will become an industry in the near future. This is a dangerous trend that we want to resist.

It will do no good to create a future where by 2050 we have eliminated poverty and war, created

Summary: THE EXTREME FUTURE

open global trade and increased productivity and standards of living for the 9 billion residents of Earth but have traded our individual rights for this false prosperity. As America moves forward in promoting the model of democracy and capitalism on the world stage, there is nothing more important than the respect for individual freedoms that must be at the heart of this quest. We must be aware of creeping threats to the individual, the invisible war that is encroaching on the very freedoms our nation was founded upon.

The right of the individual to stand free and make his or her own choices must be the central pillar of civilization's future. The track record on this score over the past thousand years often has been hit or miss. Religious fundamentalists, kings and dictators have attacked the freedom of the individual over history. We must guard our rights to freedom or lose this war for ourselves and our children. It is our destiny to forge a balance between the rights of the individual and the government that preserves that individual's right to freedom. Individuals should control the government, not the other way around. ●

Dancing Dragon: The Future of China

If there were ever a time to wake up to the sheer power of China's population, buying power, energy needs, consumer demands and eventual military strength, that time is now. As China rises, the evolutionary needs of 2 billion people in a few scant years will reshape markets, competition and trade on a scale we can only imagine. Trillions of dollars of wealth will be traded, exchanged and moved from West to East.

The engines of productivity in China today are cheap labor, innovation and capitalism on steroids — a supercharged, hyperaggressive need to catch up with the rest of the world's developed economy. In the future, it will be smart labor coupled with even smarter innovation. This represents a new challenge and opportunity for the world and for China. China's growth could bring future stability and peace or chaos and insecurity — both internally and externally. This is the challenge of the future, and it reflects China's immense role in meeting this challenge effectively.

The relationship between China and the U.S. is paramount to the future growth and security of the world. Both nations realize this. It is not often spoken of, but it is widely understood at the very highest levels of government and commerce. Together, they will form the cor-

nerstone of economic and political security that will define the outcomes of the conflicts in the 21st century. ●

The Future of America and Democracy

America's future is bright primarily because of our inherent capacity to adapt, embrace change, confront crisis and continually meet challenges successfully. America's future readiness, this infinite optimism, the capacity to adapt, this continual wave of revitalization, embracing the new, inventing the impossible, seems to be a fundamental ingredient of the social DNA of America.

The landscape ahead will be fraught with many new types or risks that will threaten the future of America. The capacity of America to rise to meet these risks will be great — but not without significant changes in preparing for this Extreme Future. America's readiness for the future will help prepare the nation. But if we do not successfully address every one of the threats to America, the greatness of the past will be lost.

With proper attention paid to education, immigration, the environment, security, leadership and other key challenges, America will prosper in the future. It will require a long-term vision that inspires the people and gives meaning to the direction, the changes and even the sacrifices that might come.

America's future success as a nation is tied fundamentally to the future of democracy and the fate of the world. Though there is much for Americans to do — starting now — to ensure a productive, safe and innovative future, the destiny of America is linked to the destiny of the world's markets, people and economy. The values that we share, of peace, security, free trade, diversity tolerance, innovation and democracy, will greatly shape our future. They should also shape the future of the world. It will be an interesting century. ●

RECOMMENDED READING LIST

If you liked *The Extreme Future*, you'll also like:

1. ***The Next Global Stage* by Kenichi Ohmae.** Business strategist Kenichi Ohmae synthesizes emerging trends into a coherent view of the future global economy.
2. ***The New American Workplace* by James O'Toole and Edward E. Lawler III.** Based on thorough research from hundreds of top management scholars, this book offers insight into where we are and where we're headed.
3. ***Get There Early* by Bob Johansen.** Leaders are responsible for understanding how the decisions they made yesterday will affect their organizations five years from now. Learn how to navigate the road to the future.

· Book 25 of 32 ·

The Growth Map



The Growth Map

Economic Opportunity in the BRICs and Beyond

THE SUMMARY IN BRIEF

In 2001, Jim O'Neill predicted the fastest growing economies of the past decade. Now he's back to explore the new growth markets we should all be watching closely today.

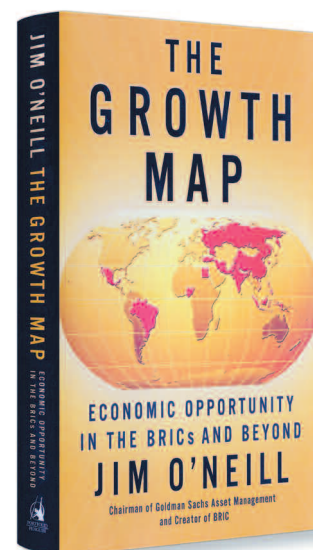
It's been 10 years since O'Neill conceived of the BRIC acronym. He and his team made a startling prediction: Four developing nations — Brazil, Russia, India and China (the BRICs) — would overtake the six largest Western economies within 40 years. The BRIC analysis permanently changed the world of global investing and its accuracy has stood the test of time.

The Growth Map features O'Neill's personal account of the BRIC phenomenon, how it has evolved and where those four key nations currently stand after a turbulent decade. And the book also offers an equally bold prediction about the "Next Eleven" (N-11) countries: Bangladesh, Egypt, Indonesia, Iran, Mexico, Nigeria, Pakistan, Philippines, South Korea, Turkey and Vietnam. These developing nations may not seem exceptional today, but they offer exciting opportunities for investors over the next decade, just as BRIC did before them.

O'Neill also shares several compelling insights about the world economy. He reveals the value for growing countries in being "willing to play" by meaningfully committing to policies that encourage further engagement with globalization.

IN THIS SUMMARY, YOU WILL LEARN:

- How Brazil, Russia, India, China and emerging nations have joined the global economy.
- How the BRICs are helping the West recover its economic health.
- Why the BRICs and other nations are crucial to a better economic future.
- The countries that form the "Next 11" and why they have the potential to power the next economic boom.



by Jim O'Neill

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THE COMPLETE SUMMARY: THE GROWTH MAP

by Jim O'Neill

The author: Jim O'Neill is the chairman of Goldman Sachs Asset Management. He previously served as the firm's head of Global Economics, Commodities and Strategy Research. He created the term BRIC in 2001.

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For additional information on the author, go to www.summary.com.

Introduction: Audacious Growth

In 2001, I wrote a research paper in Goldman Sachs' *Global Economics* series that examined the relationship between the world's leading economies and some of the larger emerging-market economies.

I thought the global economy in the coming decades would be propelled by the growth of four populous and economically ambitious countries: Brazil, Russia, India and China, and I coined the acronym BRIC from their initials to describe them.

Since then, my career has been shaped, in large part, by that single term. Ten years later I am even more eager to convince the world that they, along with some other rising stars, are the growth engines of the world economy, today and in the future.

Based on my analysis of global gross domestic product (GDP), I wrote that four countries — Brazil, Russia, India and China — which then controlled 8 percent of the world's GDP, would see their share of the world economy grow significantly in the next decade.

Brazil's GDP overtook Italy's in 2010, making it the seventh largest economy in the world with a GDP of around \$2.1 trillion. The other three BRICs have made similarly impressive progress. In the first two months of 2011, we learned that China's economy had overtaken Japan's as the world's second largest; IndiGo, a little-known low-cost Indian airline, had ordered 180 A320s, making it two-thirds the size of Europe's long-established easyJet; and Russia had become Europe's largest car sales market.

All four of the BRIC countries have exceeded the expectations I had of them back in 2001. Looking back, those earliest predictions, shocking to some at the time, now seem rather conservative. The aggregate GDP of

the BRIC countries has close to quadrupled since 2001, from around \$3 trillion to between \$11 and \$12 trillion. The world economy has doubled in size since 2001 and a third of that growth has come from the BRICs. Their combined GDP increase was more than twice that of the United States and it was equivalent to the creation of another new Japan plus one Germany, or five United Kingdoms, in the space of a single decade.

Given the BRICs' success, it should be no surprise that many other countries are now vying to be dubbed the next BRIC. ●

The Birth of the BRICs

In 2001, what particularly interested me about Brazil, Russia, India and China was that they all appeared increasingly eager to engage on the global stage. Whatever had occurred in their past was over and done with. Globalization was happening and they wanted to be part of it. The Internet was obviously helping, enabling companies to outsource more and more activities to cheaper parts of the world. China was an easy pick, given its size and the enthusiasm of its leaders to embrace capitalism — or at least large parts of it. If those billion-plus people had access to the same technology and advantages enjoyed in the West, their progress would be prodigious.

That India's demographics were so powerful, and the fact that so many Indians spoke English, put them in a great position to benefit from the Internet and the boom in outsourcing services. Here was another nation of more than 1 billion people that seemed to want to embrace globalization and to allow its workforce and products to enter the global marketplace.

Russia had already been invited to join the G7 in 1997 as the West sought to encourage the country



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toward free markets and democracy following the collapse of communism. By 2001, the G7 leaders had given up on Russia to a degree. The replacement of Boris Yeltsin with Vladimir Putin had slowed Russia's progress toward capitalism, to the disappointment of the West. This mind-set lies at the heart of why some Western observers today find it so easy to be skeptical about Russia. Russia can still generate the economic might and opportunities that the G7 perceived back in the 1990s.

Brazil's opportunity came in the brief period after 1999, following yet another economic crisis. Brazil's leader floated its currency, the real, letting it promptly drop in value, and appointed Arminio Fraga, a fan of inflation targeting, as the new head of the central bank. By placing the control of inflation at the center of macroeconomic policy, it at last seemed that Brazil's leaders have the will to end the hyperinflation cycles of the previous two decades and give their country a serious chance to reach its potential. ●

From Emerging to Emerged

The aggregate GDP of the BRIC countries quadrupled during the decade following my original paper, from \$3 trillion to close to \$12 trillion. In hindsight I should have been even bolder in my predictions. Even though I had always known it for my basic economics training, I had not fully appreciated the simple but critical importance of demographics and productivity.

The Power of Demographics and Productivity

I often hear people talking enviously about growth in the United States versus Europe, or with astonishment at the growth in India and China. A lot of that is due to the demographics.

Between them, the four BRIC countries are home to close to 3 billion people, not far off half the world's population. China and India are the two huge nations, with populations of more than four times the size of the United States. Brazil and Russia have much smaller populations, with around 180 million and 140 million, respectively, but this is more than any country in Europe and, indeed, more than the 125 million or so in Japan.

More working people make an economy easier to grow, unless, of course, they are extremely unproductive (as can be the case in many developing economies). More people produce more output. More people earn wages and income, which is the basis for their consumption.

The other essential driver of growth is productivity. The more a group of workers can produce with a given

set of inputs, from time to materials, the faster their economy will grow.

The scale of the opportunity for productivity growth is much larger in developing countries than in developed ones. Countries with young and expanding labor forces, which are becoming increasingly efficient, will show the largest gains in real GDP.

Growth Environment Scores

By 2005, when my colleagues Dominic Wilson, Roopa Purushothaman and I, together with another colleague, Anna Stupnytska, wrote our next major review of the BRICs, we had evolved our understanding and measurement of their growth prospects even further by introducing a measure called the growth environment score (GES).

Economists believe that higher productivity is critical for sustaining growth and helping to improve welfare. What is not known is exactly what causes productivity to increase. If it were so easy, then growth would be more predictable, achievable and easy to attain.

The GES index consists of 13 different variables, five macroeconomic in nature and eight microeconomic. We simply average out the scores without giving one variable any more weight than another.

In 2005, China's GES ranked highest among the BRICs, followed by Russia, Brazil and India. As a measurement tool, the growth environment scores have proved extremely useful. We now calculate them for 180 countries, and they have played a significant role in our thinking about the N-11 growth economies as we defined them in 2005. ●

BRIC by BRIC

To understand fully what the BRICs are all about, it is necessary to examine each country individually.

Brazil

Brazil today is the most popular of the BRICs so far as foreign direct investment is concerned. Investors, ranging from global private equity firms to hedge funds, are battling it out to acquire Brazilian assets.

The decision to include Brazil among the BRICs was far from automatic. Many were skeptical and some, including some Brazilians, even begged me not to include it.

Goldman's own Brazilian economist, Paulo Leme, shared the concerns of many. Brazil, after all, had always been "the country of the future" that somehow never got there. In the 1960s, people predicted that Brazil and

Argentina would soon be the biggest economies in the world. Inflation and inept, highly centralized political leadership killed that dream. Brazil was undone by perpetual economic and political crises.

Brazil's rise as an economic power has happened far more quickly, at least in U.S. dollar terms, than we envisaged back in 2001 and 2003. It has the capacity to become an economy close to \$10 trillion, about five times bigger than it is today.

Russia

It is hard to find people quite so optimistic about Russia. In fact, it is the one country many think should be dropped from the BRICs. It is not a view I share. The argument goes that Russia's unfavorable demographics, excessive dependence on energy and raw materials, and its poor record in governance and legal structures make it an unworthy recipient of the power bestowed by its status as a BRIC.

While Russia does have serious challenges, it also has the potential to have a higher GDP per capita than the other BRICs, and even higher than all other European countries.

At the core of Russia's present challenges are its demographics. Anecdotes about Russia's poor life expectancy abound. Its population has been falling since the collapse of the Soviet Union owing to a combination of emigration, rising death rates and falling birth rates. Putin proposed a wide range of subsidies and financial incentives to increase Russia's birth rate. By 2007, the government was claiming progress. If Russia can pull off this demographic shift, its economic prospects will improve dramatically.

Russia's GDP could grow to \$7 trillion by 2050, around four times where it is today. If its population simply stops declining, Russia could quite easily become as large as Brazil, at around \$10 trillion in 2050.

India

India is the greatest mystery among the BRICs. Its demographics are astonishing, the most favorable in the world. Over the next 25 or 30 years, its working population might increase by the same number of people as currently live in the United States, 300 million. Its population in 2011 was already 1.2 billion and by 2050 could reach 1.7 billion — that's 10 to 20 percent more than China's, and with far more young people.

India also has the great advantages of a credible legal system, many English-language speakers and homegrown technology companies that are expanding globally. India is the most vibrant, beautiful, creative, inspiring place I

The Path to 2050

My colleagues Dominic Wilson and Roopa Purushothaman had helped to push the BRIC concept firmly into the mainstream with their 2003 paper "Dreaming with BRICs: The Path to 2050." What they did so effectively was to compare the BRICs in 2050 to the then current world economic superpowers. "If things go right," they wrote, "in less than 40 years, the BRIC economies together could be larger than the G6 in dollar terms."

A simple chart they produced showing what they expected to be the largest economies in the world by 2050 — with China first, followed by the United States, India, Japan, Brazil, Russia, the UK, Germany, France and then Italy — was downloaded from the Goldman Sachs website 10 times more often than any other document.

have ever seen. But the scale of poverty is astonishing and the difficulties of getting things done are equally so.

Its regions are very autonomous, so central government cannot dictate policy. Ordinary permits and approvals can take months to come through, gumming up even the simplest procedures. India attracts the least foreign investment of the BRICs partly because of this mystifying bureaucracy.

China

I love traveling to China and sharing its people's optimism. It's a change from the cynicism and negativity I hear constantly in the West, where people seem to have lost their excitement about the future.

There is simply no overstating China's importance to all of us, not just to 1.3 billion Chinese. The entire planet is invested in China's success. When I joined Goldman Sachs in 1995, China's economy was worth around \$500 billion. It has grown more than tenfold in just 15 years, averaging more than 10 percent real GDP growth throughout that period. In 2010, China overtook Japan to become the second largest economy in the world.

The key, of course, to China's extraordinary growth has been its population. China does have some challenges in this regard. Its working population is aging and may soon peak, which could land China with the kind of challenges faced by Italy, Japan and perhaps Russia. China's growth rate will not be as strong in the future as it has been in the past 20 years.

China's challenges, like everything else about the country, are monumental. A popular criticism of China is that investment spending is too high, too unprofitable

and thus unsustainable, as it was in Japan in the 1980s. There are significant doubts about the accuracy of Chinese official data.

When I meet young Chinese people and hear them talk and sense their energy, then I am back to being optimistic again. I remain as intrigued about China's future as I was that first time I visited Beijing. ●

The New Growth Markets

The rise of China and the BRICs has not gone unnoticed among other large emerging economies. The remarkable success of China alone has encouraged other countries to explore ways of boosting their prosperity by becoming more engaged with the rest of the world.

Back in 2001 and 2003, many people wondered why we singled out only the four BRIC economies for dramatic growth. This prompted us to explore more closely the growth opportunity for other countries and, in our 2005 paper "How Solid Are the BRICs?", we introduced the "Next 11" (N-11).

The N-11 grouping is not particularly cohesive, but all 11 are developing countries with large populations and many would have exciting potential if they were to participate more fully in the global economy. It includes several contrasting nations: Mexico from Latin America, Turkey on the edge of Europe and Asia, Egypt and Iran from the Middle East, Nigeria from Africa, and six countries that span the whole of Asia — Bangladesh, Indonesia, South Korea, Pakistan, the Philippines and Vietnam.

Mexico's GDP could make it the world's sixth largest economy, comparable to that of Russia, and Indonesia, Nigeria and South Korea could overtake Italy and Canada.

There are countries with specific weaknesses: Vietnam needs to reduce its government deficit, Turkey must improve its technology scores and be more open to international trade, while Iran's political system scores low. Then there are those with broad-based challenges like Egypt, Indonesia, the Philippines, Bangladesh, Nigeria and Pakistan, which underperform in every area, from fiscal discipline to education, investment rates and health care.

In addition to the critical policies each BRIC nation will individually need to introduce, there is one common variable that suggests that the next 50 years are to be more supportive for their economies than the last: technology. ●

Chinese Contradictions

Like all the BRICs, China is rife with contradictions, and no experience captures these better than a visit to Mao's mausoleum in Tiananmen Square in Beijing. It was like going to a soccer match, with thousands of poor Chinese crowding around, pushing and spitting on the ground. It was a little scary at first. The police herd you and you worry you might get trampled. Near the entrance is a shop where you can buy flowers for three renminbi (yuan), and so many people were buying a bunch to present before the embalmed body of China's Great Helmsman. We saw banks of flowers rising up around Mao. But then I noticed a man picking up the flowers and taking them back around to the store to resell them. So we had huge crowds coming to pay their respects to a man who had authorized the killing of millions of people and buying flowers knowing they would be resold the moment they laid them down. Within a few hundred yards of the mausoleum there is a Lamborghini showroom, where China's new rich buy sports cars with cash. If you can process this mess of confusing images, then you have a chance at understanding modern China.

Are There Enough Resources?

It has been a natural fear for centuries that the more of us occupying the planet, the fewer resources there will be to go around. The 18th-century English scholar Thomas Malthus painted the most famous and grimmest picture in his *Essay on the Principle of Population*. Whenever there are too many people, he wrote, what follows is "misery and vice" in the form of epidemics, famines, war and extreme poverty, until the balance between people and their means of subsistence is restored.

There are many today who look at the rise of the BRICs and see the realization of Malthus's fears. If there is a single reason the BRIC dream I outlined for 2050 won't materialize, goes their argument, it is the lack of resources to satisfy this hungry new world.

There is no doubt that resources will be crucial to the growth of the BRICs and their relations with the rest of the world. In 2004, my colleagues analyzed the energy markets in the context of our predictions for the BRICs in 2050. They found that if the BRICs grew at the pace we thought they could between 2005 and 2050, that a major imbalance would develop between supply and demand of energy resources.

Summary: THE GROWTH MAP

I side more than ever with the optimists, who argue that the reason Malthus's fears never came to pass and will not in the foreseeable future is technology.

At key moments in human history, man has found solutions to his most acute problems. An oft-quoted example of this was the great horse manure crisis that afflicted America's cities in the late nineteenth century. In New York, in 1900, the population of 100,000 horses reportedly produced 2.5 million pounds of manure every day. Streets were apparently covered with the stuff and the air thick with flies. The future of cities was at stake. What saved them was the arrival of motorized transport. The entire manure problem vanished at a stroke, courtesy of men like Henry Ford.

I'm not suggesting that feeding the BRIC's appetite for resources will be easy. Nor do I wish to trivialize the challenge it presents. But I do have faith that scientific innovation, wise government policy and the markets can provide solutions that will help us avoid the doomsayers' scenarios.

We have a complex world evolving in the commodity markets, with strong price pressures influencing many aspects of the world economy. Much will depend on how countries can coordinate and cooperate to respond to these immense challenges. ●

Consumption

The rising levels of consumption in the BRIC countries are a compelling sign of how quickly these economies are changing. Consumption and foreign direct investment are the components of GDP that I follow most closely. They tell me how a country is maturing, how much wealthier its people are becoming, what they are choosing to buy and to what extent their economy is opening up to the world.

In London, the top end of the property market is almost entirely driven by non-British buyers, many from the BRICs. Apartments in South Beach in Miami are now being snapped up by Brazilians. Wealthy Chinese travel and shop in Paris and Tokyo en masse. Russian tourists have been a fixture in the most fashionable European resorts for years now.

At the end of 2010, consumption and the BRIC countries came to about \$5 trillion. In the United States it was \$10.5 trillion, in the European Union \$9.5 trillion and in Japan around \$3 trillion.

When I talk to auto executives, I find that their concerns about the global economy have changed in the past decade. In recent years, they have wanted to hear

my projections for the BRICs, and to better understand the risks and opportunities in these markets.

Take China: many multinationals first went to the country to take advantage of its cheap labor. They saw a chance to improve profitability through lower costs. But what first brought them into this market is not what is keeping them there. As wages rise, the labor cost advantage of manufacturing in China is eroding. These days, the greatest opportunity is for those companies with the strongest brands. A huge and expanding population now desires and can afford their products.

Another important indicator of BRIC consumption is the pace of urbanization. People who live in close proximity to others want what they have or more and this stimulates economic competition, which leads to faster growth.

In India, at least 50 cities have a population of more than 1 million people. So many people living close together, inching up the economic ladder and wanting what so many others have, is a dream for consumer companies.

Switzerland does not worry about the growth of France, Germany and Italy. In fact, it wants it to grow, as it means the Swiss can export more and earn more income. European countries should think about the BRIC countries in the same way, as export markets to be expanded for their own economic benefit. ●

New Allies Ahead

The rise of the BRIC economies and the growth markets will result in dramatic changes in relationships between those countries and the rest of the world, and regional economic and political ties will be subject to deep and lasting change.

Brazilian commodity exports to China have risen so much that China is now easily Brazil's number one export market. China's direct investments into Brazil are rising sharply. China's expanding investment into Africa is a similarly exciting development, and raises the prospect of very different external relations for many African countries.

Asian Axis

Within 20 years, China might be the world's biggest economy and India the third largest. More than two-thirds of the world's population is in Asia. Six of the N-11 economies are in Asia, as, of course, are China and India. Taken together, the prospects for the continent are incredible.

How will the new giants, China and India, treat each other? What will be the regional role of the still prosper-

ous but economically much smaller Japan? The same issue faces South Korea and all those large population countries with great potential, such as Bangladesh, Indonesia, the Philippines, Pakistan and Vietnam, and the smaller, more prosperous economies, such as Singapore. The often fraught relationship between India and Pakistan could be tested even more by India's emergence as the world's third largest economy. These are all significant challenges for Asia's fall leaders, who need to find ways of rising to them.

The BRICs and the United States

The dynamics involving the United States are nearly as complicated and exciting. How will the world's only superpower continue to deal with the prospect of losing this mantle, especially to a "communist" regime in China? How will the United States manage its Asian relationships? Will Japan remain its pre-eminent geopolitical partner in the East as it has been for much of the modern era, despite its relative decline? Will the United States "drop" Japan? How should the United States support the emergence of Russia without dramatic changes in how the Kremlin presides over business and general life in Russia? And what about Latin America, in which Brazil and Mexico may emerge as more forceful voices?

Despite the threat to its sole dominant world leadership, many signs suggest that U.S. policymakers are coping admirably with the emergence of the BRICs, allowing the economic forces of globalization to benefit their globally minded companies and thereby supporting an environment in which the BRICs can emerge.

During the next five years, the most important goal of U.S. economic policy will be to double its exports and reduce its large foreign debt. If the United States is to succeed in reversing its balance of payments deficit, managing the trade relationships with the BRIC economies is vital. ●

A New World Order

Unless the BRICs are embraced more fully by the powers that now dominate the world's economic policy councils, we cannot enjoy the full benefits of their growth.

G7, G20 and the BRICs

The G6 club of the richest and largest industrialized countries was founded in 1975 when U.S. President Gerald Ford convened a summit to discuss the first oil price crisis. He invited Japan, the United Kingdom, Germany, France and Italy to talks with the U.S. In 1976, he added Canada, to balance the large European

contingent, thus forming the G7. As large economies with reasonably similar income levels per head and shared democratic values, the G7 countries are vaguely alike. But they are hardly representative of the world economy in the way they were back in the 1980s. Back then, China was economically irrelevant. Today, it is the second largest economy in the world. Brazil is bigger now than Italy. Brazil, India and Russia are each bigger than Canada. Yet the G7 still meet and their leaders still behave as though their nations dominate the world.

If membership hinged only on economic criteria rather than political influence, I would suggest that a new "Growth 8" grouping comprising the Growth Markets (Brazil, Russia, India, China, Indonesia, Mexico, South Korea and Turkey) would be a much more sensible club than the G7. From 2011 to 2020, the change in the aggregate GDP of the "Growth 8" is likely to be around double that of the G7 in U.S.-dollar terms.

The G20 members include 19 of the world's largest economies plus the European Union, as well as the heads of the International Monetary Fund and World Bank. As of now, it has become the most representative group to discuss truly global economic issues. It may include more members than is ideal for frequent decision-making, but has more legitimacy than the (still influential) G7, as it includes BRIC countries.

The BRICs, however, are not just standing by waiting to be invited by the traditional economic powers to join one or the other of their clubs. In 2009, their leaders decided to hold their first summit. I was delighted to see an acronym I had created evolve into a rival to the G7. They met again in 2011, with South Africa added to the mix.

The BRICs and Monetary Policies

As the BRICs and the other Growth Markets become ever more intertwined with the rest of the world, their political leaders will exert ever more influence on the global monetary system and their demands from it will be increasingly relevant. But, at the same time, their internal stability will continue to be paramount. Their ability to control inflation, and thus keep their citizens happy, will partly depend on what they choose to do about their currency regimes.

Consider again the possible path for the world economy in the current and next decade. Before the end of 2020, the BRIC economies combined will become larger than the United States. Before the end of 2030, China may become as large as the United States, and the other big economies may match those of the G7. Can

Summary: THE GROWTH MAP

we have a global monetary system that does not include the currencies of all its biggest economies? No.

For the BRIC countries themselves, this is a vital domestic issue. Adopting a more flexible exchange rate system would be a useful tool in targeting inflation, which, as I've said, should be a priority for any ambitious developing economy.

The rise of the BRIC currencies might ultimately threaten the supremacy of the dollar in the currency of international trade, finance and exchange rate setting. It is apparent from the communiqués of BRIC finance ministers and leaders I read that an increasing amount of bilateral trade among the BRICs is bypassing the dollar and being conducted in their own currencies.

One thing is for sure: if the world economy continues to unfold in the manner I expect, the monetary system is likely to evolve into something very different. ●

Invest and Prosper

It should be clear by now that I no longer regard the BRICs as emerging markets. They are a fundamental part of the modern world.

At Goldman Sachs we came up with the Growth Markets concept to help people get out of this old way of thinking.

Talk to multinational companies such as JCB, Burberry, WPP or General Motors. Do they think of China as an emerging market or as an essential part of their present and future?

The key is to pay attention to the evidence and keep your emotions at bay. Investing in BRICs is no different from investing anywhere else.

In my 30 years in finance, I realized that the day everything becomes crystal clear is probably the day we should stop investing in that idea: they could not get any better or perhaps something new will appear.

Having said that, I have little doubt that as the BRICs comprise ever more of the world's GDP, their capital markets will develop and the opportunities will multiply for domestic and foreign investors to participate in their growth.

Comparing Investment Concerns

Ironically, and in contrast to many international companies, financial investors typically find India a lot easier to invest in than China, partly due to India's colonial history or perhaps its English-based legal system. In Russia, the main concern is also often the government. That said, the Russians today are talking seriously about

creating a special center for trading financial instruments. Brazil is probably the easiest of the BRICs from an investing perspective. It is more Western than the others and has better-established domestic capital markets.

One cannot invest around the world these days and ignore or be frightened by the rise of the BRICs and the Growth Markets. It is much better to be open-minded. Despite the instability such changes bring, for millions of people around the world economic growth on this scale is a very positive story — and one that can be good for our investments. ●

A Better World

The exciting prospects of these countries are good not just for them, but for us all. As we go through dramatic changes in the economic landscape, it is important for people to keep remembering this.

For the overindebted, burdened nations of the West, selling goods to the rising Growth Markets is their future. Before this decade is over, I expect the dollar value of consumption in the BRIC economies to exceed that of the United States. Many of us in business and finance have grown up thinking that the U.S. consumer drives the world. By 2020, this notion will be a mere historical observation.

Tens of millions of people from the BRICs and beyond are being taken out of poverty by the growth of their economies. We at Goldman Sachs estimate that 2 billion people are going to be brought into the global middle class between now and 2030 as the BRIC and N-11 economies develop. The same is beginning to happen in some of the most challenging parts of Africa, and, while it is very early days, the uprisings in the Middle East suggest it could happen there, too.

Rather than be worried by such developments, we should be both encouraged and hopeful. Vast swaths of mankind are having their chance to enjoy some of the fruits of wealth creation.

This is the big story. ●

RECOMMENDED READING LIST

If you liked *The Growth Map*, you'll also like:

1. ***The Elephant and the Dragon* by Robyn Meredith.** Meredith provides an essential guide to understanding how India and China are reshaping our world and your business.
2. ***Escape Velocity* by Geoffrey A. Moore.** This summary offers a pragmatic plan to move beyond past success and drive next-generation growth from new lines of business.
3. ***Macrowikinomics* by Don Tapscott and Anthony D. Williams.** Tapscott and Williams provide new examples of organizations that are successfully embracing the principles of wikinomics to change the world.

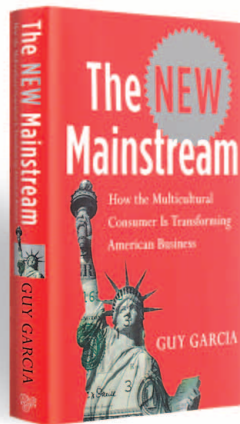
· Book 26 of 32 ·

The New Mainstream

Guy Garcia

SOUNDVIEW Executive Book Summaries®

FILE: ECONOMICS



By Guy Garcia

How the Multicultural Consumer Is Transforming American Business

THE NEW MAINSTREAM

THE SUMMARY IN BRIEF

A new America is emerging. Its population and culture are more diverse than ever before and it is more connected to the outside world than ever before. As the multiculturalism of Hispanics, African Americans, Asians and new immigrants comes together, they forge a New Mainstream-based culture and economy that will soon overcome the Anglocentric "Old" Mainstream. Today, 80 million African Americans, Hispanics, and Asians make up more than one fourth of the country and spend more than \$1.2 trillion a year. By 2050, non-Anglos will grow to 47.2 percent of the population. Corporations, politicians, institutions and the media will not only have to accept and understand the New Mainstream, but they will have to embrace it and become part of it. The one constant in American culture is commerce, and to understand where the economy is heading, people will have to understand who determines it and makes it up.

In The New Mainstream, journalist and multimedia entrepreneur Guy Garcia offers a wake-up call and a road map to the new multicultural reality in America, creating a corporate survival guide for the uncharted markets of the 21st century.

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What You'll Learn In This Summary

- ✓ The astonishing growth in buying power of so-called minorities.
- ✓ How the current move toward multiculturalism is actually part of a repeating cycle re-enacted throughout American history.
- ✓ How the media, celebrities and art facilitate the creation of the New Mainstream by popularly melding ethnicities to culture.
- ✓ Why it is important to foster the creative class that propels the New Mainstream and why many Americans' post 9/11 politics may be hostile to it.
- ✓ How Americans can create cohesiveness in the New Mainstream as race and culture are melding.

THE NEW MAINSTREAM

by Guy Garcia

— THE COMPLETE SUMMARY

Terra Incognita

The New Mainstream is an unprecedented intersection of demographic, cultural and economic forces remodeling American society. As population trends and profit-driven interests converge, a third force, the “creative class,” will join them to create and maintain the infrastructures, system and content of the information age. It is the antithesis of the old ethnocentric nativism that many people believe is the true and threatened America. It thrives on the diversity of ethnicity, but also on the diversity of consumers. Companies that recognize and enter the New Mainstream instead of holding back or treating it like a separate entity will propel the economy of the future.

Ethnicity Inc.

The New Mainstream is causing a shift in culture that will change the economic and business landscape. Marketers learned long ago to translate their commercials into Spanish and show Asians on their billboards, but race is only one indicator of cultural and ethnic differences. Latinos come from many different countries, and in the United States, they have different preferences based on whether they are native-born or immigrants, whether they are speaking English or Spanish, or both. Eventually these differences will disappear.

Diversity initiatives and in-culture knowledge will be unnecessary components of strategy, because the New Mainstream will be the strategy. Panethnicity will be the norm and there will be no need for companies to study the likes and dislikes of different ethnicities. The cultural convergence of companies, marketers and decision makers will be built in, because they will be converged ethnicities.

Latino Growth Opportunity

By 2008, the projected growth for Latinos is 315 percent, for African Americans is 170 percent, for Asians is 287 percent, and the numbers of Native Americans and gays and lesbians will grow as well. Companies must jump on these trends now.

Fannie Mae realized that owning a home in the United States is the single most important generator of wealth, and though natural-born ethnicities equate it with stabil-

Bank of America Finds a Market

After the 2000 Census, Bank of America (BoFA) decided to examine the relationship between U.S. Hispanics and their friends and family in Mexico. Those who came to work in the United States often sent money back home, producing \$1 billion in bank fees. With at least 21 million Mexicans in the United States, 16 percent of them were in BoFA's Southwest footprint.

In 2001, the bank acquired Grupo Financiero Santander Serfin, the most profitable bank in Mexico. They developed a product, SafeSend, an electronic fund transfer system leveraging the Internet and the thousands of ATMs in both countries. It allowed people to send money from any ATM and introduced new customers to the bank's other products. BoFA conducted focus groups to determine how to best market and publicize SafeSend to this market, and enlisted the blessing and support of Mexican and local politicians.

ity, security and permanence, foreign-born immigrants have an even stronger desire to own a home. Fannie Mae leveraged that knowledge to market to immigrant ethnicities, who are already more likely to own homes than their native counterparts.

Companies must do more than recognize the New Mainstream: They must act. Without a diverse work

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The author: Guy Garcia is an award-winning journalist, novelist and multimedia entrepreneur. A staff writer at *Time* magazine for 13 years and a longtime contributor to the *New York Times* and other publications, he has also written two novels, *Skin Deep* and *Obsidian Sky*.

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Terra Incognita

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force they will be at a disadvantage in hiring, and they will lose a cultural link to an increasingly critical part of their market. Companies should realize that working with minority clients, suppliers and vendors, and making a strong commitment to diversity in upper management, all create:

- **Increased profits and lower costs.**
- **Improved morale and productivity.**
- **Expanded market share and new products and services.**
- **New markets and position brands for continued growth.**

The Tiger Effect

The increasing visibility of ethnic celebrities is one of the most obvious manifestations of the multicultural economy. From Michael Jordan to Jackie Chan to Enrique Iglesias, marketers and advertisers have legitimized the multicultural vision of America by following the money flowing to the New Mainstream.

Professional sports is where this symbiosis is most apparent. Sports stars are not just rewarded for athletic prowess, but for their ability to connect with an increasingly diverse and global fan base. Tiger Woods is the exemplification of this phenomenon. A combination of African, Thai, Chinese, Native American, and European heritage, he has opened up the sport of golf, which used to be for middle-aged white men, to a new generation of multiethnicity.

Commercials showing ethnicities borrowing recipes and traditions from other cultures and playing together without any racial self-consciousness send the message to all consumers that once-marginal groups have joined non-Hispanic whites in the economic and cultural mainstream.

Appealing to the New Mainstream holds the risk of cultural offense when ethnically targeted ad campaigns

ruffle cultural sensitivities. Though the majority of Hispanics speak English or are bilingual, they often prefer their media, goods and services in Spanish.

Celebrities who vent ethnically divisive polemics can also find themselves crossing the invisible foul line of New Mainstream economics. When Rush Limbaugh observed on ESPN that the African-American quarterback for the Eagles, Donovan McNabb, was overrated because the liberal media is willing to lower the bar to allow a black athlete to succeed, he was fired from ESPN, a national TV sports network. The comment may have passed without notice on his conservative talk show, but ESPN's sponsors are in the business of reaching as many potential customers as possible, including people of color.

Eye of the Beholder

The multiracial, multiethnic look is expanding. The 2000 Census showed that respondents under 18 were twice as likely as adults to identify themselves as multiracial. Their culture taps into every aspect of the mainstream. Whether Halle Berry appears on the cover of *Cosmopolitan* magazine, films like *Spy Kids* become international franchises, multiethnic chic shows up in suburbia, or Jennifer Lopez and Vin Diesel become icons of ambiguity, multiethnic culture is making brown the new white.

Everything from mannequins to plastic surgery to hair products is diversifying to meet the needs of a more ethnically blended population.

Hip-hop clothing designed for athletes, teenagers, women and babies is showing up in the suburbs, promoted by rap stars and Russell Simmons' empire of clothing and music. On the West Coast, hip-hop style is mixed with Latin styles that include oversize T-shirts, bandannas, and religious tattoos to create the *cholo* look.

Despite the shift, ethnic representation is still scattered and skewed in the media. On television, there are more Hispanics in front of the camera, but not behind it. Though African Americans and whites appear more frequently on TV shows together, there is still a dearth of Hispanics on comedies. Latinos are making inroads in Hollywood directing, producing and acting in films like *The Others* and HBO's *Six Feet Under*. Ethnicities show up in big-budget movie roles where they never would have before, most prominently in buddy movies that portray the minority character as faster, smarter or more stable than the white character.

diversity.com

Early on, America Online (AOL) could see the need for a Spanish-language area on the Web, and attempted

Pepsi Disrespects Ludacris

Sponsors must be sure they are willing to stand behind their celebrities and respect their right to free expression. When Pepsi dropped the rapper Ludacris as a corporate spokesperson in 2002 because a FOX TV commentator questioned his suitability as a role model, Ludacris made very public statements about the company and how he did not agree with the way it did business in urban areas. Eventually, Pepsi became a target of a boycott by the Hip-Hop Summit Action Network and was forced to apologize.

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Terra Incognita

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to launch America Online Latin America (AOLA), but logistics and a lack of understanding of the necessary content caused it to flounder.

Latinos can come from Puerto Rico, the Dominican Republic or Mexico, so they have diverse cultures. However, they do share a common language and a unique pattern of assimilation, arriving continually instead of all in a lump like previous migrants. These factors make it difficult to tailor any kind of media or successful magazines, newspapers and entertainment to the entire group.

In the end, Internet-enabled cell phones and cyber-cafes took Latin America online.

Minorities and the Internet

The Internet was a powerful tool for moving minorities and women into the cyberspace mainstream. Instead of being left behind, ethnicity and culture seeped onto the Internet. America is actually losing dominance on the Web, and at the same time companies are finding global markets for their products.

The global Digital Divide was growing between whites and nonwhites, but U.S. Hispanics are going online at a faster rate than any other group. African Americans are second. The anonymity of the Internet and the many opportunities for interaction in chat rooms, retail, online games and e-mail create a culture that is rapidly becoming more ethnically diverse.

Cohesion and Trust

In the multicultural mindscape of the New Mainstream, people will work best in social environments that build cohesion and trust. A tribe — or company — that rejects diversity is undermining its own ability to grow and create alliances. Cyberspace is merely a high-tech manifestation of a tribal imperative to communicate and a reminder that all human beings are distant relatives who depend on one another for survival.

Young Americans — with more than \$200 billion in annual income — are the most able to deal with the Internet and diversity. Advertisers and the entertainment industry working to tap into that network must realize that the tastemakers of this powerful group are part of a decentralized urban ethnic youth culture that knows how to communicate quickly and frequently. The youth market and eventually the dominant market will be less a demographic than a series of interconnected networks and subcultures and will spread across the country and the world. ■

Mexicans and Indians In Commerce

The conquered Indians and annexed Mexicans provide the foundation of the New Mainstream and America's economic future. They provide a cultural transfusion that has generated great wealth along with ecological conscience. The fusion of materialism and myth, past and future, provides insights into the multicultural consumer.

In the New Mainstream, natural, organic and ecologically responsible products outsell others. Purity commands a premium. For example, in 2004, filtered water reached sales of \$8.3 billion. Americans drank 22 gallons per person. Companies will learn the benefit of social responsibility and "giving back."

America's Future Is Its Past

In order to understand the future of the New Mainstream, which is constructed of a constant influx of new immigrants and melding ethnic cultures, it is important to understand how immigrants and ethnic cultures created the "Old" Mainstream. The current changes are no different than they have always been.

Melting Pots and Salad Bowls

Americans are united by a common experience of immigration. It began with the first Native Americans crossing the Bearing Strait and continued with Spanish, English, French and Dutch settlers all seeking religious, economic and cultural freedom. Every wave of immigrants was repulsed at first and then assimilated into our great melting pot.

By the end of the 20th century, the idea of multiculturalism, that America is a salad bowl of different cultures instead of a melting pot of one culture, emerged as people wanted to retain their ethnic culture to celebrate their uniqueness and not assimilate into the Anglocentric culture that was rapidly losing its majority. Neoconservatives threatened by the natural alliance of minorities and immigrants feared for their shrinking demographic.

In 2003, the Supreme Court upheld the University of Michigan's right to use race and ethnicity in making admissions decisions. That decision recognizes that diversity gives the United States a competitive advantage against other nations. The influx of foreigners and the economic and intellectual vitality they represent will make America thrive and expand while more ethnically homogeneous societies like Japan and Europe age and shrink. Because deaths exceed births in Japan, the coun-

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America's Future Is Its Past

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try could lose half its 120 million population by the end of the century, causing economic deflation, a shrinking tax base and the collapse of its national pension system.

The median age in Europe will rise from 37.7 to 52.3 by 2050, and its fertility rate of 1.34 children-per-woman is less than the 2.1 rate needed to sustain a stable population. In the United States, the median age will only rise slightly to 35.4 in the same period.

Cowboys and Indians

The first cowboys — the stoic, fearless and self-sufficient spirit of the American West — were originally *vaqueros*, or Mexicans who took care of herds of cattle on huge ranches. Many of the behaviors and symbols come from Mexican culture and were taken over by the white Americans who believed it was their Manifest Destiny to seize and settle the land from the Indians and Mexicans and civilize them along with the blacks.

In a war with Mexico over Texas, the United States annexed 529,000 square miles in 1848, encompassing the present-day states of California, New Mexico, Nevada and parts of Texas, Arizona and Utah. Weeks after the treaty was signed, gold was found in California, and the resulting population, industry and Mexican laborers are largely responsible for driving America's economy into the next century. The 1800s held many instances of bigotry despite the interdependence of immigration and prosperity that was already apparent.

Outsiders in Their Own Land

After the Alamo and the Mexican-American War, the Know-Nothing Party rose in prominence to oppose mostly Irish and Catholic immigrants. They then turned against the Mexicans and Asians in the West. *The Indian Question* by Francis Amasa Walker tackled yet another minority problem. He recommended that eventually the Indians would be blended into society, but that reservations should act as holding tanks until the Indians were significantly Americanized. The massacres of the Indian Wars leading up to Wounded Knee effectively ended the struggle for the frontier as well as most Native American culture, and they are still treated very much as outsiders in their own land.

Frederick Jackson Turner, a historian in the 1800s, felt that the frontier defined what it meant to be American: a clash of opposites where a dynamic wave of cultural mutation absorbed previous waves before rolling forward again. Once a new community was firmly established, the pathfinders would pick up stakes and move West again, pushing and accepting.

Matricula Consular

In December 2003, the United States held a lottery for 55,000 legal resident documents, or "green cards," representing only a fraction of the immigrants seeking legal resident status. To cover the gap, some municipalities and states began recognizing the *matricula consular*, or consular registration card, as a way of tracking and delivering civil services to illegals who may have fallen through the cracks. During the summer of 2003, several Midwestern cities with growing Hispanic communities recognized the identity card issued by the Mexican government to undocumented Mexican nationals living in the United States.

The card has existed since 1870 for citizens in America, so they could receive consular assistance with U.S. employers, police authorities and transporting dead relatives back to Mexico. In Indianapolis, the card can be used to apply for building licenses and permits to drive taxis and operate vending carts. National City Bank in Minneapolis accepts it as identification to open an account. In Chicago, it can be used at the public library or to open an account with the local water utility. The card is now recognized by more than 100 cities, 900 police departments, 100 financial institutions and 13 states. Police departments in New York, Connecticut and New Jersey do not accept the card, and officials in the FBI and the Department of Homeland Security cite the possibility of fraud or counterfeiting, so it may be a security risk.

Immigration History

Almost as soon as the United States was born, the first naturalization law was passed in 1790 that limited citizenship to free white people. Even so, discrimination against non-Anglo European immigrants was extreme, and especially against Irish Catholics. In the Mexican-American War, 150 enlisted U.S. Army troops defected from the United States and fought with those from Mexico — fellow Catholics.

Since then there have been many more instances where the United States responded with bigotry toward new immigrants and minorities. The wave of Chinese immigrants who came for the Gold Rush and to build the railroads was succeeded by the Chinese Exclusion Act of 1882. After gaining the Philippines at the end of the Spanish-American War in 1899, the United States began a bloody campaign of pacification against the rebelling natives to civilize them. When it looked like Woodrow Wilson would accelerate Philippine indepen-

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America's Future Is Its Past

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dence, developers disseminated propaganda suggesting that Filipinos would revert to savages wearing banana leaves without U.S. rule.

In the early part of the 20th century, immigration from Southern and Eastern Europe reached an all-time high and far outstripped immigration from England and Northern Europe. By 1929, Congress had redefined immigration policy with country- and race-based quotas designed to preserve a Northern European ethnocentric population. Immigration tapered off until World War II, but after 1945 immigration began again because of changes in public attitudes and immigration policies. Despite hate-mongering against Germans and the Japanese internment camps, America did oppose the racist regimes of Nazi Germany and imperial Japan, and in 1943 the Chinese Exclusion Act was repealed. In order to address wartime work shortages, the United States allowed Mexicans to immigrate temporarily to take low-level jobs.

As America began to see itself as a bastion of freedom and opportunity from the totalitarian and Fascist regimes, asylum seekers from the Soviet bloc, Eastern Europe, and Cuba arrived. The original quotas were abolished, and by 1965 every country in the Eastern Hemisphere was allowed 20,000 immigrants, while Mexico and Canada were allowed 40,000.

The arrival of all these immigrants coincided with the civil rights era, and minorities such as African Americans and Mexicans began to question the superiority of Eurocentric white culture together to celebrate their uniqueness. This sparked ethnic identity movements among Asians and Native Americans, paving the way for women's liberation and Gay Pride.

Amexica

America has an ambivalent relationship with Mexico. The country that is poised to replace Canada as America's largest trading partner is also the source of much of the labor that fuels the economies along the border. Americans tend to believe that Canada is "more important" to their country than Mexico, while Mexico "impacts the United States more" in economy, culture and politics. They think it should be harder to cross the border from Mexico than from Canada, but most Americans would encourage their children to learn Spanish.

Once considered the homogeneous, stodgy sibling to America, Canada is now the most multicultural country in the hemisphere. At the same time its social and political beliefs are moving toward Europe and away from a conservative America. It is odd that non-Hispanic Americans identify with Canada despite the fact that

their attitudes about marriage, homosexuality and religion in the United States are far more aligned with Mexico than with Canada.

At least 600,000 Americans live in Mexico. Baja is becoming a California suburb, Mexican companies are publishing newspapers in American cities, and the American president feels the need to assure Latinos that "*mi casa blanca es su casa blanca*."

NASCAR has launched a "Drive for Diversity" to broaden its fan base. Wal-Mart has 633 stores and more than 100,000 workers in Mexico. In addition, Mexican religious ceremonies such as the Day of the Dead have migrated well north.

Despite these connections, there is still a subtle feeling that Mexicans, native-born or not, are not quite American. And to some degree, large numbers of Latinos cede their own Americanness, feeling that if they reject the label first, no one can take it away from them. But for better or worse, someone born in the United States is an American, and it has always been the responsibility of all Americans to participate fully and help define it.

Immigrant Destinations

America has always been a nation in flux. The number of immigrants has more than tripled since 1970, when immigrants made up about 4.7 percent of the population. If current immigration policies and trends continue, the foreign-born population could be 15 percent by 2050, approximately the same as in 1900. Then as now, xenophobes and racists clamored for immigration controls and closing the borders. Then immigrants through Ellis Island were mostly Southern European and Russian-Jewish. Now many immigrants come through Kennedy Airport and they are predominantly Asians, Latin Americans, and West Indians.

The immigrants are looking for work, asylum or to escape crowding or calamity at home. As before, once they get their footing, they send word of opportunities and encourage others to follow, creating a chain migration.

America's immigrants are amazingly diverse. The 2000 Census showed that Los Angeles County represents 75 countries of origin, and New York City has 109. Most are from Mexico. But this current round of immigrants represents more educational and occupational variety than their predecessors. Though New York City is still seen as synonymous with America for many immigrants, today's immigrants are migrating away from the major hubs of the past. Ethnic populations have taken root in towns in Minnesota, Georgia and Nevada. There they have become integral to the economy, often doing work that others won't do, and at the

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America's Future Is Its Past

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same time they have added to the social and ethnic diversity that stimulates and nourishes the multicultural appetites of the cultural class.

Despite the belief that foreigners with strong ties to their home countries will not learn to speak English, studies show that the longer immigrants live in the United States, the more like the native-born they become. They begin to own homes at the same rate, and their median family income increases. ■

The Unfinished Pyramid

The American market is by and large the world market, and therefore, the dollar is the most recognized and prized organ of the world's economic system. In 2003, 20 percent of America's debt was held by non-Americans. Foreign trade is approximately 25 percent of the Gross Domestic Product, and the ethnic market is the fastest growing segment of the economy and an increasingly critical component in projected growth.

Liquid Assets

Despite its power, few people have actually looked at the physical dollar bill and considered the meanings of its decorations. The Great Seal on the dollar includes an unfinished pyramid symbolizing the founding fathers' conviction that democracy was a byproduct of the evolution of human civilization; a multicultural society with differing viewpoints. Unfinished, it would continue forever. America's authors, such as Walt Whitman and Ralph Waldo Emerson, also wrote of new Americans in the future carrying on its evolution. "Each age forever needs architects. America is not finished, perhaps never will be ..." Whitman was one of the first multiculturalists and did not believe these future architects would be the Anglocentric revolutionaries who laid the first foundations.

The many faces of America have always caused ambivalence in the world. Seesawing between idealism and pragmatism, myopia and farsightedness, self-interest and altruism, the country has unsettled and confused the rest of the world. A 2003 poll by the Pew Research Center showed that there is a growing mistrust of the United States, even among countries who were formerly friendly.

Since 9/11 there is an instinct to close ranks, to keep out immigrants or multiculturalism. Tighter visa restrictions have sent possible immigrants to Europe. The Patriot Act breeds mistrust among immigrants at a time when America needs diversity the most. It was a lack of diversity in the intelligence community that hampered the FBI's ability to read Arabic documents before 9/11. In the past, America has attracted the best and brightest

Ricky Martin: The New Mainstream Star

The size of the Spanish-speaking population has nurtured an entire world of Spanish media, music and art. Ricky Martin, the international pop star, has navigated that world to become an all-around multi-ethnic, New Mainstream idol. He is a model of how to introduce multiculturalism into a society that doesn't want to think about it, but is clearly ready to accept it. He is white, with a white name and no accent. Yet he established himself as a Spanish-language star before recording an English album and exploding the Latin boom of the 1990s with his chart-topping, genre-bending "Living La Vida Loca." The song garnered him 14 million sales worldwide in spite of his unabashed blend of Buddhist spirituality, sexual ambiguity, and multicultural identity. He was a true testament to the commercial and cultural potency of the New Mainstream.

from all over the world. Albert Einstein, Google co-founder Sergey Brin, Irving Berlin, Sammy Sosa and Frank Capra were all immigrants, and an America without them is unimaginable.

Though still influential, the United States is no longer the only game in town. The international creative class may no longer see it as a place that champions the rights of the oppressed and powerless. The brain drain that other companies have long complained of may turn around. The United States alienates the people it needs more than ever.

America needs to wage an effective peace to regain admiration and respect. It needs to reiterate the symbols of the dollar bill.

Creative Consumption

Consumers gravitate toward brands, products and activities that reinforce their self-images. Multicultural consumers are the key to the new American economy because their perception is what the world has already become. Will race continue to rule socioeconomic factors? How long will white people dominate the country's social and economic agenda?

On the 2000 Census long form, 20 million people identified themselves as unhyphenated Americans. This could be because of accelerating intermarriage between ethnic groups, the aging immigrant population, or an ability to identify with a larger cultural fabric.

As being American means being white less and less,

(continued on page 8)

For additional information on the dollar bill,
go to: <http://my.summary.com>

The Unfinished Pyramid

(continued from page 7)

what will generate social cohesion? Most Americans are patriotic and proud to be Americans, but their definitions of what that means are different. For each patriot, the American Dream is different. New beginnings, religious freedoms, prosperity, racial equality and the good life are all part of the American Dream, but since Americans cannot agree, it does not foster cohesion.

Capitalism is what assimilates immigrants more than language or nationality. It turns them into consumers, which gives them a stake in the evolving social order. The bottom line of American democracy is literally the dollar. It is in Americans' — and their economy's — self interest to let other people in. The instinct to exclude will always succumb to the inclusive forces of commerce. The freedom to make the American Dream our own is ultimately what binds all Americans and keeps us dreaming together.

As New Mainstreamers climb the socioeconomic ladder, ethnicity, nationality or sexuality give way to concerns about children, electronic media, and cars. The New Mainstream likes multiculturalism in their music, art and language. It fosters cross-cultural understanding, diplomacy and economics. Bilingual education, incoming scientists, traveling world music festivals, and sushi reinvigorating the California rice industry are effects of the New Mainstream.

Beyond the New Mainstream

There is a growing visibility and viability of transcultural themes in American fine arts, music, movies, theater and dance. American-born artists draw on the ancient traditions of their own cultures to enhance their creativity. Museums, galleries and institutions realize that ethnically diverse exhibitions and shows attract new, multiethnic generation of collectors, ticket buyers and art lovers.

Urban planners and civic groups use it, too, to revitalize metropolitan areas and contribute to social prosperity. Public art can instruct, empower and allow an opportunity to mix cultures. For example, a mural in Los Angeles that was started in 1970 by a group of Hispanic teenagers eventually cataloged the history of California. Since then, hundreds of new murals have been commissioned by African American, Asian, and white artists, and they are considered to be part of the greatest creation of public art in the United States since the Works Progress Administration.

In movies, it is the New Mainstream, the minorities, who are the powerful ones. Women, elves and mutants are the action heroes in stories that traverse continents, races and centuries. American culture is the lingua franca of Western civilization because it is multicultural. Europeans are not interested in each others' art. But

America created the *Matrix* films that are among the most popular and profitable ever. They blend technology with mythology, and borrow freely from Christianity, Buddhism and metaphysical philosophy.

How Soon Is Now?

The myth of "America = white" is slowly but surely being debunked. The multicultural consumer and the American consumer are one and the same. The multicultural economy is the American economy because the economics of diversity affect every American and industry. The growing buying power of ethnic groups will continue to transform how products and services are marketed. Therefore the multicultural economy is the global economy because America drives market trends. The multicultural identity is the American identity because no single culture can define the nation. The issues and conflicts that divide us also unite us.

A New Sense of Community

Ignorance of the implications of one's actions is no longer acceptable; for the multicultural consumer, it matters if their favorite sneaker company exploits workers in Asia, or if their bank does business with oppressive regimes, or if their lipstick was tested in a way that tortured innocent animals. According to a 2002 Cone Corporate Citizenship Study, 89 percent of Americans say that in light of the Enron collapse and other examples of corporate corruption, it is "more important than ever for companies to be socially responsible."

Consumers also say they are willing to back up their feelings with action, saying they would punish irresponsible firms by switching to another company's products or services (91 percent), speaking out against the company to family and friends (85 percent), refusing to invest in the company's stock (83 percent), and boycotting its products and services (68 percent).

Better Citizens

The multicultural consumer understands that the act of buying is not just an expression, but also an extension of self. In the New Mainstream, the mysticism and meaning printed on the dollar bill and the social and spiritual values of the people who spend it are one and the same.

New Mainstream consumers seek out brands that speak to their definition of self and reflect their worldview and aspirations. They expect the companies they work for and buy from to share their values, but they are also willing to learn, to evolve and to become better citizens, parents and lovers. They realize that the true value of any product or service is determined by its ability to have meaning, to make sense and to matter. In other words, for the new multicultural consumer, making and spending money is nothing less than a sacred, life-affirming act. ■

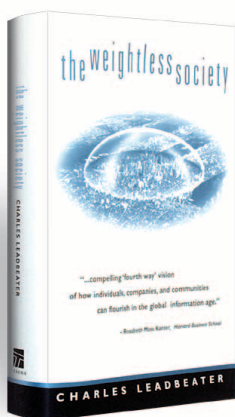
· Book 27 of 32 ·

The Weightless Society

Charles Leadbeater

SOUNDVIEW Executive Book Summaries®

FILE: ECONOMICS



By Charles Leadbeater

Living in the New Economy Bubble

THE WEIGHTLESS SOCIETY

THE SUMMARY IN BRIEF

It's hard to keep a sense of balance these days. The turbulent economy in which we all make our living constantly throws things out of kilter. At times we seem blessed. The generation, application and exploitation of knowledge is driving modern economic growth. Most developed economies make money out of thin air: We produce nothing that can be weighed, touched or easily measured. We make our living providing service, judgment, information and analysis, whether in a telephone call center, a lawyer's office, a government department or a scientific laboratory. This is the knowledge economy.

Yet many of us feel uncertain, stressed, insecure and less in control of our lives. Our powerlessness is not a personal failing, but an institutional one. Institutions seem paralyzed. They were designed for another era. We are on the verge of a global, twenty-first century knowledge economy, yet we rely on national institutions inherited from the nineteenth century. We are scientific and technological revolutionaries, but political and institutional conservatives.

In this summary, Charles Leadbeater describes how we can create the organizations to unleash and spread the benefits of the knowledge economy. We can't retreat from modernization, but must instead embark on a wave of radical innovation in basic political, social and economic institutions. We must create the weightless society.

The weightless society, according to Leadbeater, is optimistic. Globalization is good. If we turn our back on the global economy, we turn our backs on the most vital force in modern societies: the accelerating spread of knowledge and ideas. A thriving knowledge society must be cosmopolitan and open, reward talent and creativity, and invest in people and education. Knowledge societies are democratic and dissenting, open to new ideas from unusual sources, and boasting cultures in which authorities and elites are constantly questioned and challenged.

The pages that follow offer a fascinating detailed glimpse into the weightless society of the knowledge economy.



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— THE COMPLETE SUMMARY

PART I: LIVING ON THIN AIR

When Ignorance Works

Compare your house with your grandparents.' Your house is packed with equipment whose inner workings you are ignorant about — computers, faxes, telephones, digital televisions, CD players and microwaves. Your domestic life is built on a foundation of ignorance. Your grandparents, on the other hand, knew how things in their house worked because these items were mechanical. Although our society is far richer in knowledge, you are more ignorant than your grandparents were.

Ignorance isn't bliss, but it's a lot better for us than we generally think. Ignorance is a good measure of just how rich and productive our societies have become. Ignorance allows us to be efficient. We can rely on other people's knowledge. We specialize and combine our knowledge with others to create new products and businesses. For example, Finnish mobile telephone manufacturer Nokia combines engineering knowledge with consumer styling and sophisticated software. Nokia is a place where scientists, engineers, product designers and consumer marketing specialists combine talents.

We are learning to trust the knowledge of other people, allowing ourselves to be ignorant where they are knowledgeable. We don't need to know how a cell phone works; it would be a waste of time to find out. As the knowledge economy becomes more developed and our lives more interdependent, the ability to trust the knowledge of other people will become more vital. All of us are made richer by our ability to remain ignorant while other people do the learning and inventing for us. Ignorance is efficient because it helps us economize on knowledge. That's the power of the division of labor in the knowledge economy. ■

The Driving Forces Of the Knowledge Economy

Your father probably had a steady, predictable and dependable career which carried him through a well-earned, properly funded and enjoyable retirement. Today, you might be self-employed, independent and working from home. If so, you are a "portfolio worker," armed with a laptop, a modem and some contacts. You

are also what Peter Drucker calls a "knowledge worker." Simply put, you live by your wits.

We're Going on a Bear Hunt

To go it alone is risky, demanding and stressful. Yet to rely upon larger organizations and institutions, companies, and trade unions isn't much of an improvement. Where can you turn to find greater security in an environment as hostile as the modern global economy? The unlikely answer lies in a children's book, *We're Going on a Bear Hunt*. In it, a family sets out to find a bear, but runs into daunting obstacles: deep mud, a cold river, a dark forest and a violent storm. At each obstacle, the family chants, "We can't go under it. We can't go over it. We'll have to go through it." That's the challenge we face. We have to steel ourselves to press on because there is no going back.

Financial Capitalism

Three forces drive the new economy: financial capitalism, knowledge capitalism and social capital.

The first, financial capitalism, allows the world's financial system to switch vast resources around the globe in an instant. A dealer in London can buy stocks in Lebanon, government bonds in Thailand and futures in Brazil, all while sipping a café latte. Combine these powerful and volatile financial flows with fragile emerging economies equipped with feeble, sometimes corrupt, and poorly regulated financial systems, and you have a recipe for disaster. And that's exactly what happened with the rolling financial collapse of 1998.

The answer is not to retreat, but to push for the creation of a more globally interconnected and regulated economy. The task is to maintain beneficial long-term

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The Driving Forces Of the Knowledge Economy

(continued from page 2)

global investment flows to emerging markets and innovative economies while taming speculative excess.

Knowledge Capitalism

The second driving force is “knowledge capitalism.” Knowledge capitalism is the drive to generate new ideas and commercialize them. This process of creating, disseminating and exploiting new knowledge is the dynamo behind rising living standards and economic growth. Collaboration is the driving force behind the creativity reflected in knowledge capitalism.

Social Capital

That collaboration gives rise to the third driving force, social capital. Trusting and being able to rely on others reduces the risk inherent in the new economy. That’s because the larger the range of people you can depend on, the less risk you will experience. In order to succeed, we must reach a point where we are an innovative and inclusive society. We cannot write off a percentage of our people through poor schooling, poverty and unemployment. We must move away from the winner-takes-all mentality that leaves most people at the bottom. We invest in new institutions of social solidarity.

These three forces are driving modern economies. It’s no coincidence that they are all intangible. When they work together, the economy hums and society seems strong and creative. When they are at odds, society is in danger of fragmenting and becoming more volatile. The task is to combine finance, knowledge and social capital in a virtuous circle of innovation, growth and social progress. The goal of politics in the twenty-first century should be to create societies that maximize knowledge, the wellspring of economic growth and democratic self-governance. ■

A Piece of Cake

There is no better example of the power of the knowledge economy than a simple recipe. Each year at Christmas, millions of people give cookbooks. This exchange is an annual, global knowledge transfer on a vast scale. A few thousand cookbook writers around the world distill their knowledge and deliver it to millions of cooks. It’s a worldwide upgrade of the software which runs our kitchens.

Tacit vs. Explicit

There are two kinds of knowledge, tacit and explicit. Tacit knowledge is that which you acquire by experience. It’s best communicated by example. Explicit

Myths About the New Economy

Myth 1: Learning is the Only Key to Success.

In the knowledge economy, the ability to unlearn is more important than the ability to learn. Unlearning is harder than learning, but absolutely necessary if companies and organizations are going to survive challenges.

Myth 2: Information is Always Valuable.

What counts is not the accumulation of information, but what we do with it. Information must be turned into understanding and insight. What sets entrepreneurs apart is not their raw information processing power, but their capacity for insight and imagination.

Myth 3: Formal Education is the Best Model for Learning.

Having more college graduates than ever before is not necessarily a great idea. If more people have degrees, the value of having just a college degree will go down. Consequently, many professional organizations try to boost the earning power of their members by creating more and more professional qualifications. Thus we have created qualification inflation. As more have these advance certifications, the value goes down. Two other qualifications will become more important than education: experience and entrepreneurship. In a society where virtually everyone is formally educated to high standards, the skills and qualities that cannot be taught will gain greater value.

Myth 4: We Live in a Time of Endless Choice and Opportunity

The new economy is supposed to open up endless choices for consumers, but it’s just not true. The global economy is instead dominated by a few global brands like Nike, Armani and Calvin Klein. The new economy does open up countless opportunities to make a living any way you want, but it also means a greater chance of failure.

knowledge, on the other hand, is codified in reports and books. Explicit knowledge is easier to transfer, but less rich. For example, there are two ways of delivering a recipe — tacitly or explicitly. You may have learned how to create a beautiful chocolate cake by watching your mother make one. That was the transfer of tacit knowledge. The same recipe in a cookbook or posted on the Internet will transfer the knowledge faster, and to a lot more people.

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A Piece of Cake

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Commoditizing Knowledge

Knowledge about how to cook has become a commodity. Instead of acquiring our own knowledge, we economize and buy the book. Imagine for a moment that you have invented the perfect chocolate cake recipe. You can exploit this two ways. One is by making cakes. But there is a limit to how many cakes you can make, and each one costs money to produce. If, however, you perfect the recipe, and sell it, there is no practical limit on how many you can produce, at very little cost. ■

Knowing to Compete

Our generation is the beneficiary of an unprecedented tide of formal knowledge which is lifting us up. That knowledge is coming from a combination of scientific research, a concerted investment in education, and the spread of information technology.

Together, these “push” factors are making available unprecedented amounts of valuable know-how. And another powerful set of competitive pressures is pulling companies toward know-how as a durable source of competitive advantage. Companies are driven to invest more in assets that weigh nothing but which are of great

How Waterford Globalized

Shortly after he took over Waterford Wedgwood, the Irish fine goods company, Tony O'Reilly commissioned research to determine if U.S. consumers knew Waterford crystal came from Ireland. If they did, it would be important to keep production in Waterford. If they didn't, he reasoned he could outsource production elsewhere more cheaply so long as quality was maintained. The study found most consumers thought of Waterford as a brand, not a place. Outsourcing began. Waterford's distinctive assets were intangibles — brand names, design traditions and know-how.

value: brands, research and development, and new approaches to building customer loyalty.

The message for companies is clear. Most of their value comes from “stealth assets” like brands, research, patents and other intellectual property. The tangible assets recorded on most corporate balance sheets are often no more than a fraction of the total worth of a company. The gap between the value of a company's tangible assets and its true worth, known as the market-to-book ratio, is especially large for service and high-technology companies. ■

PART II: COMPANIES

Corporate Collapse

Each day, we pick up, without thinking, the intelligence of others, embedded in easy-to-use products. The manufactured products we use and enjoy embody the knowledge and skills of thousands, and were made possible by the contributions of Frederick Winslow Taylor.

Born into a privileged family, Taylor suffered from poor eyesight and debilitating headaches that kept him out of Harvard. Instead, he took a job as a patternmaker. By day, he was a laborer, but in the evening he dined with family and friends who owned factories. This dual perspective of work and business, combined with a fanatical attention to detail and abhorrence of waste, encouraged him to develop theories of scientific management.

In *The Principles of Scientific Management*, published in 1911, he became a prophet of one of the dominant ideologies of our times: that we should make ourselves more efficient and productive by applying scientific methods to work. His ideas helped create mass manufacturing industries that produced the consumer affluence of the last century. He turned organizations into well-oiled machines. His ideas are at work in every

McDonald's, and has shaped our schools with their standardized tests and specialization.

Corporations took Taylor's ideas and applied them to not just the shop floor, but also other aspects of production. However, by the end of the century, competitive forces, particularly foreign ones, meant a shift in attitude. Workers began to be cross-trained and multi-skilled. Teamwork became the mantra. There was panic and confusion, dressed up as strategy and renewal.

Now, at the beginning of the twenty-first century, the giant corporation has a new lease on life. Global organizations are exploiting opportunities for economies of scale, and selling to global markets. A new breed of corporate giant is being created through global consolidation, with mergers such as Daimler-Benz and Chrysler, BP and Amoco, and Exxon and Mobil.

Yet in much of the rest of the economy, the old corporate regime is being stripped down and new organizations are slowly emerging. These have little hierarchy and encourage teams while rewarding initiative. The most successful companies in the new economy will be mutants and hybrids in software, communications, media and biotechnology. ■

Creating Knowledge

A company's health depends on whether it has the flow of ideas it needs to renew its products. If the knowledge flow runs dry, so will the company's reservoir of know-how. A company has to excel at finding and generating knowledge and then protect that intangible asset through branding, patents and copyrights. The process is full of difficulty. Visible knowledge is easily imitated, while intangible knowledge is more complex. Companies that will succeed will figure out how to create knowledge one of two ways: through incremental knowledge creation or through radical innovations.

Incremental knowledge creation involves the transfer of best practices through an entire company. Take, for example, the case of 42 almost identical food plants within the same company. A study showed that the best plants were three times more efficient than the worst. If the best practices of the high-performance plants are transferred to the worst plants, the savings are astonishing.

Radical knowledge creation, on the other hand, moves fast. For example, the U.S. computer industry developed an "intelligence network" to spot new ideas among bright graduate students on the theory that there are more innovative ideas outside their companies than inside. They develop and test radical new ideas and learn from failure.

To engage in radical innovation, a company often has to be open to ideas from the outside and from unusual sources, quick to recognize and reward talent, open to counter-cultural ideas, and able to combine know-how with other assets and skills such as finance and marketing. The best companies combine both radical and incremental knowledge generation. They improve their productivity, quality and cost performance continually while being open to radical, new ideas. ■

Evolutionary Innovation

We all know an innovative company when we see one. Dell Computers created a new industry by combining just-in-time manufacturing with telephone sales and home distribution. McDonald's created an industry by developing standardized cooking methods and training workers to deliver low-cost hamburgers, just in time, in hygienic conditions. Charles Schwab forced its competition to take e-commerce seriously by launching an online financial services business. They all created new products or industries by innovating new business models. But the process is anything but easy, since it typically requires a new organization and new processes, new incentives and a new culture. Here's how to go about it:

- **Diversity:** Evolution needs diversity. Bring out-

The Knowledge-Creating Company

The knowledge-creating company of the future will be good at learning and unlearning and will embrace eight principles:

- 1. Cellular Structure:** Know-how companies will be cellular. They act on their own to satisfy basic needs and in concert to achieve more complex tasks.
- 2. Self-Management:** The cellular company practices self-management and self-organization of motivated, educated and ambitious workers. People will self-manage within a clear set of values and corporate goals, so there will be less bureaucratic oversight.
- 3. Entrepreneurship:** All organizations will become more entrepreneurial. Entrepreneurship, which is the ability to spot and take advantage of opportunities in the face of uncertainty, needs to spread throughout the entire organization.
- 4. Equity Pay and Membership:** Organizations will need to be held together by a sense of membership. Knowledge-creating companies will resemble clubs, which have distinctive, self-regulating codes of behavior and values. There is equity pay and opportunities for people to pursue their interests.
- 5. Deep Knowledge Reservoirs:** A strong company needs to be sustained by deep reservoirs of knowledge. It must acquire and generate specialized expertise and know-how. A company can't be a loose collection of generalists.
- 6. Integration:** The ability to integrate diverse skills and complementary resources will become more critical. Companies are knowledge integrators.
- 7. The Holistic Company:** Public legitimacy is a vital asset. Companies that want to harness new ideas into new products will have to establish public trust.
- 8. Collaborative Leadership:** A knowledge-creating company needs to be an enterprise rather than a business; an organization with a purpose. Entrepreneurial companies are a purpose in search of assets. Leaders must create that sense of purpose and must engage in a constant search for creative collaboration, promoting a culture of curiosity and inquisitiveness, attacking complacency, encouraging dissent, dispute and creative abrasion.

siders in when possible. Develop networks that include educational institutions, research laborato-

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Evolutionary Innovation

(continued from page 5)

ries, suppliers and competitors.

- **Selection:** Companies must allow good ideas to be tried while weeding out bad ones. Reward good efforts, as well as good proposals that didn't make the cut, to encourage further idea generation.
- **Replication:** Once selected, a good idea has to spread. Turn good ideas into new products, processes or routines.
- **Organizations and Environments Innovating Together:** Companies have to change with their environment as well as change the environment. Form partnerships. Rather than retaining exclusive rights to a patent, companies can license that technology to others, spread the idea, and become a global leader through partnership.
- **Equilibrium Punctuated by Disruption:** Long periods of incremental change are punctuated by explosions of creativity. Companies must be capable of continual incremental change but also radical reinventing.
- **Design for Evolution:** Successful companies are

The Personalized Company

As human capital has become more critical, large companies are finding it harder to recruit, retain and motivate the talent they need. Workers are simply demanding more in terms of corporate culture, benefits and work-life balance. Companies that fail to address these issues will make themselves vulnerable to competition in labor markets.

In the last three decades, there has been a dramatic increase in the number of women with children in the workforce. This shift creates demands by mothers and fathers for a better balance between work and family life. Companies that employ a diverse workforce will have to respond, or lose a vast source of talent. Women are more likely to turn down a job or leave a company because it does not provide family-friendly policies, individualized career planning, sound anti-discrimination policies, or flexible work times.

better at learning, adapting and evolving. Companies must design organizations, and promote a culture that is cellular, self-managing, entrepreneurial and quick to adapt. ■

PART III: ENTREPRENEURS AND NETWORKS

Entrepreneurerve

The knowledge economy will not be the sole preserve of global companies. It will breed a rich undergrowth of entrepreneurial high-growth companies who will be the source of many of the brightest and best ideas. Of these, the most important will be the knowledge entrepreneurs. The assets they will trade on — know-how, skill, good judgment — are intangibles.

Entrepreneurship involves two main ingredients: sensing opportunity and mobilizing resources. Entrepreneurs spot value in ideas, resources and people that large companies often overlook. They excel at rapidly mobilizing resources to exploit opportunity.

We are witnessing the emergence of a new entrepreneurial generation, willing to take risks. They're not just looking for profit, though. They value their independence and want a sense of achievement from building a business or even changing society. ■

The Networked Economy

Successful global companies are really networks of information, knowledge and relationships. Take, for example, Visa, the credit card company. It isn't a company at all, but an alliance of banks brought together

into an international settlements system. Visa is a service owned by 20,000 financial institutions that offer credit card services. Visa handles \$650 billion in consumer transactions per year, yet it is nothing more than a brand and a set of relationships. ■

The Intelligent Region

Silicon Valley is known for its high-tech industry. There, in a congested space, more and more intelligence has been packed, making it the largest agglomeration of knowledge capital in the world. It also has the world's highest concentration of venture capitalists. The region's economy is a network of social ties that stretch from universities to companies, from venture capitalists to lawyers, from large companies to small.

Entrepreneurship thrives there because once an idea emerges, its creator is embraced by a network of venture capitalists and advisors, who help bring in companies and managers with complementary skills and assets. It is these ties that let Silicon Valley adapt to changing conditions and stay at the forefront of the new economy. It exemplifies the connection between innovation, collaboration, relationships and social capital. Like

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The Intelligent Region

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Silicon Valley, the global economy is evolving into a patchwork of regions and urban agglomerations. The social and political communities fostered by the new economy are likely to be regional and city-based rather than national. These will be intelligent regions. ■

The Ethic of the New Economy

Trust and cooperation are as critical to success in the modern economy as self-interest. People share and act on ideas when they trust one another. Yet many of our traditional bases for trust have been eroded by social and economic change. Established institutions are suffering from a malaise, if not a crisis, of trust. Large companies cannot be trusted to deliver security. The political system is treated with widespread cynicism. We need to embark on a wave of innovation in both public and private institutions to reform them to inspire and reproduce trust among workers, consumers and financiers.

As the character of the economy continues to shift

toward global production and trade of intangible services, trust will only become more important. As the international division of labor expands, so we depend on goods we barely understand, made by strangers, in factories thousands of miles away. And entrepreneurial cultures thrive when there is a high tolerance for well-intentioned failure, when people are trusted enough to be given a second and third chance. How will trust be seen in the new economy? In one of four distinct ways:

- **The role of contracts will be extended from commerce into other areas, such as government, to set clear yardsticks of acceptable behavior.**
- **To win public trust for innovation, we need to establish a transparent, publicly accountable system of trusted, expert third parties who will assess risk on our behalf.**
- **We need to improve procedures for injured consumers or workers who feel they have been treated unfairly to obtain redress, perhaps through arbitration.**
- **We must create a society where information is open and accessible.** ■

PART IV: THE KNOWLEDGE SOCIETY

Who Should Own Knowledge?

Who should own knowledge in the new economy? The old ideas of ownership embodied in the far right notions of private ownership coupled with the free market and the far left notion of collective, public ownership won't work in the new century. We need to innovate new forms of ownership that are both postcapitalist and postsocialist.

The traditional idea of company ownership is a myth. All over the world, managers justify decisions on the grounds that they have to deliver value to the ultimate owners of the business, the shareholders. In theory, all power flows down from the shareholders.

This account of shareholder ownership is one of the most powerful fantasies of corporate life. Ownership is not a simple concept. Ownership confers the right to possess, use and manage an asset, to earn income from it, to claim an increase in its capital value.

But a knowledge-based form differs markedly from this model in both practice and theory. The core to a knowledge-based company is the know-how of the people who work there. The critical issue is how these people are combined. A know-how business is created when people come together, give up their individual property rights over their work, and jointly invest these rights — temporarily — in the enterprise. Property rights are pooled by a social contract among peers, not by the top down

delegation of power from shareholders to managers. That fundamental distinction, between social contract and hierarchy, has far reaching implications in the way knowledge companies will be organized and owned.

The rise of the knowledge economy will encourage hybrid ownership that combines the public and the private. The old capitalism was founded on strong property rights; the new economy will be founded on fuzzy, pooled property rights and will only come to life with new forms of ownership. ■

Is the New Economy Green?

Has the Holy Grail — a new economy in which economic growth can be combined with environmental sustainability — appeared on the horizon? It is an alluring promise. For decades, the demands of economic efficiency and environmental sustainability has been at odds. Regulations designed to protect the environment have been opposed by industry because they threatened to raise costs and undermine competitiveness. Electorates have been presented with a dilemma: Consume less or degrade the environment for your children and grandchildren.

If the promise of a green and prosperous future is to be realized, it will not be through technology alone. The new

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Is the New Economy Green?

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economy will benefit the environment only if it gives rise to social, commercial and organizational innovations which change our attitude toward basic economic activities like consumption, investment and ownership.

Dematerialization

The new economy is driven by information. As we consume more entertainment and information, and use more computers and software, we will produce more and more with less energy and material. Physical products are becoming lighter. Building technology allows us to enclose more square footage with less material. Consumers can download songs digitally rather than buying and storing a CD. Shopping online consumes less energy than driving to the mall. The confluence of two trends — dematerialization and virtualization — means the economy should become less material intensive and therefore more environmentally friendly.

The effect may be more pronounced in the services sector of the economy, as we shift away from manufacturing. As consumers grow more affluent and more satiated, they spend more on services and less on basic goods. ■

Creating Social Capital

Why do financiers find it difficult to come up with ways to lend a few hundred dollars to poor people with no credit rating, or a few thousand to budding entrepreneurs with no track record in business? There is nothing stopping us, other than our lack of will and ingenuity. It can and is being done, on a small scale for now.

A good place to start looking for a model is Shorebank. The Chicago bank has broken through the superficial and outmoded divide between charity and commerce, social purpose and profits. Shorebank invests in social capital creation, and does it so well, it makes a financial return comparable with any bank in the United States. Shorebank began in 1973 when four Chicago bankers bought an ailing bank which was the last financial institution left in a poor neighborhood.

The bankers saw that capital was flowing out of the neighborhood, homes were in a state of disrepair, property values were falling, store owners were quitting, and there were fewer and fewer employment opportunities available. Shorebank began lending money for rehabilitation of rundown houses to people who ordinarily wouldn't pass bankers' credit requirements. Repayment was structured to meet the needs of the borrower. The bank now has a capital base of \$77 million and assets of \$725 million.

The End of Tax and Spend

We are in the midst of a chronic crisis in the balance between tax and spending. Too much social spending delivers too little lasting benefit. Our tax systems will find it increasingly difficult to finance these growing demands. Traditional tax and spend policies are no longer sustainable. The new economy will make it more difficult to raise money for public spending through the old tax system. Taxpayers will be increasingly unwilling to pay more in tax unless they see lasting benefits. More social spending will have to become social investment. But that will require radical changes to the structure, culture and organization of the public sector. Public spending must deliver lasting social capital.

Tax collection will become tougher and tougher, as money becomes electronic and inventories will no longer be physical and countable. Our industrial-age tax system is clearly in trouble. We must create an intelligent tax system based on four principles for raising funds for social investment:

1. **The system must be able to adapt to the speed of the society around it.** Old style entitlement systems can't continue to function beyond their usefulness. Pensions and social security systems must be rearranged so that investment decisions are placed in the hands of individuals, towns and regions.
2. **The social investment system must be capable of matching the diversity of the needs it serves with financing from different sources.** The financing must be matched to the activity that is being financed. For example, pensions must be funded from investment income rather than by transferring resources from one group of the population to another.
3. **The scale of the challenge posed by an aging population, the rising demand for education, and growing inequality requires society-wide response.**
4. **Developing countries face a service revolt as well as a tax revolt.** People want to see results. ■

Closing Thoughts

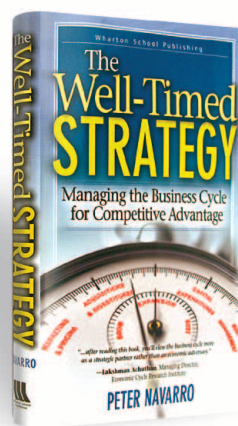
We must not retreat into narrow nationalism. That would be like our ancestors a century ago trying to retreat from the cities to their country communities. The knowledge economy goes to the heart of issues of global equality and development. There is no one best route into the knowledge economy. The production of new ideas within schools, colleges, companies and teams can be organized in a vast array of ways, while firms, governments and societies have a widening array of choices about how to organize themselves. ■

· Book 28 of 32 ·

The Well-Timed Strategy

Peter Navarro

SOUNDVIEW Executive Book Summaries®



By Peter Navarro

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Managing the Business Cycle For Competitive Advantage

THE WELL-TIMED STRATEGY

THE SUMMARY IN BRIEF

The business cycle has a profound impact on the fortunes and fate of many businesses large and small — and the employees and investors who depend on them. This summary offers a comprehensive guide to strategical-ly and tactically managing the business cycle.

This summary shows you how to manage not just the business cycle and industry cycles, but also today's unprecedented level of macroeconomic turbulence. It also shows you how to align every facet of business strategy, tactics and operations to reflect changing business conditions — so you can ride with the business cycle — not get run over.

You'll also learn how to tailor your marketing messages and product lines to the business cycle "seasons;" manage production and inventories to anticipate recessions, recoveries and sector rotation; exploit necessary "soft spots" to negotiate better deals; use tactical hedging and long-term contracts to insulate against inflation; prepare for layoffs before a recession; hire earlier in an upswing, when you can "cherry pick" better staff at lower wages; and how to time strategic acquisitions, divestitures and major capital investments.

No matter what markets you serve, this summary can help you increase your profitability — every day, every quarter, every year.

In addition, this summary will show you:

- ✓ *How to profit from the chaos and turbulence of business cycle volatility.*
- ✓ *How to implement strategies and tactics for profiting from every phase of the business cycle.*
- ✓ *How to manage macroeconomic turbulence and geopolitical shocks — from oil price hikes, war and terrorism to drought and disease.*
- ✓ *How to align all your operations to the business cycle: finance, supply chains, production, marketing, HR and more.*
- ✓ *How to put this knowledge to use as an executive, strategist and investor.*

THE WELL-TIMED STRATEGY

by Peter Navarro

— THE COMPLETE SUMMARY

Introduction

As inexorably as the sun rises and sets, the business cycle moves from a bright and healthy expansion and prosperous peak to a dark and often difficult recessionary trough and then back once again to prosperity. The fortunes of most companies literally ebb and flow, while some companies tumble down the trapdoor of bankruptcy, often never to rise again. So, too, is it that thousands of jobs are created in boom times while thousands more are again lost when things inevitably go bust.

The business cycle has a profound impact on the fortunes and fate of many businesses. It is one of the single most important determinants of corporate profitability and stock price performance.

So, how can the modern executive team strategically and tactically manage through the various recessionary and expansionary phases of the business cycle to gain competitive advantage over rivals?

The hundreds of companies analyzed to answer this compelling question run the gamut from well-known behemoths such as DuPont and Citigroup to much smaller niche players such as Isis and Xilinx. ■

Strategies and Tactics of The Master Cyclist Executive

Timing is everything — in love and war, most certainly. But certainly also in managing the business cycle.

Consider, for example, a “Master Cyclist” CEO such as Johnson & Johnson’s Ralph Larsen, who studiously follows key leading economic indicators, who accurately anticipates an approaching recession, and then implements an appropriately “well-timed strategy.”

In contrast, consider a brilliant but nonetheless “Reactive Cyclist” CEO such as John Chambers of Cisco. Lacking the appropriate “business cycle literacy,” Chambers failed to read numerous signs that the March 2001 recession was on its way — from a doubling of oil prices and a flattening yield curve in 1999 to a collapsing stock market and dramatically rising interest rates in 2000.

Is it any wonder that Cisco got caught flat-footed in the 2001 recession and was eventually forced to write

off more than \$2 billion in excessive inventory — even as the company had to lay off more than 8,000 people? While J&J’s stock price was soaring, Cisco’s came crashing back to Earth.

The Master Cyclist Management Wheel

The Master Cyclist management “wheel” provides an overview of the key functional areas of marketing and pricing, production and inventory control, and human resource management, as well as risk management, the strategic implementation of capital expenditure programs, and the tactical timing of acquisitions and divestitures.

The wheel spans virtually every major activity of the modern corporation. A careful understanding of this wheel will help any business executive team dramatically improve company performance.

Cutting capital expenditures in anticipation of recession is a prudent *defensive* strategy that preserves cash flow at a most opportune time. However, the most proactive of Master Cyclist executive teams also use the countercycling of capital expenditures as a potent *offensive* weapon. This is done by *increasing* capital expenditures during a recession in anticipation of a recovery and renewed and surging demand. In this countercyclical way, Master Cyclists can position their companies to take the market high ground when the recovery begins.

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For additional information on the Master Cyclist management wheel, go to: <http://my.summary.com>

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Strategies and Tactics of The Master Cyclist Executive

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Strategically Timing Acquisitions and Divestitures

From a strategic perspective, there are many compelling reasons why one company acquires another. Still, from a Master Cyclist perspective, it never makes any sense to impulsively make an acquisition if the stock price is too high — no matter how compelling the strategic reason.

The Master Cyclist knows that it is precisely at the trough of a recession that the labor pool is at its deepest and highest quality. To the Master Cyclist, a recession is a great time to “cherry pick” the labor market.

A large inventory overhang can also leave a company with obsolete or out-of-fashion products that then must be dumped at fire-sale prices — even as more nimble competitors swoop in to seize market share.

Business Cycle Seasons

The strategic and tactical implications of Master Cyclist marketing and pricing offer some of the richest insights into building competitive advantage in all of management strategy. For example, as a very young upstart, Dell illustrated that increasing advertising during a recession can be a highly effective way of building a brand and increasing market share. This is because during recessions, ad rates are at their cheapest, and there is far less competition and “noise” in the marketplace.

The business cycle can be very risky business indeed. For example, a company like Good Humor-Breyers always hedges the costs of its most important ingredients — from premium vanilla cultivated in Madagascar to premium-quality New Zealand butterfat for its heart-stopping ice cream brands. The true mark of the Master Cyclist involves not just static strategic hedges to neutralize risk but also more proactive “tactical hedging” to opportunistically leverage such risk.

Beyond simple hedging instruments such as futures and options, the Master Cyclist deploys two other important risk management tools: *business unit diversification* and *geographical diversification*.

Random Shocks and Profitable Opportunities

Master Cyclists are immediately able to parse both the tactical implications of random shocks as well as their longer-term strategic opportunities. Many diverse companies deftly illustrate how to develop new products or retarget old markets in response to the ravages of randomness.

Professor John McCallum — one of the earliest advocates of managing the business cycle for competitive advantage — writes that “knowing when to act” is strategically just as important as “knowing what to do.”

In an increasingly global and fiercely competitive econo-

my, the line between corporate success and failure is now being drawn by the ability — or lack thereof — of the modern executive team to first understand the business cycle in all of its strategic and tactical richness, and then proactively manage that cycle for competitive advantage. ■

Countercycling Your Capital Expenditures

Nothing can get a company into more trouble than ramping up an overleveraged capital-expansion program into the teeth of a recession. Such an overaggressive capital expansion creates large cash flow needs to service an ever-larger debt at a perilous time when revenues can fall dramatically. When top executives confuse their own management skills with the conditions of a “do no wrong” boom, they can easily fall prey to a classic “build the empire syndrome.”

Taking a page right out of J&J’s playbook, DuPont’s highly sophisticated forecasting team pays shareholders big dividends as the company prospers by cutting back on capital expenditures in anticipation of the recession. The Master Cyclist DuPont is one of the few major corporations in America to still have a staff of its own economists.

The Well-Timed Countercyclical Expansion

Intel’s countercyclical culture leads it to dramatically increase its capital expenditures during the recession while rivals are cutting back, and the company rides prosperously into the new economic recovery with new products blazing.

Lowe’s CEO obeys one of the most important Master Cyclist commandments — “Know Thy Sector” — and leaves the Reactive Cyclist Home Depot in the home-improvement dust.

Where the true Master Cyclist goes on the offensive is through the implementation of a well-timed countercyclical expansion to prepare for the next recovery.

The following are three key points to remember:

- **The Credit-Crunch Dangers of Overexpanding Into a Recession.** Top executives whose companies prosper during boom times can easily fall prey to a “build the empire syndrome.”

- **Protecting Cash Flow Through Countercyclical Retrenchment.** Countercyclically cutting capital expenditures in anticipation of a possible recession is a very important defensive strategy employed by the Master Cyclist. It preserves cash flow at a most opportune time.

- **The All-Important Well-Timed Countercyclical Expansion.** A true Master Cyclist also goes on the market-share attack by countercyclically increasing capital expenditures during a recession. In this way, the company is ready with new capacity and new and innovative products when the recovery takes hold. ■

The Credit-Crunch Dangers of Overexpanding Into a Recession

- Labor Ready's CEO "confuses brains with a bull market," overexpands into a recession, and brings down himself and (almost) his company.
- A morally challenged "whiz kid" MBA leads the once lean and mean Gateway to commit business model hari-kari by opting for an ill-advised, and exceedingly ill-timed, retail outlet strategy.
- Calpine's Pinocchio CEO succumbs to a classic "build the empire" syndrome by choosing the worst possible time to try to "repower North America" — and learns how to spell "junk bond."

The Acquisitive Master Cyclist Buys Low and Sells High

The age-old maxim "buy low, sell high!" is as true for a small investor laying down \$500 for 100 shares of stock as it is for a large corporation shelling out \$5 billion for a strategic acquisition. In the euphoric white-hot heat of the late stages of an economic expansion, Reactive Cyclists turn the "buy low, sell high" rule completely on its head.

In such heady times, your executive team must constantly remind itself that any overpriced acquisition will saddle your company with a long-term competitive cost disadvantage. Moreover, if your company takes on a heavy debt at high interest rates to finance a series of overpriced acquisitions — as both Nortel and Exodus did — it might face a major cash flow or bankruptcy problem as soon as a recession and new bear market hit.

One of the most important qualities of the well-timed acquisition strategy is not just the "opportunistic swoop." Rather, it is that antonym of irrational impetuosity: ruthless patience. ■

The Art of 'Cherry Picking' and Other Well-Timed Tactics of the Human Resources Manager

Here are some examples of "cherry picking" the talent pool in anticipation of recovery:

- Progressive Insurance robs not the cradle but rather the college campuses during recessions to sign up and train high-quality college recruits desperate for jobs.
- Isis Pharmaceuticals leverages a sharp downturn in the biotech industry to lock top scientist talent into permanent long-term positions at bargain salaries.
- A "Lone Ranger" Lehman Brothers goes contrarianly against the industry grain to stock up on elite stock broker-

age talent laid off by recession-battered competitors — and positions itself beautifully for the next bull market.

In the deep dark depths of a recession, the last thing that many companies want to do is to hire more people. Not so for the Master Cyclist. The Master Cyclist knows that it is precisely at the trough of a recession that the labor pool will be at its deepest and wage pressures will have subsided. That is a great time to cherry pick this labor market with the goal of staffing the company with the most talented workers at bargain wages.

The Master Cyclist executive team is able to deploy a more highly skilled work force with lower labor costs than its rivals when the new expansion begins.

Protecting Your Work Force During Recessions

Programmable chip wizard Xilinx preserves its highly skilled work force during a recession using creative measures such as sabbatical leaves, tiered pay cuts, and forced vacations. To humanely "right size" the company by the time the recession hits, just stop hiring. Supplement the work force with more temporary hires. Implement an early-retirement program to accelerate the rate of attrition.

Offer employees financial inducements to take education "sabbaticals" or other forms of leave — and thereby cut costs while preserving the employment relationship.

Nucor Steel uses wage and work-hour flexibility, tactical cross-training, and a highly supportive organizational culture to make its "no-layoffs" policy a strong asset rather than a recession liability.

Every company that adopts a no-layoffs policy implicitly acknowledges a fundamental economic trade-off between the cost savings from work force reductions during recessions and the often greater costs of rehiring and retraining during expansions. A second reason is that companies often bundle the promise of "no layoffs" with higher wages and benefits to become "employers of choice." Finally, no layoffs help keep employee morale high, with morale being an important intangible asset that helps boost productivity. ■

'Macromanaging' Your Production, Inventory, And Supply Chain

Reactive Cyclist executive teams are prone to at least two types of errors when it comes to managing their production and inventory levels over the course of the business cycle. The first is that a company's executive team might fail to build either an internal or external forecasting capability. The second, and perhaps even less-forgivable sin, is that some companies actually have the relevant forecasting information in-house to make the right decisions. But the

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‘Macromanaging’ Your Production, Inventory, and Supply Chain

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company chooses to ignore that information.

Micromanaging and Macromanaging Inventory

Walgreens’ *micromanagement* demons dance supply chain management circles around CVS. The superior inventory *macromanagers* of trucking giant Paccar leave lumbering rival Navistar in the recessionary dust. The sharp contrast between two drug retailing behemoths — CVS and Walgreens — and two trucking giants — Paccar and Navistar — provides an interesting illustration of the subtle but critical difference between *micromanaging* versus *macromanaging* one’s inventory turnover ratio over the course of the business cycle.

A standard piece of supply chain micromanagement advice is to “keep your inventory turnover ratio as high as possible.” The equally standard prescription to achieve this high turnover ratio involves applying a variety of micromanagement tools *independent* of the business cycle — from warehouse operations consolidations and improving supply chain relations to applying computer simulation models and the latest scanning technologies.

It is arguably as important from a Master Cyclist perspective to *macromanage* your inventory turnover ratio. This means tactically *increasing* the ratio by cutting production and trimming inventories when your forecasting models or economic indicators signal possible recession.

The ideal turnover ratio should move in a wave-like pattern over the course of the business cycle, rising as a recession approaches and falling as the promise of a new expansion looms.

Build-to-Order and Production-to-Order Strategies

As the examples of Dell and KB Home show, the beauty of such *build-to-order* and *production-to-order* systems from a Master Cyclist perspective is that they obviate the need for holding large inventories and thereby help insulate a company from business cycle fluctuations.

Using its pioneering build-to-order system, Dell has been able to reduce the days of inventory it holds on hand to an average of four days! The result is an inventory turnover ratio that is absolutely off the charts — more than 100 as compared to less than 30 for rivals such as Gateway and Hewlett-Packard! Dell’s build-to-order system has also proven to be a very powerful weapon to seize market share from rivals whenever the economy has softened or plunged into recession.

When the worst recession since the Great Depression hit the housing market back in July 1990, KB Home was caught totally by surprise with a mountain of inventory on its hands and few buyers in what had just months earlier been a red-hot housing market. KB Home dodged the

bankruptcy bullet that hit many of its developer competitors, and the company’s top management learned from its traumatic business cycle experience and quickly began to prepare for what they viewed as the inevitable recessionary “next time.” As housing market analyst William Walter observed, “Today, KB Home chooses to build in a particular area only after it has conducted extensive market surveys and statistical studies of the region.” ■

Master Cyclist Marketing Through the Business Cycle Seasons

The Master Cyclist marketer is adept at tactically changing both the marketing messages and product mix to fit the customer’s changing “moods” across the business cycle seasons. Some companies have been able to build their brands through countercyclical advertising.

Others have failed to use this tactic. For example, Kmart’s “Mac the Knife” CEO slashed advertising during a recession and helped drive the company straight into Chapter 11 bankruptcy — with a little push from Wal-Mart.

During recessionary times, the cost of advertising is much lower and a relatively better value. There is also less clutter and “noise” in the market when your rivals have gone to the advertising sidelines.

Cycling the Product Mix and Advertising Messages

The most sophisticated Master Cyclist marketer understands the enormous tactical advantages of changing both the *product mix* and *marketing messages* through the business cycle seasons. The simple truth behind such tactical cycling of the mix and messages is that many consumers respond more to product value than style during recessionary times.

For example, El Pollo Loco’s value proposition of cheaper dark-meat specials for dark recessionary times allows this not so “Crazy Chicken” to boost revenues and profit margins. Also, YUM!’s Pizza Hut chain hawks its large-dish delights as a low-cost-per-slice “family meal.”

Retargeting the Customer and Market

Movements in the business cycle, and the related stock market and interest rate cycles, can often trigger the need to retarget one’s customers or one’s market.

For example, Singapore Airlines retargeted its market toward first-class and full-fare customers flying transcontinental routes to smooth out the effects of business cycle volatility while boosting profit margins. Also, the Nature Conservancy’s transformational retargeting of its donor base in the wake of the 2000 stock market collapse significantly boosted its donations — and showed us that Master Cycling is for nonprofit organizations, too. ■

Pricing the Cycle and Managing Credit and Accounts Receivable

Price elasticity measures how sensitive buyers are to changes in price. Price elasticities can vary significantly across the business cycle: They are not fixed. *Raising prices in the face of “price-elastic” product demand will decrease — not increase — profits!* This is because when demand is elastic, an increase in revenues from a price hike is more than offset by a fall in the number of goods actually sold.

The Master Cyclist marketing team recognizes this key economic principle as well as the often subtle shifts in price elasticities over the business cycle. That’s why it typically raises prices in good expansionary times to boost revenues and cuts prices in bad recessionary times to protect or build market share.

To the Master Cyclist, the timely management of credit and receivables most resembles metaphorically that of an “accordion.” That is, the Master Cyclist loosens credit and allows receivables to build in anticipation of an expansion. However, credit is quickly tightened, and the collection of receivables is accelerated in anticipation of a recession.

The Master Cyclist Risk Management Wheel

There are three major components of the Master Cyclist “risk management wheel.” These are:

1. The hedging of general business cycle risk. This is typically accomplished by using tools such as business unit and geographical diversification. Other tools include natural business hedges, outsourcing and offshoring.

2. Hedging — and often opportunistically leveraging — the more specific risks associated with movements in commodity and oil prices, interest rates and exchange rates. This is usually done using various “financial derivatives” such as options and futures.

3. A wide variety of so-called *exogenous shocks*. Such random external shocks to the economy range from war and terrorism and drought and disease to earthquakes and tsunamis. The onset of such shocks often creates opportunities for the Master Cyclist executive team to develop new products or markets. ■

For additional information on how Goodyear snatched defeat from the jaws of victory, go to: <http://my.summary.com>

Proactive Profiting From Oil Price Spikes, Interest Rate Hikes, and Exchange Rate Risks

One of the biggest challenges many companies face is hedging the costs of raw materials. In the examples of both Good Humor-Breyers and Southwest Airlines, we

see two companies using highly sophisticated forecasting tools as the prelude to employing their hedging strategies and tactics.

Whereas Good Humor-Breyers opts for a complete *strategic* hedge for its key ice cream ingredients, Southwest Airlines illustrates a more nimble *tactical* opportunism. That is, although virtually all airlines maintain a partial hedge against fuel price increases, Southwest has tactically increased its hedging at key intervals when its macroeconomic forecasting models suggested an approaching oil price spike. This kind of proactive and tactical opportunism is the true mark of a Master Cyclist.

Consider that just a 1 cent change in the price of butterfat can move Good Humor-Breyers’ profits by half a million dollars. That’s why the company’s annual shopping hunt for its all-important cheap butterfat is conducted with all the precision of a Space Shuttle launch and all the zeal of a missionary.

Southwest Airlines offers an example of a hard-nosed Master Cyclist that relies heavily on macroeconomic forecasting to manage all phases of its business. The company’s own internal model incorporates not only various aspects of global supply and demand, monetary aggregates and exchange rates, but also assessments of geopolitical risk.

One of the least understood — but often most important — risks that companies face in an increasingly global economy is that of “exchange rate risk.” This kind of risk can wear many faces — two of which are “translation risk” and “transactions risk.”

If your company is based in the United States but sells many of its products in Europe, if the euro weakens, your net profits from foreign operations will go down because to “repatriate” those profits from Europe, you have to exchange the weaker euro for a stronger dollar. This is a translation risk.

The fluctuations in currency value that take place between the signing of an overseas contract and the delivery of a product can create a transactions risk. ■

When You Can’t Beat the Business Cycle, Hedge Its Risks!

Master Cyclist strategists often seek to hedge at least some of the business cycle risk. The tools most useful in this task range from *business unit diversification* and *geographical diversification* to the *outsourcing* and *offshoring* of different elements of the manufacturing and supply chain.

Business Unit Diversification

While a myopic Hewlett-Packard sank deeper into the computer hardware cyclical muck, IBM daringly

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When You Can't Beat the Business Cycle, Hedge Its Risks!

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escaped by diversifying into services, Web hosting, and strategic outsourcing.

The contrasting examples of Hewlett-Packard and IBM show how two technology giants both sought at one critical juncture to strategically diversify to avoid the extreme cyclicity of the computer hardware industry. The abject failure of HP to successfully execute its diversification strategy both led to its fall from shareholder grace and gave a huge, albeit unintended, boost to IBM's diversification efforts.

Companies engage in business unit diversification for many reasons other than to hedge business cycle risk — from achieving greater economies of scale and scope to capturing the synergies that result from sharing markets, distribution systems, or processes.

However, business unit diversification can also be used to construct natural business hedges to achieve more stable earnings over the course of the business cycle.

Two business units are naturally hedged if their activities are *negatively correlated* over the business cycle.

Geographical Diversification

By diversifying into new foreign markets, companies can achieve greater economies of scale. They can also deploy their core managerial and production skills across a broader range of opportunities. It is also true that one of the primary benefits of geographical diversification is to significantly reduce business cycle risk.

For example, using a mastery of the intricacies of exchange rates learned from an earlier peso crisis, the Mexican cement magnate CEMEX tactically advanced its geographical diversification strategy during the Asian currency meltdown.

The effectiveness of geographical diversification as a hedge is rooted in the fact that business cycles and political conditions of various countries are not perfectly correlated. Because the business cycles of *developing* coun-

tries such as China or Brazil tend to be less correlated with the business cycles of *developed* countries such as Canada or France, “multinational companies” view developing nations as excellent risk-hedging destinations.

Outsourcing and Offshoring Risk

Outsourcing refers to work done for one company by another or work done by people other than the company's full-time employees. Such outsourcing can be done domestically within a company's own country or, alternatively, the outsourcing can move “offshore” to other countries.

Although outsourcing and offshoring might help to reduce the business cycle risk of maintaining a work force to provide an element of a company's business, these strategies are not without their own risks.

For example, it might not always be wise to outsource a “mission-critical” subassembly or procedure to an outside group. This is particularly true if the procedure or subassembly has been offshored to a country where there might be political or economic instability. ■

Surviving — and Prospering From — Economic Shocks

A new kind of dangerous mountain warfare in Afghanistan and an ugly form of close urban combat in Iraq create lucrative opportunities for companies such as General Atomics to sell its high-altitude spy drones, Flir to move its infrared goggles, and Ceradyne to hawk its ceramic body armor.

Terrorism sparks a boom in products as diverse as bomb-detection equipment and biometric identification, and companies such as InVision and Viisage prosper while a bird flu sweeping across Asia sets off a vaccine-development sweepstakes to the benefit of large companies such as MedImmune and small speculative ventures such as China's Sinovac.

Unfortunately, in the chaos that often ensues after a random shock, many executive teams are caught flat-footed. Master Cyclist executive teams are, however, immediately able to parse both the tactical implications of a random shock as well as their possible longer-term strategic opportunities.

Random Shocks

Macroeconomic shocks range from war, terrorism, and oil price spikes to drought and disease.

Although macroeconomic shocks are, by definition, random, their after-effects are often quite logical and therefore possible to exploit with well-timed strategies and tactics.

Master Cyclist executive teams can quickly hedge prices, switch markets, strategically expand the product

(continued on page 8)

Hedging the Many Faces of Exchange Rate Risk

The captains of industry at Royal Caribbean find calm economic seas in both war and peacetime by buying euro-priced cruise ships with fully hedged dollars.

Procter & Gamble's “dumb and dumber” gamble against the (Bankers Trust) “house” offers a painful lesson in why most companies should limit their use of financial derivatives to risk hedging instead of engaging in highly leveraged gambling.

Surviving — and Prospering From — Economic Shocks

(continued from page 7)

line, change the marketing message, or hedge particular risks in response to random shocks.

War, Terrorism, and Mother Nature

War and terrorism give rise to the need for new products — from bomb detection equipment to ceramic armor. A drought in Australia can reduce beef exports and thereby raise U.S. chicken prices. Rain in Brazil leads to lower coffee bean prices and higher profit margins for coffee retailers. Business executives must regularly engage in this kind of “big-picture” thinking when parsing Mother Nature’s economic implications.

Demographic shifts represent some of the most powerful forces that shape the business environment. The Master Cyclist knows how to skillfully ride these demographic waves.

Most exogenous shocks are negative. However, in some cases, a company or industry can use its lobbying prowess to proactively create a positive “regulatory shock” that opens new markets, streamlines the regulatory process, or results in lower costs. ■

The Master Cyclist’s Favorite Forecasting Tools

Managing the business cycle for competitive advantage means, first and foremost, learning how to forecast the business cycle in an accurate and timely manner. In this task, the Master Cyclist relies on these three sets of tools:

1. A select group of leading economic indicators. These include the “yield curve,” stock and oil prices, the Index of Leading Indicators, and the even more useful “ECRI dashboard” of growth and inflation indicators.

2. A variety of more complex forecasting models.

3. The daily following of the monthly macroeconomic calendar of economic reports. Such reports are issued by government agencies and private institutions around the world on topics ranging from consumption, production and trade to growth, inflation and productivity.

Which leading economic indicators really lead? The (almost) infallible yield curve stands tall atop the pyramid of Master Cyclist leading indicators.

The stock market plays Sundance Kid to the yield curve’s Butch Cassidy as a valuable co-leading indicator.

Although both prove useful, the ECRI’s economic dashboard decidedly trumps the Index of Leading Indicators on both accuracy and timeliness.

Like a bad moon rising, higher oil prices almost always mean recessionary troubles are on the way.

The Master Cyclist closely follows a number of such indicators, each of which has been proven, in the crucible of repeated historical experience, to be very useful — if not infallible.

Economic Indicators

The yield curve is a very powerful forecasting tool because it embodies the collective wisdom of bond market investors speculating on the future direction of the economy. Yield curve inversions signal recessions. Steep curves signal expansions.

The stock market’s predictive power derives largely from the fact that stock prices reflect investor expectations about a future stream of earnings. Stock prices must fall as expectations of a recession and lower earnings rise, and vice versa.

The ECRI economic dashboard has two gauges: a Weekly Leading Index and a Future Inflation Gauge. This dashboard has proven to be a more powerful and timely tool than the Index of Leading Indicators and many forecasting models.

One of the most efficient ways for you to process the available forecasting data is to subscribe to the Blue Chip Consensus Survey, which has performed better than any individual forecaster.

Following the Macroeconomic Calendar

By diligently following the macroeconomic calendar, your Master Cyclist team can effectively become your own forecaster. By watching how the stock, bond and currency markets react to each piece of economic news, you can build both financial market literacy and a savvy business cycle “sixth sense” about where the economy might be heading.

Although most stock prices rise in a bull market and fall in a bear market, over different phases of the “stock market cycle,” certain industry sectors tend to “outperform” others. Cultivating an awareness of these patterns of sector rotation has great strategic and tactical value for you as a Master Cyclist. ■



If you liked *The Well-Timed Strategy*, you’ll also like:

1. ***Competitive Strategy* by Michael Porter.** Porter provides the techniques and tools that managers need to successfully conduct industry and competitor analysis.
2. ***Heads Up* by Kenneth G. McGee.** McGee describes how managers can break the pervasive pattern of surprises that are often followed by desperate responses.
3. ***World Out of Balance* by Paul A. Laudicina.** Laudicina provides a practical framework for making sense of changes in the external environment and offers straightforward scenarios of how the future global business environment might evolve.
4. ***The Agenda* by Michael Hammer.** The author presents nine core principles critical to contemporary corporate success. Among Hammer’s agenda items: “managing without structure” and “creating order where chaos reigns.”
5. ***Making Strategy Work* by Lawrence G. Hrebiniak.** The author describes how managers and executives can lead effective execution and change within their organizations.

For additional information on Gateway’s disastrous expansion into retail outlet stores, go to: <http://my.summary.com>

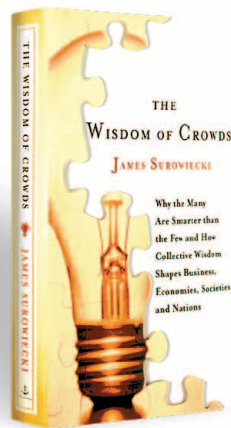
· Book 29 of 32 ·

The Wisdom of Crowds

James Surowiecki

SOUNDVIEW Executive Book Summaries®

FILE: LEADERSHIP



By James Surowiecki

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Why the Many are Smarter Than the Few and How Collective Wisdom Shapes Business, Economies, Societies and Nations

THE WISDOM OF CROWDS

THE SUMMARY IN BRIEF

Western society is focused on the power of the individual mind, but under the right circumstances, groups can actually make better decisions than even the smartest person within them. When individuals in a crowd are appropriately diverse, independent and decentralized, their aggregated decisions are surprisingly on point. With this knowledge, the power of groups can be used to find unknown answers and determine how to coordinate behavior and cooperate in all areas of society. Our everyday activities, our government and our economy are all affected by the power of crowds, and when things go awry, it is often because one of the key elements of an intelligent crowd is missing or underexpressed.

In The Wisdom of Crowds, journalist James Surowiecki explores the underlying implications of the idea that large groups of people are smarter than an elite few, no matter how brilliant.

What You'll Learn In This Summary

- ✓ How a properly structured group can answer problems of cognition and come up with the best or right answer.
- ✓ How members of crowds — shoppers, subway riders — coordinate their behavior with each other, knowing everyone else is doing the same thing.
- ✓ How self-interested people cooperate when logic dictates there is no reason to do so.
- ✓ How small groups are not as effective at decision making as crowds, even when the small group is made up of experts.
- ✓ How corporations can truly live up to the promise of decentralization.
- ✓ How imperfect, irrational players in a market can still allocate resources efficiently.
- ✓ How an uninformed electorate can still manage to elect the people who will make decisions in favor of the public good.

THE WISDOM OF CROWDS

by James Surowiecki

— THE COMPLETE SUMMARY

PART ONE: COLLECTIVE INTELLIGENCE

Tapping Into Crowds

In 1906, British scientist Francis Galton watched a weight-judging competition at a livestock fair. People bet on the weight of an ox after it was slaughtered and dressed. Butchers, farmers and nonexperts all bought tickets and guessed.

Galton borrowed the tickets after the competition and calculated the mean of the 787 guesses — the collective wisdom of the group. The crowd guessed 1,197 pounds. After the ox was slaughtered and dressed, it weighed 1,198 pounds. Galton had discovered that, under the right circumstances, groups are remarkably intelligent and often smarter than the smartest people in them, especially if individual guesses are aggregated and averaged. The group is not better than every single person, and some individuals will be smarter the more incentive they receive, such as in the stock market. But it is rare that the same person will be right as consistently as the group.

Game Show Contestants

On the TV show *Who Wants to be a Millionaire*, contestants answered a series of four-answer multiple choice questions. When stumped they could have two choices of answers removed, call a smart friend or poll the audience. The smart people were right 65 percent of the time, but the studio audience was right 91 percent of the time.

Cognition problems can also have answers that are unknown or in the future. For example:

Within 21 minutes of the 1986 *Challenger* explosion, the stock price of Morton Thiokol had fallen well below that of the other three companies involved in building the shuttle. Six months later, the cause of the explosion was determined to be the O-ring seals on the booster rockets made by Thiokol.

Google lets all of the pages on the Web vote on which pages are most relevant to your search.

The Iowa Electronic Markets (IEM), made up of about 800 people buying and selling futures on different election outcomes, is often more accurate than national polls.

Futures markets like the IEM exist for Hollywood box office receipts, news and sports. They work because they have the fundamental characteristics — diversity, independence and decentralization — that are key to making good predictions. ■

The Difference Difference Makes

Ransom E. Olds started selling cars in 1899 and prospered by selling the curved-dash Olds: a car for the middle class. With amazing marketing, he did quite well and sold more cars than any other U.S. manufacturer in 1903. Olds had fierce competition from hundreds of automobile companies. There was no standard, so they were peddling a huge array of vehicles with different sizes, shapes and power generators. Toward the end of the decade, most contenders began to fade, but innovators like Cadillac and Ford stayed. By World War I, Olds had been bought by General Motors.

The histories of most new industries are similar — a profusion of alternatives in the early days and a winnowing out of the winners who effectively choose the prevailing technologies. It seems inefficient, but the **diversity of ideas** allows meaningful differences among early ideas, not just minor variations on the same concept. The system works when it can recognize losers and kill them off quickly.

It is not enough to generate a diverse set of possible solutions.
(continued on page 3)

The author: James Surowiecki is a staff writer at *The New Yorker*, where he writes the popular business column, "The Financial Page." His work has appeared in the *New York Times*, the *Wall Street Journal*, *Wired* and *Slate*.

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The Bay of Pigs

The Kennedy administration planned and carried out its Cuban invasion strategy without ever really talking to anyone who was skeptical of the prospects of success. The people who planned the operation were the same ones who judged its likelihood of success. The few who voiced caution were silenced, and no one consulted the CIA or the Cuban desk of the State Department.

The group ended up neglecting some elemental facts, including the popularity of Fidel Castro, the strength of the Cuban army, and even the size of the island. They even convinced themselves that the world would believe that the United States had nothing to do with the invasion.

The Difference Difference Makes

(continued from page 2)

tions. The crowd also needs to be able to distinguish the good from the bad. Diversity adds perspectives that would otherwise be absent and makes a group better at solving problems. In fact, grouping only smart people together might not be that good an idea because they tend to resemble each other in skills. Adding people who know less but have different skills improves the group's performance. A group with diverse knowledge and skills will almost always make a better decision than one or two experts.

Homogenous groups, particularly small ones, are often victims of "groupthink." They become more cohesive, dependent on each other and isolated from outside opinions. They become more convinced that the group opinion must be right and will rationalize away possible counterarguments and believe that dissent is not useful and improbable. ■

For additional information on the knowledge of experts, go to: <http://my.summary.com>

Imitation, Information Cascades and Independence

Another key quality for good decisions is **independent thought** — not isolation, but relative freedom from the influence of others. It keeps the mistakes that people make from being correlated, and it increases the odds that the group will have new information rather than the same old data. Even if a person is biased and irrational, if he or she is independent, the person won't make the group dumber.

Independence is difficult to maintain when learning is a social process. The more personal contact people have with each other, the less likely it is that a group's decisions will be wise. Here are several ways that groups can

sabotage themselves:

Social Proof — People tend to assume that if many people are doing something, there must be a reason why. It is why the crowd becomes more influential as it grows.

Herding — People stick with the crowd because it is less risky than doing something radical that could fail enormously.

Information Cascades — People with different information, much of it imperfect, make decisions in sequence because they believe they're learning something from the example of others. Once people stop relying on their own knowledge, the cascade is no longer informative. They are making decisions on what they think people who came before them knew, instead of on their own knowledge.

Complicated Calculations

Despite these pitfalls, imitating others instead of undertaking complicated calculations before every action is a rational response to our own limits. Used well, it is a powerful tool for spreading good ideas fast. But people have to be willing to stop imitating and learn for themselves when the benefits become high enough. Intelligent imitation depends on an initially wide array of options and information and the willingness of at least some people to put their own judgment ahead of the group's. ■

Plank-Road Fever

The Erie Canal, completed in 1825, was a boon for commerce between large towns, but it didn't help people in smaller towns. George Geddes had seen the success of new plank roads in Canada — wooden planks laid over two lines of timber — and he thought it would be a solution. It was clearly a good innovation, but it wasn't clear that it would be cost-effective as a privately owned, toll-funded enterprise. Geddes believed a typical road would last eight years, providing a good ROI.

Geddes convinced Salina, New York, to build a plank road in 1846, and plank roads spread across the state and through the Midwest. Within a decade there were 352 plank-road companies in New York and more than 1,000 in the United States.

Unfortunately, plank roads only lasted four years, not eight. By the late 1850s, it was clear that they were ineffective. By the end of the Civil War, almost all were abandoned.

When the plank roads in the first years were successful, people saw a ready-made solution. As more were built, their legitimacy became entrenched, and the desire to consider other solutions shrank. By relying on dependent information, it took years before people realized the fundamental weakness of the roads, and it was more rational to rely on their own knowledge.

Putting the Pieces Together

The U.S. intelligence community is a collection of virtually autonomous, decentralized groups — ideal conditions for a group to make good decisions. Sept. 11, 2001, revealed the flaws. Given the sheer volume of information that intelligence agencies process, it is not surprising that a retrospective look at the data did not cry out any warning, but the fact remains that the intelligence community did not anticipate any of the terror attacks from 1993 to 2001. Congress found that decentralization without aggregation and a lack of information sharing were parts of the problem.

Decentralization has been very popular in business over the past 15 years. There is also a renewed emphasis on social networks, such as Napster, that allow people to connect and coordinate. In order to make good decisions, crowds need **decentralization**. This means their power does not fully reside in one central location, and important decisions are made by individuals based on their own knowledge. Specialization increases the scope and diversity of opinions and information that can be used to solve difficult problems. The weakness of decentralization is that there is no guarantee that the information will get to the rest of the system. The information must be **aggregated**.

Galton counted the ox-weighting votes to aggregate them, and in a free market, the aggregating mechanism is usually the price. Without aggregation, the best solution a group can come up with is that of the smartest person, and there is no guarantee that solution will emerge.

FutureMAP

FutureMAP was a market for people to buy and sell contracts based on expectations of events in the Middle East and elsewhere. It was a way for the government to aggregate information from many sources. An internal market, limited to between 20 and 30 people, could help circumvent internal politics by putting a premium on accurate forecasts, not keeping the boss happy. The Policy Analysis Market (PAM) would be a similar market open to the public.

The possibility of people profiting from terrible events caused a firestorm. Intended to collect information from people from whom the American intelligence community might not normally hear, it was considered “offensive” and “morally wrong” by Senators Ron Wyden and Byron Dorgan who led the campaign to quash it.

Their concerns were misplaced since U.S. government analysts get paid to try to answer the same questions as PAM every day. PAM was not a macabre game, but a tool to achieve a better sense of the economic health, civil stability and military readiness of Middle Eastern nations.

The U.S. intelligence community was practicing the wrong kind of decentralization. It did have diverse and decentralized sources of information, but it did not aggregate the information or its judgments. Linking computer databases and setting up decision markets are both ways for the agencies in the U.S. intelligence community to aggregate more effectively. ■

Coordination in a Complex World

Some problems have a right answer — the weight of the ox — or a definitive answer — anticipating terror attacks. Coordination problems occur when a person has to determine the right answer for him- or herself, but also what other people think the right answer is. These problems are less amenable to clear, definitive solutions.

The sociologist William H. Whyte spent a great deal of time studying the streets and sidewalks of New York City to see how so many people could coordinate themselves so well. Despite their small space, they don’t bump into each other. Without anyone telling them what to do they constantly anticipate each other’s behavior, slowing and speeding slightly to avoid collision.

Social scientist Thomas C. Schelling, set up experiments in which pairs of subjects chose “heads” or “tails,” with the goal of matching their partners. Thirty-six of 42 people said “heads.” When asked to name a positive number, 40 percent of the subjects chose “one.” Schelling believes there are salient **focal points** in a society where people’s expectations converge. They allow people to find their way to collectively beneficial results without centralized direction.

Established Norms and Conventions

Coordination also occurs through established norms and conventions. They maintain order and stability and allow groups of disparate, unconnected people to deal with certain situations without wasting time thinking about them or experiencing disruption.

Conventions should be irrelevant to economic life, but companies have them too. They lay people off in a recession instead of cutting wages across the board. Movie theaters charge as much to see a popular film on opening night as a dog limping along after five weeks. Yet without anyone leading or directing them most companies work in the free market, coordinating and getting resources to the right place at the right time. Studies show that most markets will settle on the right price between buyers and sellers over time, when rational people have complete information. But even imperfect markets populated by imperfect people can produce near-ideal results. ■

For additional information on coordination,
go to: <http://my.summary.com>

First Come, First Served

“First come, first served” is a practice so basic that we don’t even think of it as a convention. On a subway or in a movie theater we assume it is the best way to distribute seats, even though it doesn’t take into account how much a person wants to sit down, who the person wants to sit with, or the person’s age or health.

In the 1980s, social scientist Stanley Milgram had his graduate students ride the subway and simply ask people, in a courteous but direct manner, if they could have their seats. Remarkably, half of the people gave up their seats, even without a reason. The most difficult part was not convincing the people, but mustering the courage to ask them in the first place. The students felt “anxious, tense and embarrassed” when standing in front of a subject. Much of the time they couldn’t even bring themselves to ask. The norm of first come, first served seating was so ingrained that it required real labor to violate it.

Taxes, Tipping and Trust

Cooperation problems often look like coordination problems, but they require taking everyone else into account. Even though most individuals pursue their own self-interest, cooperation problems require a group to expand its definition of self-interest beyond maximizing short-term demands. They also require trust.

In 2003, Richard Grasso, CEO of the New York Stock Exchange, essentially got fired for making too much money — \$139.5 million in total. He had done a good job, but he had to step down in the face of deeply irrational public outrage. Economists assume that humans are basically self-interested and that they will make choices that benefit themselves no matter what others do. But, in fact, people want decisions to be fair and they expect a reasonable relationship between accomplishment and reward. Though members of the public did not have to foot the bill, they felt that Grasso’s compensation was grossly unfair.

The reaction to Grasso’s package and the players in the ultimatum game (see sidebar on right) were irrational,

but they show a willingness to punish bad behavior and transcend a narrow definition of self-interest to serve the common good.

Prosocial Behavior

This prosocial behavior makes societies and organizations work, since they cannot rely on laws and contracts alone. Cooperation usually makes everyone better off, even though it is rarely rational for the individual to cooperate. People don’t want to pay their taxes, but to keep them doing so, they must trust that most other people are doing so. People cooperate and do not take advantage of each other partially because they will have to repeatedly deal with each other. And yet we still tip waiters we will never see again. In order for cooperation to work, we must trust each other.

Unfortunately, the more people trust, the easier it is to exploit them, so most market societies develop mechanisms to limit corruption. In the end it is capitalism and market forces that have allowed trust between strangers, driven by the benefits of mutual exchange. Markets may foster greed and selfishness, but people still show an irrational but critical willingness to reciprocate with trust. ■

The Ultimatum Game

A well-known behavioral economics experiment gives a pair of people \$10 to divide between themselves. The proposer decides how to split the money and then makes an offer to the responder. The responder can accept and they both keep the money or reject the offer and they both lose the money.

If the players were rational, the proposer would keep \$9, offer \$1, and the responder would take it, since rejecting it would leave him or her with nothing. In practice, proposals below \$2 are usually rejected. People would rather have nothing than let the other person walk away with too much.

The proposer anticipates this behavior, because he or she would do the same, and the most common offer in the game is \$5. No matter where in the developed world the game is played, people respond the same way, even when the amounts of money become quite significant.

PART TWO: EXAMPLES

Traffic: What We Have Here Is a Failure to Coordinate

In 2003, London started charging people to drive downtown during peak hours. Singapore has an electronic smart card in every car that pays a toll as soon as the car enters the central business district. Mexico City lets people drive on specific days based on their license plate numbers. The best solution to congestion would be responsive pricing so

that people paid to use a road based on precise conditions such as traffic, weather and their vehicle. Americans will accept congestion pricing with long distance telephone calls and midweek flights, but they abhor the idea of paying more to drive during rush hour. They would rather suffer in traffic than allow some people to pay to get out of traffic. But traffic is notoriously hard to coordinate.

Cars on a crowded highway are decentralized individuals
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Traffic: What We Have Here Is a Failure to Coordinate

(continued from page 5)

uals following simple rules: don't hit the car ahead, shift lanes when you can and drive as fast as you can safely. When there aren't too many, vehicles can move freely from lane to lane and speed up or slow down without causing trouble. When more cars enter the highway, others have to brake and a wave of braking ensues. As people try to change lanes to move faster, the lane speeds even out. Now, cars are in an unstable pattern traveling at similar speeds but more slowly than before. That creates a traffic jam that is hard to unstick. Cars leaving the front of the jam move more slowly than those entering the back. Jams also make drivers more cautious as they try to coordinate in complete uncertainty. They increase space between them, making lane changes more likely and slowing everyone down more.

Slowing Down and Speeding Up

Coordination on the highway is difficult because of the diversity of drivers. Diversity is good to decision making, but makes solving coordination problems harder. Experiments with computer-controlled cars moving in exactly the same way show that driver homogeneity is actually a solution to traffic jams. If cars could travel as a solid pack that would not constantly slow down and speed up, there would be almost no traffic jams. ■

Science: Collaboration, Competition and Reputation

Scientists routinely work in large groups, which allows them to incorporate many different kinds of knowledge. It makes it easier to work on interdisciplinary problems and guarantees a diversity of perspectives, making scientists more productive. The more productive and better known scientists are, the more frequently they work with others. Scientists also generally do not keep new knowledge to themselves, understanding that it does not get used up as it is consumed. They release discoveries so that others can use them to make their own hypotheses. Scientists depend on their predecessors and colleagues to do good work, so that they can build on it.

Scientists are self-interested, but they have discovered a way for their self-interest to benefit everyone. They pick what they find interesting and in the process of winning notoriety for themselves they make the group smarter. Like the SARS network, no one is in charge.

The challenge for the scientific community at the moment is that an increasing amount of scientific research is being funded by corporations, which have an economic interest in protecting information rather than

SARS Collaboration

In February 2003, the Chinese Ministry of Health notified the World Health Organization (WHO) of an entirely new disease. The WHO set in motion a global effort to uncover the source. On March 17, 11 research laboratories around the world began collaborating to find the source of what was known as SARS. The labs had daily teleconferences, debated results and posted photographs of viruses isolated from SARS victims. Different labs worked on the same samples, multiplying their speed and effectiveness.

By March 21, scientists at Hong Kong University had isolated a likely source. The same day, scientists at the Centers for Disease Control and Prevention (CDC) in the United States separately isolated a virus. Over the next week, other labs detected the same virus, and labs in Germany, the Netherlands and Hong Kong began sequencing it. By April 16, the labs were confident enough to announce that they had found the source of the disease. Though Cynthia Goldsmith at the CDC was the first person to spot the virus, it took weeks of collaboration by people all over the world to prove it was the right one.

disseminating it widely. Also, when famous scientists collaborate, they get a disproportionate share of the credit, because other scientists pay more attention to reputation than the work. These issues challenge the independence of the members of the group. ■

The Columbia Disaster and How Small Groups Can Be Made to Work

After the *Columbia* launched in January 2003, the people at NASA tried to determine how much damage had occurred when some foam broke off and hit the Orbiter during lift-off. The Mission Management Team (MMT) was briefed by Don McCormack who had talked to the Debris Assessment Team (DAT). The DAT did not have good enough photos to draw a conclusion, but it was very concerned. McCormack did not convey the concern in an MMT conference call, and Linda Ham, the MMT leader, indicated that since there wasn't anything the team could do, the problem wasn't important. Because Ham had already decided the foam strike was inconsequential, the MMT did not collect the information it needed to make a reasonable estimate of the damage, including photographs.

The MMT assumed from the outset that the question of whether foam could do serious damage was already answered. The team also assumed that photos were unnecessary because the resolution would not be good

(continued on page 7)

The Columbia Disaster and How Small Groups Can Be Made to Work

(continued from page 6)

enough to help. In fact, none of the managers had the security clearance to know how good the resolution would be. Ham asked questions framed to get the answers she already expected. “Can we say that for any ... foam lost no ‘safety of flight’ damage can occur to the Orbiter because of the density?”

Small groups emphasize consensus over dissent. The MMT meetings had a complete lack of debate and minority opinions. Meetings were too structured with Ham asking questions but making no effort to illicit comments from others. There was also little diversity of knowledge and experience, because everyone had been at NASA since grad school. Even one different opinion or skill set makes a group wiser.

Direct Influence

Members of a market or a betting pool get feedback in the form of a price or point spread, but in small groups people influence each other directly. This can make their judgments more volatile and extreme. Often, the person who talks more sets the agenda, even if he or she doesn’t know more. Groups are also vulnerable to polarization when people constantly compare themselves to everyone else and try to maintain their relative position. When a group moves in a more radical direction, people move with it to keep their relative position, thus moving the entire group further.

American life and business are rife with small groups, but few organizations know how to make them work. There is no point if they can’t aggregate diverse opinions and make decisions. The MMT never even voted on what to do. ■

The Company: Meet the New Boss, Same as the Old Boss?

Zara is a clothing retailer that has found a way to coordinate its interactions with fickle consumers by coordinating its resources. It has cut lead time to two weeks rather than the six to nine months typical in the industry. All store managers have hand-held devices linked to design rooms in Spain. They make daily reports on what is selling and what customers want. With their own 14, highly automated factories, Zara makes small runs and tests the products with consumers, coordinating with their demands. Zara doesn’t outsource, so it has complete flexibility. The company has managed to combine different traditional ways of coordinating business, which can be illustrated through these Hollywood gangster movies:

● *The Godfather, Part II* — A top-down hierarchy allows one person to make decisions and allows for

long-term investments. But the top becomes more and more isolated from front lines and information.

● *Heat* — A small, tight-knit gang has trust, specialization and can see the immediate and direct results of its own efforts. But it is limited by its resources, and a mistake or betrayal of trust hurts the whole gang.

● *Reservoir Dogs* — A temporary group of specialists comes together for one job and disperses. They can be handpicked for specialty, but it takes a lot of work to get them together.

The Cost of Coordination

Companies exist because they reduce the cost of coordinating large groups to accomplish goals. Through the 20th century, corporations were vertically integrated, hierarchical and centralized with little diversity among top executives. They paid lip service to collective decision making but ended up with too many layers of consensus, isolating top executives from real opinions even more. The system discouraged the free flow of information and skewed compensation against dissent and independent analysis.

In the ‘90s, the companies tried to involve employees more, but that remains an unusual outcome. Decentralization can work when people will be more engaged, when they control their own environment and it makes coordination easier. Instead of relying on orders and threats from above, companies can rely on workers to find new, more efficient ways of solving problems. Decisions that corporations have to make are complicated, but they should not be left in the hands of just one expert CEO. They should aggregate the wisdom of their employees. ■

Markets: Beauty Contests, Bowling Alleys and Stock Prices

Most investors do not like to short sell stocks because it is riskier, losses are potentially unlimited and they are surrounded by negative reinforcement as everyone else wants stock prices to rise. But the measure of the stock market’s success isn’t whether stocks are rising but whether its predictions are right. A group is more likely to be correct when there is a diversity of opinions, and short sellers can provide that diversity when they know about corporate malfeasance and corruption.

Market investors are not necessarily rational. This does not mean that the market is deeply flawed, but that when aggregated even investors’ irrational choices will result in a rational and smart collective outcome as long as deviances from “rationality” are random. Only behavioral quirks that create systematic biases in opinion — decreasing diversity and independence — damage the market.

Even so, markets are imperfect at tapping into the collec-

(continued on page 8)

Markets: Beauty Contests, Bowling Alleys and Stock Prices

(continued from page 7)

tive wisdom compared to other methods. Stock prices jump around much more than they should and the long-term nature of the stock market and speculators mean that any given stock price can be wrong for a very long time.

Bubbles and Crashes

Bubbles and crashes are textbook examples of collective decision making gone wrong. In a bubble, all of the conditions that make a group intelligent — independence, diversity, private judgment — disappear. You don't see bubbles in the real economy. If the price of a television suddenly doubled, it would be less appealing, not more so. But stocks are bought to be sold again because they grow in value. This makes the investor's opinion of the market's opinion important, making stock prices a reflection of a series of dependent decisions. This is not inherently problematic. Most of the time the stock market is an ever-changing but relatively stable mix of independent and dependent decision making.

Bubbles and crashes occur when the mix shifts too far toward dependence, and it is difficult for the people inside the bubble to see. Bubbles begin as logical attempts to cash in on powerful business trends, but the temptation to trade stocks simply because other people are doing so becomes irresistible. There can be too much information about other people.

Competing Expectations

Groups are only smart when there is a balance between public and private knowledge. When people's expectations compete, the market is stable, but in a bubble or a crash,

The CNBC Effect

The stock-market bubble of the 1990s coincided with an explosion in financial news, particularly from CNBC. The cable network provided ubiquitous, non-stop coverage of the market. Before CNBC, most of what traders knew about other investors' opinions was divined from the ticker. As CNBC's popularity grew, so did its influence, and it began to unintentionally move the market instead of just commenting.

Stock prices often changed within 15 seconds of news pieces aired on the network, so investors weren't reacting to the content of the report. They knew that other people were going to react to the news, so the only question became who was going to move fast enough.

Bombarding investors with news about what other investors were thinking, CNBC magnified the dependent nature of the stock market instead of promoting independence.

expectations converge. Taking cues from the crowd, investors find it impossible to be independent. Luckily, markets are not always bubbles and the more investors refuse to buy stocks just because other people are doing so, the less likely a bubble will inflate and the more likely the market will make an intelligent decision. ■

Democracy: Dreams of the Common Good

Is democracy an example of intelligent decision making or just a way for people to express their right to rule themselves? Voters are self-interested like consumers in a market, so their votes would not necessarily be for the public good. In fact, self-interest would imply that voting isn't worth it at all, since no single vote actually counts and the winner doesn't make much of a difference. People vote out of duty, not out of self-interest, and ideology is a better predictor of attitudes on issues than self-interest.

A poll in 2003 showed that half of those surveyed did not know there had been a tax cut the previous year. Thirty percent of Americans thought Social Security and Medicare taxes were part of the income tax system and another quarter didn't know. At the height of the Cold War, half of all Americans thought the Soviet Union was a member of NATO. Can Americans pick a candidate who will make the right decision when they are this ill-informed? Through the wisdom of crowds they can.

The Common Good

Representative democracy is distinguished by the division of labor. Politicians specialize and acquire knowledge to make good choices and citizens monitor them. Competition in the form of elections makes it more likely that politicians will make good decisions. Voting also allows for the persistent injection of local knowledge, keeping the system more diverse.

What is in the interest of the common good can mean very different things to different people. That diversity might actually make the electorate an excellent decision-making system. Even the fact that most voters are not especially well-informed or sophisticated isn't a problem. There is no reason to believe that crowds should suddenly become unintelligent in the realm of politics. But it is difficult to develop a standard by which to judge success or failure.

Making policy in a democracy is not a cognition problem; it is a cooperation and coordination problem with fuzzier and less definitive answers. It helps us deal with the most fundamental cooperation and coordination problem of how to live together — how to compromise and accept an opponent's win because we believe he or she will not destroy the things we value, and we know we will get another chance. ■

· Book 30 of 32 ·

When Markets Collide



When Markets Collide

Investment Strategies for the Age of Global Economic Change

THE SUMMARY IN BRIEF

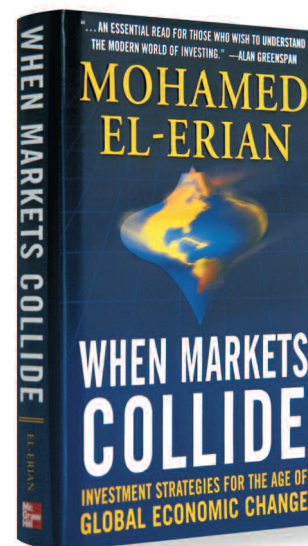
This summary provides a timely alert to the fundamental changes taking place in today's global economic and financial systems — and a call to action for investors who may fall victim to misinterpreting important signals. While some have tended to view asset class mispricings as mere “noise,” Mohamed El-Erian shows why they are important signals of opportunities and risks that will shape the market for years to come. He also puts recent events in their proper context, giving you tools that can help you interpret the markets, benefit from global economic change and navigate the risks.

The world economy is in the midst of a series of handoffs. Global growth is now being heavily influenced by nations that previously had little or no systemic influence. Former debtor nations have built unforeseen wealth and, thus, are enjoying unprecedented influence and facing unusual challenges. And new derivative products have changed the behavior of many market segments and players. Yet, despite all these changes, the system's infrastructure has not been upgraded to reflect the realities of today's and tomorrow's world. Market accidents and policy mistakes are therefore inevitable.

Investigating the underlying drivers of global change, *When Markets Collide* provides a detailed map for navigating the way through an otherwise perplexing new economic landscape.

IN THIS SUMMARY, YOU WILL LEARN:

- How to recognize new opportunities and risks.
- How to construct an appropriately diversified and internationalized portfolio.
- How to protect your portfolio against new sources of systemic risk.
- Ways to rethink the impact of central banks and financial policies around the world.



by Mohamed A. El-Erian

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THE COMPLETE SUMMARY: WHEN MARKETS COLLIDE

by Mohamed A. El-Erian

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Introduction: Finding Signals Within the Noise

We are witnessing a slow but steady transformation of the global economic and financial landscape.

At first, the changes impacted relatively small areas of the investment and policy world — essentially, the specialized segment of emerging market investing and the even more specialized and arcane world of derivative instruments and risk transference. But the phenomena — and the related good, bad and ugly that came with them — gathered momentum, and they are now critically relevant to a broad spectrum of investors, policy-makers and international institutions.

Ongoing economic and technical shifts or "transformations" are impacting the world we live in — present and future.

Transformations

Transformations are not easy to recognize or navigate, especially when they are initially unanticipated and evolve rapidly. By challenging conventional wisdom and historic entitlements, transformations feed a dynamic that is inevitably uneven and, at times, unpredictable.

As transformations in individual markets are gathering momentum, it becomes evident that the market and policy infrastructures cannot yet adequately support the emerging realities — at either the national or international levels. Activities that have been newly enabled by the transformations tend to outrun the ability of the system to accommodate and sustain them. The result is a series of blockages and other "plumbing problems" whose prevalence gives rise to an initial bewilderment, turmoil, a blame game and a subsequent realization that some type of change is needed.

Uncertainty

When the needed refinements are being undertaken, market participants — investors and national and multilateral policymakers — face uncertainty and worry about the prospect of further turbulence. The market turmoil that started in the summer of 2007 illustrates the type of over-shoots and dislocations that are likely to continue to occur.

The turmoil will shake the foundation of our global financial system. What started as a problem peculiar to the subprime segment of the U.S. mortgage market has morphed into a series of collapses whose impacts are being felt on both Wall Street and Main Street.

This reflects the secular transformation of the global economy. There are now economic and financial forces in play whose impacts are of great consequence but that cannot as yet be adequately sustained by the world's current policy and market infrastructures. As such, the efficiency gains that they bring are associated with higher risks of short-term disruptions. Indeed, the *present turmoil is neither the beginning nor the end of the transformation phase*.

Inconsistencies and Anomalies

A series of inconsistencies and anomalies acted as early signals of the growing tension between what participants or actors on the global finance stage were pressing for and what could be reasonably and safely accommodated by the existing systems in order to minimize the risk of turmoil. The signals also indicated the extent to which cross-border wealth handoffs were empowering a new set of actors and products when it came to global influence.

It is important to realize that the forces behind the recent financial crises have not gone away. Instead, underlying global transformations will play a major role



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Rebecca S. Clement, Publisher; Sarah T. Dayton, Editor in Chief; Christine Wright, Senior Graphic Designer; Chris Lauer, Contributing Editor

in defining and influencing the investment and policy landscape for years to come. ●

Aberrations, Conundrums and Puzzles

Over the last few years, economic and financial issues have arisen that could not be explained using existing models, mindsets or prior experiences. As a result, they came to be called “aberrations,” “conundrums” and “puzzles” and many in the marketplace dismissed them as being just “noise” and, as such, devoid of meaningful information. But these issues were, in fact, signals of underlying shifts or transformations that have proven to be of great consequence — in particular, as illustrated in the crisis that shook the foundation of the international financial system. These signals remain significant to investors now and will continue to be so in the future.

Investor Reaction

The biggest puzzle centered on the reaction of investors — particularly the ability and willingness of the financial system to overconsume and overproduce risky products in the context of large systemic uncertainty. It is striking how two phenomena that you would expect to be negatively correlated ended up being positively correlated for so long — namely, on the one hand, the significant fall in the premiums that investors were paid to assume risk and, on the other hand, the investors’ desire to assume even more of this mispriced risk.

The dynamics behind this positive correlation went something like this: Some investors were hesitant to accept the lower expected returns associated with the generalized decline in risk premiums. Accordingly, they tried hard to squeeze out additional returns. Leverage served as the best way to do so: By borrowing, they could put more money to work in their best investment idea; this seemingly made sense as long as the expected return was higher than the cost of borrowing. In turn, the leveraged positions pushed risk premiums even lower, encouraging another round of leverage.

The Punch Bowl

That cycle is just one illustration of the amazing sense of calm and self-confidence that prevailed despite the abundance of things that could not be explained. Rather than stay on the sidelines until proper explanations emerged, many investors rushed into ever-riskier trades and even higher leverage. Wall Street responded by putting the production of ever-more-complex products into overdrive. And while national and multilateral policy makers

expressed a mix of concerns and bewilderment, no meaningful actions were taken to “take the punch bowl away.”

A few months later, the world economy found itself in the grip of significant market turmoil. Unlike the majority of the global financial crises of the preceding 25 years, this one was triggered by events in the world’s most sophisticated economy, the United States. It impacted segments closest to the monetary authorities — namely, the interactions among banks.

The U.S. Stock and Bond Market

Consider this: The U.S. bond and stock markets are the two most liquid markets in the world. As such, economists regard them as also being the most efficient markets in the manner in which they process and price information. Yet these markets had sent conflicting signals about the prospects for the largest economy in the world. And these conflicting signals were occurring *at the same time*.

Again, several explanations were offered, but none garnered a meaningful consensus. Some cited the strength of the equity market as signaling the robust state of companies’ balance sheets. With companies holding so much cash, there is always the possibility of higher dividend payments and share buyback programs. Others pointed to the health of the global economy *as a whole* and the growing extent to which U.S. corporations were booking earnings from foreign sales.

‘Private Equity Put’

A third view stressed the “private equity put.” This notion was based on the correct observation that private equity firms were attracting a ton of cash and had access to extremely accommodating debt financing (in terms of both interest rates and covenants). As such, they were able to step in at the slightest sign of a price downturn and buy public companies in a “public-to-private” transaction. As this behavior became noticed and understood by investors, some rushed in to front-run the private equity bids and others repriced whole market sectors on the basis of private equity funds’ interest in a particular company.

We will never be able to determine with certainty what caused the U.S. equity market to behave so differ-

Secular Transformations

Long-term changes, what analysts refer to as “secular transformations,” are inherently challenging. They involve significant realignments in economic power and tricky handoffs in what determines economic growth, wealth, inflation and investment returns.

Alan Greenspan's Conundrum

Perhaps the most famous reaction to the phenomena of anomalies and inconsistencies was contained in then-Fed Chairman Alan Greenspan's semiannual monetary report to the U.S. Senate. In the February 2005 report, he noted that "for the moment, the broadly unanticipated behavior of world bond markets remains a conundrum."

ently from the bond market, and for such a prolonged period of time. However, what is clear is the importance of not dismissing the phenomena as simply "market noise" — especially when these aberrations were accompanied by other puzzling events.

Sea Change

Fortunately, all these previously unthinkable developments are now finally being recognized for what they really were — indications of a sea change. Indeed, what began as noise for many investors and policymakers became a signal of a major redefining of the global financial system. And it quickly became clear that certain parts of the international monetary system and market infrastructure were particularly ill-prepared for this change, which had costly consequences. ●

How Traditional Resources Failed Us

Institutions that are one step removed from the immediate action and that are staffed by professionals charged with "surveillance" of the international system are particularly placed to correctly identify when signals are something more than noise, perhaps even to predict them. Moreover, due to a universal membership and the power granted to them by their articles of agreement, they should play a role in facilitating welfare-enhancing changes in the global landscape. After all, they are built to reconcile domestic and international considerations. In actuality, however, these institutions have often found themselves better equipped to deal with the challenges of yesterday rather than with those of today and tomorrow.

International Monetary Fund

The International Monetary Fund (IMF) has traditionally been considered the most influential of the existing multilateral institutions that are operating at both the country and cross-border levels.

With many positive attributes, you would expect the IMF to flourish in the scenarios that have played out

among nations in the last few years — namely, lots of national policy uncertainties, new and unusual forms of cross-border flows, and the inability of any one country to deliver an *orderly* global outcome. Instead, it has languished.

Like many other entities and activities in both the public and private sectors, the business model of the IMF is ill-equipped to deal with the changes that are occurring in the global economy.

Four Considerations

Four important observations warrant further investigation and shed light on the future opportunities and risks confronting investors.

First, we are coming from a period of significant and simultaneous historical aberrations. They have been widespread and have posed quite a puzzle for long-standing models, strategies and conventional wisdom.

Second, too many investors rushed to dismiss these aberrations as noise rather than considering whether they were signaling something consequential about underlying forces. As a result, and despite the deep and wide market inconsistencies that were prevailing, many investors' initial reactions were to assume greater risk, consistent with the decline in implied volatility. At the same time, policymakers ended up taking a rather *laissez-faire* attitude in reaction to the migration of risk away from official and private supervisory bodies that had the expertise to conduct the necessary oversight.

Third, the systemic failure to distinguish signals from noise undercut the ability of both investors and policymakers to understand the nature and implications of the underlying transformations — transformations that were not only changing the secular destination for the global economy but also making for a rather bumpy journey.

Finally, when the inevitable adjustment came, it caught many off guard. The result was a major shock to the traditional parameters that underpin the smooth functioning of the market system. Yet industrial countries, rather than emerging economies, experienced the bulk of the collateral damage. ●

Separating What Matters From What Doesn't

Nobel Prize-winning economist Milton Friedman argued that the actions of a pool player may be largely predicted by a model constructed on the assumption that the player possesses high-level mathematical and other skills. These skills enable the player to compute quickly and accurately the angles and deflections that determine the best shot at any specific time.

'Black Box' Models

Friedman argued that the best test of a model is to compare its predictions with actual outcomes. To this end, it was defensible to construct the model on the basis of simplifying assumptions (as in the case of the approach used for the pool player). While one may bicker with this approach — it is nevertheless useful for thinking about how to reverse engineer a type of behavior that leads to specific outcomes. And whether they know it or not, many of today's hedge funds that use "black box" models are effectively applying Friedman's approach.

Today, the question is whether we could reverse engineer the reaction of a successful market trader by assuming that, as a starting point, he was anchored by a systematic approach to analyzing market noise and reacting accordingly. It is an attempt to reverse engineer his behavior on the basis of an analytical model.

Such an exercise would yield the following six key steps:

1. **Identify the source of the noise that creates an unusual market dislocation.** Observe the mass of market data with a view to picking out anomalies.
2. **Be disciplined in treating each episode of such noise as potentially containing important signals.**
3. **Assess the actual signal content through an evaluation based on the a priori modeling of the economic or market phenomenon.**
4. **Differentiate between factors that influence the destination and those that influence the journey when assessing the content.**
5. **After you have gone through this process, and not until then, you should actively pursue the views of the experts and the talking heads.**
6. **Be open to finding not only cyclical influences but also secular ones.**

Signals in the Noise

When you are trying to identify signals within the noise of the marketplace, you need to consider that there are many reasons why our natural inclination will be to resist notions of change. Moreover, once you overcome the recognition delay, you cannot assume that the system will simply reset itself (that is, return to the state it would have been in, absent the initial shock). There is a significant chance that the delay itself will give rise to new dynamics.

It is this type of thinking that has led experts to be sensitive not only to the emergence of a new secular destination for the global economy but also to the recognition that the journey warrants careful analysis. By

understanding the key components of the journey and destination, investors will be in a better position to exploit the benefits of our changing world while also minimizing their risks. ●

Understanding the New Destination

Analysis suggests that the markets are heading toward a secular destination involving consequential changes for investors:

- First, the engine of economic growth worldwide will no longer be so highly dependent on the United States; instead, emerging markets will increasingly constitute a consequential and independent driver for growth.

- Second, the nature of this new growth driver will evolve away from a high reliance on exports and toward domestic components of demand (namely, internal consumption).

- Third, this evolution has the potential to facilitate the much-needed and long-delayed adjustment in a U.S. economy that has been overly dependent on debt-financed consumption. In the process, the global economy will regain greater balance and reduce its financial vulnerability caused by an overly skewed distribution of global trade imbalances.

- Fourth, global inflation trends will be negatively impacted by continued pressures on natural resources. Moreover, they will be influenced by the gradual dissipation of the disinflationary impact previously associated with large chunks of efficient and cost-effective labor entering the global economy. This will complicate the policy challenge facing central banks, which are already operating in an unusually fluid world.

- Fifth, the global allocation of capital and related moves in asset prices will increasingly be influenced by the activities of sovereign wealth funds (SWFs) that take into account the interest of future generations. These SWFs are likely to gradually shift away from fixed-income investments and go toward higher-risk instruments and those that are deemed to offer stronger protection against inflation.

- Finally, these economic and financial changes will be accompanied by further technical developments centered on a highly nonlinear path for structured finance and other activities that depend on the continued proliferation of derivative products.

Risks and Returns

For investors, these changes alter the configuration of risk and returns. They call for changes in institutional and strategic approaches, and they realign the patterns of comparative advantages. They also modify the effectiveness of national and multilateral policy responses.

Summary: WHEN MARKETS COLLIDE

Market participants need to adjust if they wish to remain successful in this new age. Specifically, they have to develop an appropriate action plan that speaks to the characteristics of the new secular destination. But this is only a *necessary condition*; it is not *sufficient* to ensure success. Market participants also need to be able to navigate the journey. ●

Prospects for the Journey

As is typical of disruptive innovation, structural transformations have enabled — and will continue to do so — new activities that cannot as yet be adequately supported. As a result, it is inevitable that there will be a series of collisions between the world of yesterday and that of tomorrow.

The world of tomorrow will see a proliferation of new activities and instruments of finance, as well as a growing influence of new actors on the global stage. Meanwhile, the world of yesterday is embedded in the infrastructure and plumbing systems that seek to support these new activities, and we have already seen that they have limited and declining success in rendering that necessary support.

Yesterday's supporting structures and institutions are also reflected in the growing displacement pressure on hitherto dominant actors at the national and international levels, as well as the decline in the market share of traditional instruments and products.

Adjusting to Change

In the recent past, the world has seen the types of effects that inevitably result from the move from old to new. So we already know that we need to anticipate that different parts of the system will find it difficult to adjust quickly to the new realities. These difficulties will be experienced at individual firm and country levels, as well as at multilateral levels, and blunting these difficulties will require fundamental changes in mindsets and infrastructures.

This point is best illustrated by looking in turn at the experiences and challenges facing private sector organizations, national governments and multilateral institutions. Indeed, investors will get their arms fully around the challenges they face only if they also understand what difficulties lay ahead for national and multilateral policymakers. After all, the three parties are engaged in the equivalent of a complicated game of multidimensional chess. The game inevitably involves interdependency among players with diverse objectives, tools and constraints.

Global Change

Analysis suggests that the international economy has embarked on a major course of global change with an outmoded infrastructure. And there are distinct differences

among and within the three groups of market participants when it comes to ability and willingness to adjust.

There are therefore many reasons to expect that the journey will be inevitably bumpy. The risk is best captured in the concept of potentially compounding market accidents and policy mistakes. ●

Benefiting From Global Economic and Financial Change: An Action Plan for Investors

Having specified their expected return target and their risk tolerance, investors must adequately design and execute the three basic steps of portfolio management: choosing the right asset allocation, finding the best implementation vehicle and conducting the appropriate risk management. Specifically, investors need to design and implement a portfolio management approach that:

1. **Targets a new secular destination.**
2. **Utilizes the right instruments.**

And they must do so in a manner that also enhances their ability to navigate what is likely to be a rather bumpy journey.

Science and Art

Anyone who traffics frequently in this world will tell you that the specification of appropriate asset allocations inevitably involves a mix of science and art. Those who get into the details of these exercises will tell you that the balance has shifted significantly in the last few years away from science and toward art (also known as “judgment” and “gut feeling” or, if you wish to be less charitable, “guesstimates”). This is due to several factors: Traditional boundaries between asset classes are blurring; correlations are increasing; and when not linked by fundamentals, asset classes get connected by technical factors, including the “common ownership” of investors.

So why has the industry persisted in using an approach that has become less robust over time? It has done so for negative rather than positive reasons. Specifically, we have yet to come up with a better alternative.

Risk Factors

Rather than look at asset classes, the most promising approach starts with the risk factors that give rise to investment returns over time. Put another way, it looks at why investors are paid for allocating their capital in a certain way.

The ideal situation is to come up with a small set (three to five) of distinct factors that command a risk premium. The next step is to assess the stability of the

Summary: WHEN MARKETS COLLIDE

factors and how they can be best captured through the use of tradable instruments. This provides for a portfolio optimization process whereby the factors are combined in a manner that speaks directly to the investors' return objective and risk tolerance. The end product is a more robust and time-consistent combination of asset classes that map clearly to the underlying factors.

Hard Work

Conceptualizing the approach is one thing; coming up with answers is a completely different thing! Yet it's a very worthwhile effort, as even partial progress is valuable.

Success here involves coming up with a new method that bypasses many of the limitations of the traditional approach. This would shift the balance back toward more robust science, and it would allow investors to better capture risk premiums in a more efficient and sustainable manner. Partial success is coming up with a methodology that enables an investor to better check the consistency of his or her current approach, including whether the selected asset classes provide an efficient mix of risk premiums. ●

An Action Plan for National Policymakers and Global Institutions

Governments will need to develop a better understanding of the new realities of the financial system and respond accordingly.

In order to gain this insight, financial authorities need to be better plugged into day-to-day market developments. The Federal Reserve Bank of New York is the leader in this regard, maintaining close contacts with markets. The ability of other countries to do the same has been inadvertently hindered by the move to separate bank supervisory activities from the institutions that are conducting monetary policy.

The financial authorities will also have to improve their ability to conduct appropriate oversight on activities that have migrated outside sophisticated jurisdictions. In the case of national supervisory and regulatory bodies, this involves gaining a better handle on off-balance-sheet activities and other forms of financial alchemy and regulatory arbitrage. It will also entail retooling the bodies overseeing areas that have assumed either quasi- or full-capital market characteristics yet are still subject to backward-looking regulatory and supervisory approaches (for example, the insurance and mortgage areas). Finally, either through moral suasion or more direct methods, the fiduciaries of various investment vehicles will have

to develop stronger expertise and more robust oversight modalities. This is particularly the case for vehicles that may involve some type of contingent liability for public finances (such as pension funds).

IMF

The need for adjustments is most extreme in the case of the International Monetary Fund, an institution that has gone from being seen as the lynchpin in the complex of multilateral institutions to being questioned almost on a daily basis about its relevance, effectiveness and standing.

There is little disagreement on the needed enhancement of the IMF. Indeed, a common set of issues has emerged from the work done by the institution itself, the reports of committees, and the views of observers and practitioners. These include the need to accomplish the following:

- Retool the internal staff expertise to ensure that the traditional focus on economic issues is adequately complemented by a good understanding of the manner in which increasingly complex financial markets behave and influence the real economy.
- Alter internal modalities so that the IMF's country missions respond to the actual challenges facing member countries as opposed to imposing a discussion agenda that is driven by more narrow and inevitably dogmatic headquarter-based views.
- Strengthen the analytical standing of the institution so that it is able to engage credibly in sensitive national policy issues that require reconciliation at the global level, such as the surveillance of exchange rate policies.
- Develop a more robust internal income model that diversifies the sources of revenues and links them to the range of activities of the institution.
- Adequately budget and price where appropriate the services that the IMF is providing, and do so within the context of a more transparent system of cross-taxation and subsidization.
- Remove feudal practices that reserve key management and staff positions for certain industrial country nationalities.
- Allocate voting power and board representation on the basis of today's realities rather than those of the outmoded past. ●

Improved Risk Management

Great portfolio managers have a knack for scaling their trades. In doing so, they combine the right degree of insurance with a manageable cost.

Summary: WHEN MARKETS COLLIDE

An important consideration here relates to the effectiveness of the circuit breakers that come with today's global economic and financial conditions. Indeed, analysis sheds light on the way in which certain aspects can help ensure that the inevitable bumps (including those that pertain to the potential policy mistakes and market accidents) do not completely derail the journey.

Three Circuit Breakers

The global economy is fortunate at this time to benefit from three circuit breakers that reduce, but not eliminate, the probability of individual dislocations contaminating the long-term economic well-being:

1. Policymakers seem willing to intervene in an attempt to safeguard the smooth functioning of their international financial system and the robustness of economic growth; in the process, they are willing to underwrite the inevitable risk of moral hazard (the notion that insurance arrangements can, in themselves, change people's behavior).

2. There is considerable fresh capital on the sideline able and willing to step in; in the case of the funds held by the SWFs, this is starting from a position of significant absolute and relative underexposure to risk assets.

3. The breakout phase of economic growth in key emerging economies provides the global economy with a degree of resilience that it has generally lacked in the past.

Investors would be well-advised to maintain a careful check on the strength and lag structure of these three circuit breakers, whose effectiveness also depends on the potential duration of the technical dislocation (itself a function of the degree to which existing institutions have gotten themselves offside and, therefore, need to de-lever and reduce balance sheet). ●

Conclusion

As an aggregate, the global economy is navigating structural changes at a time of considerable fragility. Certain balance sheets are stretched, particularly in the United States; not all segments of the population benefit from the new global realities; the challenge of global climate change is real and as yet unaddressed; and political cycles are increasingly deviating from economic ones, raising the risk of disruptive protectionism and "beggar-thy-neighbor" policies.

Indeed, the global economy is in the midst of a tug-of-war. On the one side, we have pockets of financial excesses, overleverage, resource pressures and inequalities — all of which serve to undermine the sustainability and beneficial impact of globalization and integration. On the other side, the coming onstream of more balanced growth led by emerging economies and the development of their

excess savings act as stabilizers and provide a meaningful potential for a new welfare-enhancing phase for globalization, economic growth and poverty alleviation.

Coordination and Interdependency

There is a lot at stake, and the challenges are considerable and multifaceted. There are also critical coordination and interdependency issues.

Even if it were feasible and desirable, the official sector is in no position to lead the private sector to an orderly adjustment path. The private sector must assume this responsibility. The best that the official sector can do is to help encourage a potentially more orderly process by making much-needed progress on its own set of urgent reform priorities. Indeed, for the private sector to get it right, it needs support in the form of concurrent adjustments in the parameters that govern important aspects of market behavior, including those in the regulatory and policy channels at both the national and multinational levels.

Enhanced Global Welfare

The hope is that, in classic Adam Smith manner, global welfare will be enhanced by each group of market participants simultaneously pursuing its self-interest in response to the ongoing structural transformations — thereby reinforcing the potential incentive alignments and feeding the virtuous elements of the adjustment process. The danger is that differences in the willingness and ability to adapt will further complicate the journey and make the global economy more vulnerable to growth slowdowns, protectionist forces, liquidity sudden stops and financial market dislocations.

It is time for investors and policymakers to take measures. By acting in a decisive manner, they will shift the balance away from the dynamics of a vicious cycle toward those of a virtuous cycle. The resulting gains will go well beyond superior investment performance and good policy implementation. They will also be reflected in the ability to make this age of global economic change consistent with high global growth, declining poverty and relative financial stability. ●

RECOMMENDED READING LIST

If you liked *When Markets Collide*, you'll also like:

1. ***Intelligent M&A* by Scott Moeller and Chris Brady.** Moeller and Brady set forth a solid strategy for thriving in the high-stakes, high-stress environment of corporate mergers and acquisitions.
2. ***Judgment* by Noel M. Tichy and Warren G. Bennis.** Leaders are remembered for their best and worst judgment calls, and their judgment can determine the fate of an entire organization.
3. ***Crisis Leadership Now* by Laurence Barton.** Learn how to form a framework for building crisis management thinking into your company's strategic toolbox.

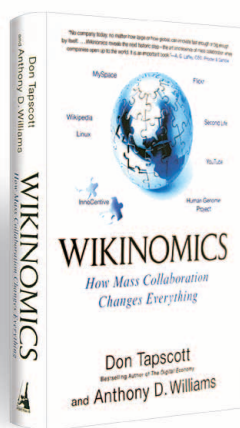
· Book 31 of 32 ·

Wikinomics

Don Tapscott and Anthony D. Williams

SOUNDVIEW Executive Book Summaries®

FILE: ECONOMICS



By Don Tapscott and
Anthony D. Williams

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How Mass Collaboration Changes Everything

WIKINOMICS

THE SUMMARY IN BRIEF

Based on a \$9 million research project led by best-selling author Don Tapscott, *Wikinomics* shows how masses of people can take part in the economy like never before. Billions of connected individuals can now actively participate in innovation, wealth creation and social development in ways we once only dreamed.

For companies to succeed, leaders must think differently about how to compete and be profitable, and embrace a new art and science of collaboration the authors call “wikinomics.” This is more than open source, social networking, smart mobs, crowd wisdom or any other idea that touches upon the subject. Rather, it’s about deep changes in the structure and modus operandi of the corporate entity and our economy, based on new competitive principles such as openness, peering, sharing and acting globally.

The authors describe the rapid growth of new collaborative enterprises such as MySpace, InnoCentive, Flickr, Second Life, YouTube and others. They also offer examples of how mature firms such as Boeing, BMW, Procter & Gamble and others have seized on collaboration and self-organization as ways to cut costs, innovate faster and co-create with customers and partners.

In this summary, Don Tapscott and Anthony D. Williams challenge our most deeply rooted assumptions about business. They describe what happens when masses of people and firms partner openly to drive innovation and growth, and they offer compelling reasons why anyone in business over the long run should pay close attention to this fundamental evolution.

In addition, this summary will discuss the following:

- ✓ *The weapons of mass collaboration and how to use them in your organization.*
- ✓ *How technology, demographics and global economics are converging for the first Category 6 business revolution.*
- ✓ *The “ideagoras” that are becoming marketplaces for ideas, innovations and uniquely qualified minds.*
- ✓ *Why consumers are becoming prosumers, and how customers are becoming co-innovators.*
- ✓ *How sharing and peer production will replace traditional ways of conducting business.*
- ✓ *How to live in the new “wiki workplace.”*

WIKINOMICS

by Don Tapscott and Anthony D. Williams

— THE COMPLETE SUMMARY

Building the Community of the Future

While hierarchies are not vanishing, profound changes in the nature of technology, demographics and the global economy are giving rise to powerful new models of production based on community, collaboration and self-organization rather than on hierarchy and control.

Smart companies are encouraging, rather than fighting, the heaving growth of massive online communities. As a growing number of firms see the benefits of mass collaboration, this new way of organizing will displace the traditional corporate structures as the economy's primary engine of wealth creation. ■

Wikinomics

Due to deep changes in technology, demographics, business, the economy and the world, we are entering a new age in which people take part in the economy like never before. The growing accessibility of information technologies puts the tools required to collaborate, create value and compete at everybody's fingertips. This new mode of innovation and value creation is called peer production or peering.

New low-cost collaborative infrastructures — from free Internet telephony to open-source software to global outsourcing platforms — allow thousands of individuals and small producers to co-create products, access markets and delight customers in ways that only large corporations could manage in the past. People can contribute to the “digital commons” at very little cost to themselves, which makes collective action attractive. Indeed, peer production is a very social activity.

These changes are ushering us toward a world where knowledge, power and productive capability will be more dispersed than during any other time in our history. A power shift is under way and a tough new business rule is emerging: Harness the new collaboration or perish.

The New Promise of Collaboration

A new art and science of collaboration is emerging — called “wikinomics.” This isn't just about developing online encyclopedias such as Wikipedia and other docu-

ments. A wiki (Hawaiian for “quick”) is more than just software for enabling multiple people to edit Web sites. A wiki is a metaphor for a new era of collaboration and participation.

The new promise of collaboration is that with peer production we will harness human skill, ingenuity and intelligence more efficiently and effectively than anything we have witnessed previously. The ability to integrate the talents of dispersed individuals and organizations is becoming the defining competency for managers and firms.

To innovate and succeed, the new mass collaboration must become part of every leader's playbook and lexicon. Learning how to engage and co-create with a shifting set of self-organized partners is becoming an essential skill, as important as budgeting, R&D and planning.

The Principles of Wikinomics

Wikinomics is based on four powerful new ideas: openness, peering, sharing and acting globally.

Being Open. Today, companies that make their boundaries porous to external ideas and human capital outperform companies that rely solely on their internal resources and capabilities. People and institutions that interact with firms are gaining unprecedented access to

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The authors: Don Tapscott is chief executive of the think tank New Paradigm. He is also the author of 10 books, including the best sellers *Paradigm Shift*, *The Digital Economy*, *Growing Up Digital* and *The Naked Corporation*. He teaches at the University of Toronto. Anthony D. Williams is a research director at New Paradigm. He teaches at the London School of Economics.

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Wikinomics

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important information about corporate behavior, operations and performance.

Peering. Peering succeeds because it leverages self-organization — a style of production that works more effectively than hierarchical management for certain tasks. Its greatest impact today is in the production of software, media, entertainment and culture.

Sharing. Smart firms are treating intellectual property (IP) like a mutual fund — they manage a balanced portfolio of IP assets, some protected and some shared. Of course companies need to protect critical IP. But companies can't work together effectively if all of their IP is hidden.

Acting Globally. The new globalization is both causing and caused by changes in collaboration and the way firms orchestrate capability to pioneer and produce things. Winning companies will need to know the world, including its markets, technologies and people. ■

The Perfect Storm

The new Web is the natural habit for a new cohort of collaborators called the “Net Generation.” For them the Web is the new glue that binds their social networks. Phenomena like MySpace, Facebook, Flickr, 43things, Technorati and del.icio.us aren't just Web sites, they're dynamic online communities where sprawling and vibrant clusters of interaction are forming.

As the new Web and the Net Gen collide with the forces of globalization, we are entering what might be considered a perfect storm, where converging waves of change and innovation are toppling the economic order.

The New Web

Today, the Internet is evolving from a network of Web sites that enable firms to present information into a computing platform in its own right. Whether people are developing, sharing or socializing, the new Web is principally about joining in rather than about passively receiving information.

Today's most exciting and successful Web companies and communities are stitching together their own services from shared databanks and Lego-style pieces of Web software. They use Web services to design platforms for people to engage and co-create with their peers.

What does the programmable Web mean for users? Increasingly, we are all witting and unwitting co-conspirators in building one massively sophisticated computer. The Web is no longer about idly surfing and passively reading, listening or watching. It's about peering:

sharing, socializing, collaborating and, most of all, creating within loosely connected communities.

Growing Up Collaborating

A new generation of youngsters has grown up online, and they are bringing a new ethic of openness, participation and interactivity to workplaces, communities and markets.

The Net Gen spends time searching, reading, scrutinizing, authenticating, collaborating and organizing. The Internet makes life an ongoing, massive connection, and this generation loves it.

The Net Gen's modus operandi is networking. It would be easy to dismiss online social networking as another fickle youth fad. But online social networking is uniquely attuned to the Net Gen's cultural habits and will be part of the social fabric going forward.

The opportunity to bring Net-Geners (and other customers) into the enterprise as co-creators of value possibly presents the most exciting long-term engine of change and innovation that the business world has seen.

The Collaboration Economy

Traditional corporations are finding themselves thrust aside by an entirely new kind of business entity. That new entity is the business web, or the b-web. B-webs are clusters of businesses that come together over the Internet. While each company retains its identity, the companies function together, generating more wealth than they could ever hope to generate individually.

The future lives in collaboration across borders, cultures, companies and disciplines. Effectively, it's globalize or die.

In the collaboration economy, the real advantage of global sourcing is not cost savings, but the endless possibilities for growth, innovation and diversity. The greatest growth engines of the 21st century will be business webs that fuse the resources and competencies of the developed and developing worlds into unbeatable combinations. ■

The Peer Pioneers

Peer production is emerging as an alternative model of production that can harness human skill, ingenuity and intelligence more efficiently and effectively than traditional firms. The way companies address peer production will shape the future of industry and affect their very chances for survival. In its purest form, peer production is a way of producing goods and services that relies entirely on self-organizing, egalitarian communities of individuals who come together voluntarily to produce a shared outcome.

Communities of producers typically use “general

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The Peer Pioneers

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public licenses” to guarantee users the right to share and modify creative works, provided that any modifications are shared. By opening up the right to modify and distribute, these open-source licenses allow larger numbers of contributors to interact freely with larger amounts of information in search of new projects and possibilities for collaboration.

Peering works best when at least three conditions are present: 1) The object of production is information or culture, which keeps the cost of participation low for contributors; 2) Tasks can be chunked out into bite-size pieces that individuals can contribute in small increments and independently of other producers; and 3) The costs of integrating those pieces into an end product, including the leadership and quality-control mechanisms, must be low.

The Future of Open Source

Open source, it seems, may at last be coming of age. Embracing open source means embracing new mental models and new ways of conceptualizing value creation. Profiting from peer production groups like Linux is a new skill that requires companies to recognize and seize chances to build new products and services on top of vibrant open ecosystems.

Peer Production is Here to Stay

Peer production will continue to grow in importance because key enabling conditions are present and growing. These include access to computing power and applications, transparency, globalization, the democratization of knowledge and skills and the increasing complexity of systems. Firms must invest in the technology and business architecture to become truly networked and open enterprises, and engage in collaborative networks that help build the culture and strategic capabilities to leverage peer production. ■

Ideagoras

Ninety thousand scientists from 175 countries have registered with InnoCentive to provide solutions to companies such as Boeing, Dow, DuPont, Novartis and Procter & Gamble. Launched by U.S. pharmaceutical giant Eli Lilly as an e-business venture in 2001, InnoCentive now enables some 35 Fortune 500 companies to extend their problem-solving capacity. This visionary matchmaking system links experts to unsolved R&D problems, allowing these companies to tap the talents of a global, scientific community without having to employ everybody full time.

The authors call these marketplaces ideagoras, much

The Key Benefits of Peer Production for Businesses

Harnessing external talent. Smart firms can harness innovation by using peer production to involve more people and partners in developing customer solutions than they could ever hope to marshal internally.

Keeping up with users. If you do not stay current with users, they invent around you, creating opportunities for competitors.

Boosting demand for complementary offerings. Participating in peer-production communities can boost demand for complementary offerings and provide new opportunities to create added value.

Reducing costs. By collaborating with open-source communities, companies can reduce costs dramatically.

Shifting the locus of competition. Publishing intellectual property in non-core areas that are core to a competitor can undermine your rival's ability to monopolize a resource that you depend on.

Taking the friction out of collaboration. Avoiding the problems related to ownership and exploitation of intellectual property is one reason why a growing number of firms are embracing open models of collaborative innovation.

Developing social capital. When firms join a peer-production community, sharing is the continued price of admission to the community from which the firm derives various benefits.

like the bustling agoras that sprang up in the heart of ancient Athens to facilitate politics and commerce among the burgeoning Athenian citizenry. Modern-day ideagoras such as InnoCentive make ideas, inventions and scientific expertise around the planet accessible to innovation-hungry companies. As more companies embrace the principles of wikinomics — openness, peering, sharing and acting globally — these ideagoras will come to fruition, fueling an increasingly active trade in technology, intellectual capital and other key innovation ingredients.

Questions and Solutions

Ideagoras come in two principal flavors: solutions in search of questions and questions in need of solutions. Solutions in search of questions are those 70 percent to 90 percent of ideas and inventions that go unutilized. Questions in need of solutions are just that: unanswered problems, queries or uncertainties that have not been addressed internally.

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Ideagoras*(continued from page 4)*

In the late 1990s, Procter & Gamble launched an internal survey and discovered it was spending \$1.5 billion on R&D, generating lots of patents, but using less than 10 percent of them in its own products. CEO A.G. Lafley saw it as a wake-up call and led the charge to open up the patent portfolio. P&G now makes every patent in its portfolio available for license to any outsider, as long as it has existed for at least five years or has been in use in a P&G product for at least three years.

P&G is not alone in its affinity for IP licensing. In fact, virtually all companies with sizable patent holdings are now busy mining their portfolios, looking for licensing-out opportunities and taking technologies off the shelf that can bring in revenue. Using online marketplaces such as yet2.com allows them to cast wider nets across multiple, and often unrelated, industries.

Other mature, innovation-based companies face the same dilemma. The potential for growth is out there, but it's distributed across thousands, perhaps millions, of individuals, organizations and firms. That's where ideagoras come in — they help link all of these individuals, companies and organizations together by establishing connections and facilitating transactions between buyers and sellers of ideas and technology.

Not only can ideagoras enable companies like P&G to innovate well beyond what they could muster internally, they help them hone their true value-adding capabilities and avoid reinventing the wheel.

Harnessing Ideagoras

With the emergence of global ideagoras, companies can pursue a wider set of strategic possibilities. Learning how to create, find and reapply great ideas in a global ideagora means turning the R&D organization on its head. Some of the big changes include refining its approach to intellectual property, sharpening its external radar and creating an R&D culture that supports the acquisition of external ideas and technologies. Smart firms will harness a portfolio of approaches ranging from corporate ventures to customer co-creation to peer-producing value in open communities.

Ideagoras lower the costs of communicating, collaborating and transacting and could very well revolutionize the way firms conduct R&D. Companies that learn how to harness ideagoras will divest themselves of non-core activities and conserve their resources for cutting-edge challenges and opportunities.

Internal R&D will still be important in the new world of ideagoras. But in-house innovation alone will not be enough to survive in a quickly changing and intensely competitive economy. Increasingly, the corporate R&D

process must look two ways: toward its internal projects and competencies, and toward the external marketplace to leverage new IP and capabilities. Ideagoras are the place where companies can tap a wealth of new ideas, innovations and uniquely qualified minds. ■

The Prosumers

Two forces are converging to position the customer as a co-innovator. One is that customers use the Web as a stage to generate prosumer communities, so what was once fringe activity is increasingly out in the open. Second, companies are discovering that “lead users” — people who stretch the limits of existing technology and often design their own product prototypes in the process — often develop modifications and extensions to products that will eventually appeal to mainstream markets. Companies that learn how to tap the insights of lead users can gain competitive advantage.

Customer innovation is going self-serve with the rise of prosumer communities. One of the earliest, and still most vibrant, prosumer communities has formed around Lego products. Lego's fusion of mass customization and peer production remains rare enough in today's consumer products market to make the idea particularly outstanding. Customers can make whatever they want, and Lego transforms its legion of youthful customers into a decentralized virtual design team that invents and swaps new Lego models.

Control Versus Customer Hacking

Here's the presumption dilemma: A company that gives its customers free rein to hack risks cannibalizing its business model and losing control of its platform. A company that fights its users soils its reputation and shuts out a potentially valuable source of innovation.

Customer hacking will live on. Smart companies will bring customers into their business webs and give them lead roles in developing next-generation products and services. This may mean adjusting business models and revamping internal processes to enable better collaboration with users.

That is a small price to pay to keep customers loyal to your business. In fact, the opportunity to generate vibrant customer ecosystems where users help advance, implement and even market new product features represents a largely untapped frontier for farsighted companies to exploit.

Nothing illustrates the opportunities and trade-offs of prosumption better than the growing propensity of young people to weave fluid and participatory tapestries of music content into their own unique and inviting creations. Call it “the remix culture.”

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The Prosumers

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The most popular form of Do-It-Yourself (DIY) creativity is what participants call “mashups,” “bootlegging,” “bastard pop” and a variety of other labels. The common theme is that aspiring artists fuse songs digitally from completely different genres to produce hybrid singles and, increasingly, full-length mashup albums. Unorthodox? Yes. Illegal piracy? Perhaps. Innovative and enjoyable? Most definitely.

Democratization is a scary word for those accustomed to ironclad control over the creation and distribution of music. But the music industry — and all industries for that matter — must resist the temptation to impose their will on consumers as a matter of convenience or, worse, as a result of a lack of ingenuity and agility. Rather, music labels should develop Internet business models and offerings with the right combination of “free” goods, consumer control, versioning and ancillary products and services. This includes new platforms for fan remixes and other forms of customer participation in music creation and distribution.

How to Harness Prosumers

More than customization. Customization occurs when a customer gets a product adjusted to his or her specification. The problem is that mass customization entails mixing and matching prespecified components, significantly limiting flexibility and innovation for users. True presumption entails deeper and earlier engagement in design processes and products that facilitate customer hacking and remixing.

Losing control. Customers will treat your product as a platform for their own innovations, whether you grant them permission or not. If you do not stay current with customers, they invent around you, creating opportunities for competitors. It is preferable to sacrifice some control than it is to cede the game completely.

Customer tool kits and context orchestration. Make your products modular, reconfigurable and editable. Set the context for customer innovation and collaboration. Make it easy to remix and share.

Becoming a peer. Your real business is not creating finished products but innovation ecosystems.

Sharing the fruits. Customers will expect to share in the ownership and fruits of their creations. If you make it profitable for customers to get involved, you will always be able to count on a dynamic and fertile ecosystem for growth and innovation.

Harnessing Prosumer Communities

Presumption is becoming one of the most powerful engines of change and innovation that the business world has ever seen. Co-creating with customers is like tapping the most uniquely qualified pool of intellectual capital ever assembled. But it comes with new rules of engagement and tough challenges to existing business models.

The old customer co-creation idea was simple: Collaborate with your customers to create or customize goods, services and experiences, all while generating a built-in market for your wares. This is the company-centric view of co-creation.

In the new prosumer-centric paradigm, customers want a genuine role in designing the products of the future. Products that don't enable and invite customer participation will be anathema.

If you expect to be around in the next decade, your organization will find ways to join and lead prosumer communities. ■

For additional information on the Lego prosumer community, go to: <http://my.summary.com>

The New Alexandrians

The Alexandrian Greeks were inspired by a simple but powerful idea. Take the sum of mankind's knowledge, store it in one building and share it for the betterment of science, the arts, wealth and the economy. At its crowning glory, estimates suggest that they had accumulated more than half a million volumes in their library.

We are fortunate to be living through the fastest and broadest accumulation of human knowledge and culture ever. Thanks to a new generation of Alexandrians, this fountain of knowledge, past and present, will soon be accessible in ways our ancestors could only dream of. Digital libraries are important, but the Alexandrian revolution extends far beyond the way we archive knowledge, to the way we develop and harness knowledge to drive economic and technological progress.

Collaboration, publication, peer review and exchange of precompetitive information are now becoming keys to success in the knowledge-based economy. In fact, we have entered the age of collaborative science.

Just as collaborative tools and applications are reshaping enterprises, the new Web will forever change the way scientists publish, manage data and collaborate across institutional boundaries. All the world's scientific data and research will at last be available to every single researcher — gratis — without prejudice or burden.

The New Alexandrians understand that creating a shared foundation of knowledge on which large and

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The New Alexandrians

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diverse groups of collaborators can build is a great way to enhance innovation and corporate success.

Some companies use cross-licensing and patent pools to lower transaction costs and remove friction in their business relationships. Some industries embrace open standards to enhance interoperability and encourage collaboration. Others invest in a precompetitive knowledge commons to boost the productivity of downstream product development. Regardless of which method — or combination of methods — firms choose, the result is usually the same: a more dynamic and prosperous ecosystem. ■

Platforms for Participation

Today, with open platforms for innovation inviting unprecedented participation in value creation, cumulative innovation is going into overdrive. The companies that figure out how to harness the power of open platforms while providing adequate incentives to all stakeholders are poised to reap great rewards. Retail sites such as Amazon, eBay and Apple demonstrate how platforms for participation can give rise to vibrant ecosystems around a simple activity like shopping.

Platform Incentive Systems

Should open-platform orchestrators compensate the people and organizations that add value to their platforms? And would monetary incentive systems spur more value creation, or possibly taint the dynamics that have made online communities successful?

Platforms for participation represent an exciting new kind of business that thrives on mass collaboration and embodies all of the wikinomics principles. Though the early examples are most evident on the Web, nearly all businesses can become open platforms, with enough imagination and ingenuity. ■

The Global Plant Floor

Peer production of physical things is coming of age, and smart companies are getting with the program. The old monolithic, multinational corporation that produces value in a closed hierarchical fashion is dead. Even the stodgy, capital-intensive manufacturing industries are no exception to this rule. Indeed, there is no part of the economy where this opening and blurring of corporate boundaries has more revolutionary potential.

The new reality in manufacturing, as in other spheres, is that boundaries are constantly blurring. In an age of modularity, open architectures, instant communication and globally dispersed capabilities, the answers to who

will do what and where the value will be developed are constantly changing.

Harnessing the Global Plant Floor

The rise of peer and collaborative processes for designing and building things is not unique. These processes are emerging in industries where intellectual property is widely dispersed and production capacity is fragmented among hundreds of specialized firms.

By organizing into loosely coupled networks of firms that jointly design and develop products for customers, both the suppliers and global integrators win. But harnessing the global plant floor means learning from the examples being set. Companies must focus on the critical value drivers; add value through orchestration; instill rapid, iterative design processes; harness modular architectures; create a transparent and egalitarian ecosystem; share the costs and risks; and, finally, keep a keen futures watch. ■

The Wiki Workplace

The workplace is becoming a self-organizing entity where centralized and tightly controlled processes are increasingly giving way to more spontaneous and decentralized forms of mass collaboration. This impacts five typical workplace functions: teaming, time-allocation, decision-making, resource-allocation and communication.

Waking Up to the Wiki Workplace

Where might this new wiki workplace take us in the future?

- Workplaces will become smaller and teams will be more distributed, with participants drawn from all over.
- Employment relationships will necessarily become more fluid, definitely less long term and undoubtedly more horizontal.
- The creation of ad hoc self-organized teams that come together to accomplish specialized tasks will become the norm.
- Expect new guildlike formations with codes of conduct that set the formal and informal norms and rules that govern how a growing number of people carry out their trade.
- Look for new peer-to-peer reputation-rating services to play a greater role in identifying high-quality, reliable collaborators.
- Talent agencies, auctions and markets will play a larger role in managing the interface between employers and employees.

Don't expect overnight change. But a truly self-organized and distributed way of working is not far off on the distant horizon. Mass collaboration is already

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The Wiki Workplace

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transforming the way goods and services are developed throughout the economy, and it is now becoming a growing force in today's marketplace. ■

For additional information on wiki workplaces, go to: <http://my.summary.com>

Collaborative Minds

Each model we have discussed represents a new and unique way to compete, but they all share one thing: These new forms of peer production enable firms to harvest external knowledge, resources and talent on a scale that was previously impossible. Companies that adopt these models can drive important changes in their industries and rewrite the rules of competition.

There has probably never been a more exciting time to be in business, nor a more dangerous one. We are in the midst of a paradigm shift. New paradigms cause disruption and uncertainty and are nearly always received with coolness, hostility or worse. Vested interests fight against the change, and leaders of the old are often the last to embrace the new. Consequently, a paradigm shift typically causes a crisis of leadership.

The lesson of history is that profound changes favor the newcomer and, in rare cases, the incumbent firms that learn to think differently. The choice facing firms is not whether to engage and work with peer-production communities, but determining when and how. The chance for customers and competitors to get the jump on new innovations in your area of business increases daily.

Thinking Differently

Smart firms will be able to harness external resources and talent to achieve unparalleled growth and success. The hard part will be rewiring your brain and turning off those old business reflexes so that you can capitalize on what the new world of wikinomics can offer

Being Open. A growing number of smart companies are learning that openness is a force for growth and competitiveness. Amazon, eBay, Google and Flickr open up their applications and business infrastructures to increase the speed, scope and success of innovation.

Peering. IBM joins the Linux peer producers and gives away hundreds of millions of dollars of software and resources to support them. Has IBM lost its head? No, it's stumbled onto a new mode of production called peering.

Sharing. Smart firms today understand that sharing is more than playground etiquette. Organizations like the Bill and Melinda Gates Foundation and the Tropical

Disease Initiative are leveraging open-source drug discovery to launch an unprecedented attack on neglected diseases such as cholera and African sleeping sickness.

Acting Globally. Like others in the aerospace and defense industries, Boeing has found that the costs, risks and expertise required to engage in large-scale development projects such as designing and building new aircraft are simply too large for it to do alone. So Boeing reached beyond its walls to co-create its new 787 passenger jet with a network of partners that stretches over six countries.

Wikinomics Design Principles

So how should leaders go about applying the principles of wikinomics in their businesses?

Your planning must allow for a high degree of learning on your part and the flexibility to respond to new opportunities that arise out of the interplay among participants in your business web. Peering is a design and production innovation, and the firm must learn how to operate in this new environment. You must:

- Take cues from your lead users
- Build critical mass
- Supply an infrastructure for collaboration
- Take your time to get the structures and governance right
- Abide by community norms
- Let the process evolve
- Hone your collaborative mind.

For the business manager, the number-one lesson is that the self-contained inwardly focused corporation is dead. Regardless of the industry or whether your firm is large or small, internal capabilities and a handful of b-web partnerships are not sufficient to meet the market's expectations for growth and innovation.

Managers should treat wikinomics as their playbook and harness its core principles to achieve success. Leaders must prepare their collaborative minds.

Is your mind wired for wikinomics? ■



If you liked *Wikinomics*, you'll also like:

1. *The Starfish and the Spider* by Ori Braffman and Rod Beckstrom. The authors provide a look at the decentralized companies that are taking the business world by storm.
2. *The Long Tail* by Chris Anderson. Anderson offers a visionary look at the future of business and common culture.
3. *Naked Conversations* by Robert Scoble and Shel Israel. Blogging is the latest frontier for businesses to embrace in an effort to further connect with customers.
4. *Small is the New Big* by Seth Godin. Godin has compiled entries from his blog, discussing current marketing and the source of new ideas.
5. *Made to Stick* by Chip Heath and Dan Heath. The Heath brothers provide a practical guide to effective communication and explain how great ideas tend to stick around.

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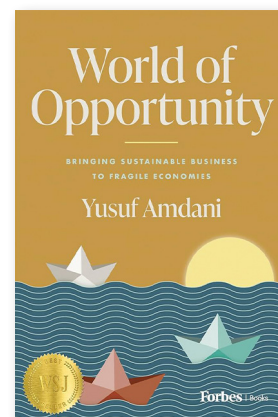
World of Opportunity

Yusuf Amdani

World of Opportunity

Bringing Sustainable Business to Fragile Economies

by **Yusuf Amdani**



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THE SUMMARY IN BRIEF

Author Yusuf Amdani pondered how to make our flawed world a better place, for people and the environment. He founded a multinational corporation headquartered in the developing country of Honduras and was eager to try out new strategies and seek tangible results. Through substantial trial and error, he discovered, to a certain extent, the secret to creating a better working and living world: creating opportunities where they are most needed.

Making this happen requires leaving your comfort zone to find those territories, establishing best practices to overcome the inherent challenges that will be faced, and staying focused on creating lasting change. And when you do, job creation, attracting other business to the area, communities, worker skill levels, the economy, and people's everyday lives get upleveled.

In *World of Opportunity: Bringing Sustainable Business to Fragile Economies*, Amdani shares the impact his corporation, GK, has made with the goal of helping you on your own journey and creating opportunities for your business and the economies in which it operates.

IN THIS SUMMARY, YOU WILL LEARN:

- What type of change your company should seek to create.
- The key considerations to make when exploring regions.
- How to prioritize education and healthcare in your efforts.
- Why building a green future matters more than ever.

Understand Real Impact

To a certain extent, the secret to creating a better working and living world is to create opportunities where they are most needed. Making this happen requires leaving your comfort zone to find those territories, establishing best practices to overcome the inherent challenges that will be faced, and staying focused on creating lasting change.

To get started let's consider the type of change we want to create, which runs deeper than occasional community events and extends beyond raises, promotions, and annual giveaways. The impact we seek involves real people. It aims to educate workers. It seeks to help low-income societies climb out of poverty. It works to expand the middle class, which is the engine of a strong economy. It brings new opportunities to regions that are often hidden or overlooked.

At every step the change encompasses sustainable practices. The aim is to set up self-supporting hubs that provide their own energy, looking for ways to create more green and higher levels of beauty where you go. Establishing a chain of aid in communities includes health-care support, educational improvement, and nutritional provisions to those in need.

Along the way there are chances to partner with those who share these goals. These arrangements might be made with local hospitals, nonprofits, school systems, or community boards. Look for leaders who have values that align with your own company and philosophy. This typically involves building relationships with informed locals. It also includes steering clear of complicated government ties or unethical practices like bribes, which are typical in many developing countries.

Anyone can make an impact. It starts with a desire to help. The following sections will equip you with everything you need to know to implement sustainable business practices and community-building initiatives.

Investigate Regions for Potential

Due to the expense related to producing goods and services in developed countries, businesses have long looked for places to shift part, or all, of their operations.

It is estimated that on average, a firm could save 20 percent to 30 percent by outsourcing non-core business processes including billing and payments, recruitment, back office work, and lead generation, primarily due to a difference in

wages between developing and developed countries.

Of course, when operating in other areas of the world, firms come across a variety of challenges. Some of the common ones include:

- Cultural and time zone clashes
- Resistance from the home country
- Increased vulnerabilities

There are no right or wrong answers when choosing a country in which to operate. Still, it is valuable to consider what is best for your particular business segment and niche. Here are a few considerations to make.

Easy Access

Look for geographical advantages. In the case of the corporation GK (a globally-recognized presence in textiles, real estate, technology, agriculture, and lifestyle solutions), Honduras was appealing because it has four ports, access to both the Pacific and Atlantic oceans, road networks connecting major cities, and daily direct flights from main cities to major hubs in the US due to close geographical proximity.

Pathways To Savings

Seek out regions that provide opportunities for outside investment. Honduras provides generous tax benefits, including exemptions on customs and other charges for bringing goods into the area.

Workforce In Waiting

Target regions who are taking steps to create qualified future workers. Investments from major corporations in Honduras led to investments in bilingual schools, which created an up-and-coming workforce prepared to participate in the international scene.

As you explore regions, keep in mind the power of potential. Countries that are set up to scale could create immense opportunities for your own company.

Make Sustainability Part of the Business Plan

GK's real estate division wanted to install an industrial hub that lived up to their goals of sustainability. They aimed to transform pasture land into a space that businesses can use, which simultaneously contributed to the environment.

Finding a low-cost place with great tax incentives, coupled with a forecast for growth, could be your company's ticket to profitability.

It was named Green Valley and serves as an example that others can follow.

Green Valley is streamlined for efficiency. Investors are drawn to it because it offers turnkey solutions. When companies decide to set up operations within the hub, they can receive ready-to-use facilities and services. GK provides customized services for investors' core and ancillary needs. These cover all steps, ranging from start-up to running operations. Offerings include business registration, permits, talent acquisition, employee training, expat relocation, supervision of specialized installations, and 24-7 support.

True to its name, Green Valley is full of green initiatives. The scenery boasts lovely greenery and landscaped boulevards. A full nursery is located within the hub, where plants are grown and distributed. An intricate compost and watering system makes the entire operation self-sustaining.

It has an infrastructure that can operate independently for its electricity, water, and telecommunications needs. Its solar panels portray a renewable energy project. It has aggressive programs for waste management and water treatment.

When workers take on a job at Green Valley, they may be upleveling their income and lifestyle in a significant way. With a manufacturing job, they receive access to free on-site medical care for their needs. They also gain the security of a steady paycheck, which may not have been an option for them in the past. In addition, through a housing program in which GK and the government participate, workers have the opportunity to purchase and own a home.

The business model is designed to confront and reverse one of the main challenges the workforce in Honduras and other Central American countries face. When they don't have the chance to learn skills and get a job in their own home country, there is an urge to go find a place where they can better their livelihoods.

Workers that come to Green Valley are more likely to stay at the center, rather than look for a different job. When they stay, they often do so for the long term.

Envision the Transformation

Around the time that NAFTA came into effect, GK scouted locations in Mexico to set up a facility. Clearly Mexico had opportunities for manufacturing expansion but the question was, where? Amdani settled on the sleepy town of Campeche, which lacked infrastructure, but had land and a young and growing workforce. Once aware of the economic indicators that pointed to opportunity, a vision formed in Amdani's mind. He could clearly see the advantages for GK and the local economy as well. But it would require a transformation. And that's exactly what they set about to do.

The transformation they created can help you consider your own strategies. Finding a low-cost place with great tax incentives, coupled with a forecast for growth, could be your company's ticket to profitability.

Despite a complete lack of manufacturing in the region, no sign of infrastructure to support machines and buildings, and a population unaccustomed to nine-to-five office routines or eight-hour stretches of factory work, Amdani did not turn around when visiting Campeche. The challenges were great, yet there were opportunities too.

During the start-up phase, they looked for ways to collaborate and instigate change. They spoke to community leaders to learn the needs of the people. They put a shovel in the ground, confident that their green practices would be implemented to improve—rather than destroy—the surrounding environment.

A strong charismatic leader was needed to drive the changes that would shape the workforce. The leader would give them a new lifestyle to think about. The person in power would also help families begin to create their future. In your own business, look for a leader who can establish a strong presence and be closely involved in the transformation effort.

Attracting New Partners

After GK established a plant and then a full industrial hub in Honduras, they provided turnkey solutions for clients in need of space, equipment, and a labor force.

Staff members took care of all legal matters and worked with local leaders to ensure seamless production and distribution. Other companies expressed interest in operating there as a result and the number of jobs in the area increased dramatically.

The best approach to take in a region that seems to have a sense of downfall is to be determined not to relive the history books that have been written. Instead, the company should seek to build and create a new, better place. In addition to increasing jobs and reducing poverty, focus on enhancing the ecosystem.

It starts with a vision of what could be. Then make it happen. Use what you see, such as trade incentives, local trends, and interest in industrial development. Then maximize those qualities. In doing so, the entire landscape changes for the better.

Prioritize Education

There are a smattering of challenges that are found in developing countries related to education. In areas stricken with poverty, the government might not pay wages to educational staff. Workers may not be held accountable. Schools can lack resources like school supplies. Children often drop out to work and help at home.

For these reasons, GK takes a specific approach when starting any education-minded project. Understanding it can help others develop strategies to deal with this global, present, and ongoing issue.

GK's approach focuses on constructing and remodeling classrooms at schools. This doesn't have to be carried out in a singular, massive overhaul. Instead, classrooms can be changed one at a time.

With each school year, a classroom can be repainted. Supplies can be brought in, ranging from new desks to books, coloring tools, counting blocks, and so on. When this happens, students and teachers alike tend to feel the difference. Suddenly they are in a bright, freshly painted room that exudes energy and positivity.

Along a similar line, GK makes general improvements in school infrastructure. It ensures that teachers in rural areas are paid competitive wages. It gives scholarships for private colleges and universities to outstanding students. It sponsors innovative and tech-related projects to further enhance educational quality. It provides English-language learning

opportunities so people can gain a skill that is required to connect and interact with international companies.

As you lay ground in a new country, don't overlook the power of education. As history has shown, it holds the key to further development. When people receive an education, they can get a better job. Maybe they could fill positions that you will need someday in your company. GK is committed to prioritizing education and you should do the same in your endeavors.

Show Empathy in Healthcare

In a developing area, an infant might not have the immunizations needed to protect them from disease. Mothers frequently lack knowledge about preventative care measures. An infant who develops a simple developed-country condition that needs antibiotics, such as a fever with flu symptoms, could go untreated. Infant and childhood morbidity rates are high in such places.

Coming into a country to help is not as simple as showing up and distributing medical supplies for several weeks or months. While this may sound appealing and attract volunteers who want to make a difference, the long line of challenges they face can result in suboptimal, or even dire, consequences. The obstacles to providing sustainable medical assistance in low-income countries include staff-related issues, relief work ineffectiveness, and a negative impact to the local population.

Aid workers coming in from developed countries could face different living and working conditions that present major challenges to them. The medical project itself isn't always suitable for the country, as is the case when short-term clinics leave local patients with no access to follow up or continued care. The local population can be harmed by medical projects, too, as they drain local resources like food, water, shelter, and the local hospital system.

Due to these risks, it is increasingly important for volunteer and aid groups to be in tune with how the local economy operates. They must know the available infrastructure, the resources at hand, and community norms regarding medical practices.

When a system is developed to cooperate with local medical facilities, the potential for a positive impact is higher. On a similar note, programs that work in conjunction with local resources tend to be more effective. Adding an educational

Collectively, the middle-class segment of any economy shares values of a strong work ethic, thrift, and individual responsibility.

aspect encourages long-term functionality.

For all of these reasons, it's important to approach healthcare the right way. When working in developing countries, empathy resolves myriad issues. Creating access for everyone is the foundation. You can then build in high-quality care and patient experiences to uplevel health in poor areas, starting with the main healthcare issues in the area and keeping overall well-being in mind as you develop plans.

Lean Into Tech Advances

Historically technology has held the key for individuals and communities to move up in life. It has provided a sense of hope for the future. It has enabled the middle class to rise and presented promises of prosperity for the next generation.

Taking advantage of these breakthroughs and putting them to good use can help bring more families out of poverty. Providing tech skills develops a growing middle class. Like GK, others can actively seek ways to increase the size of the middle-class population with workers that provide the engine that fuels a growing economy.

Collectively the middle-class segment of any economy shares values of a strong work ethic, thrift, and individual responsibility. Households in this category make economic-based decisions. While they participate in material consumption, they also look for ways to enjoy life, appreciate art, and participate in leisure activities.

Continued technology advancements create a promising outlook for a growing middle class. Historically, these developments are first available to the wealthy. Over time they sprinkle into other segments of society.

Despite the obstacles of connecting the developing world to the developed world, the demand for digital and data services continues to grow. Due to the expansion of cloud technology and software, along with AI and machine learning, tech is seeping into nearly every industry.

Segments ranging from financial services to healthcare, education, retail, and law are looking for tech support. The

same is true for telecom, media, life sciences, agriculture, hospitality, and energy sectors.

If established corporations don't hire workers from low-income countries, they are missing out on an available labor pool. The key to making the correlation possible lies in overcoming barriers and creating win-win situations.

A reliable, secure internet connection must be available. Staff members from developing countries need to have access to training to develop and uplevel their tech skills. Once these objectives are achieved, strong connections can develop between international companies and the low-income workforce.

Employees that are given the chance to increase their skill set and move to a higher class will likely be motivated. For many it is difficult—if not impossible—to pay for their own training. As such, if teaching programs are provided in a reliable, secure setting, a door is opened.

The worker will feel valued and see that an investment has been made in them. They will likely take their role and work assignments very seriously. Employees can use tech training to jump-start a career. Society, in turn, can benefit from a dwindling poor class. Its departure gives way for a growing engine—the middle income segment—and all the economic splendor it brings.

Build a Green Future

As evidenced throughout their industrial hub Green Valley, GK aims to positively contribute to sustainability metrics established by the UN and others. And you can, too. Creating a green tomorrow is a task that requires research and analysis. It embraces innovation and renewable resources.

During the past decades, the emergence of renewable energy sources has created a solution for environmental issues. Thanks to recent advances, green resources hold the power to ignite a revolution, hallmarked by energy efficiency, carbon-neutral processes, and human development around the world.

Through this, the power supply system will shift from ener-

gy plants to individual homes and buildings. That's because solar energy can be produced at a micro level and then shared through a grid.

A school, for instance, could generate its own power supply through roof panels that absorb the sun's rays and turn them into electricity. If more power is produced than the school needs, it can share the excess via the grid. Arrangements like this can be made in households, too, when equipped with rooftop panels. In fact, they already exist in places like Germany.

The renewables revolution could further break down barriers to energy, especially among the world's poor. In places where communities do not have access to electricity, there may be no need to build power lines. Instead solar panels could be delivered to homes, providing them with electricity for the first time. After the initial investment has been paid, the cost to soak up the sun's rays is minimal or nothing at all.

In recent years advances in renewable energy have led to more employment opportunities and the trend continues today. An investment in solar-photovoltaic equipment, which converts energy directly to electricity, creates 1.5 times as many jobs as the same amount placed on fossil fuel production. For wind power 1.2 times as many jobs are developed for each investment compared to fossil fuel processes. The growth in jobs also provides opportunities to bring more workers into the renewable industry.

There is also a quality of life component tied to renewables. From a health standpoint, the current energy supply puts our lives at risk. Populations in urban areas awaken to skies of smog every morning. Switching to renewable sources of power leads to cleaner air and could reduce the number of deaths related to air pollution, currently estimated between four to seven million lives annually.

In a world that is becoming increasingly focused on green initiatives, operating in a place that provides renewable energy eases a company's environmental concerns. This trend will likely intensify in the years to come due, in large part, to increased pressure on global organizations to reduce their carbon footprint.

The planet is well positioned for an energy revolution. Join in the campaign. Keep green at the forefront of your long term investments. You'll be able to reduce costs and serve as an example for others to follow.

Make a Multiplying Effect

Experiences in our lives affect our business decisions. As you work in a developing country, you'll come across specific challenges. To create lasting change, it's vital to overcome these obstacles. Strategies for solutions can be written into your business plan.

The best approach includes maintaining integrity at every step. It also involves collaborating with other organizations that share your firm's values. Caring for workers is the final component to instill a culture that seeks positive change.

Think about the values you want for your own organization as you consider the approach. Get intentional about how to incorporate the changes you want to make to society into your business goals. Don't underestimate the importance of culture. When workers feel appreciated and have a chance to grow, they're more likely to contribute toward the organization's established objectives.

Ethics At Every Turn

Setting an elevated bar enables you to maneuver the legal landscape of developing countries. Fragile economies throughout the world operate in a system with distinct order.

In developed countries it is considered common practice to have an established rule of law. Nations with low levels of infrastructure typically favor the elite. Common workers may be subject to the law. Those of high rank could be exempt.

GK has faced scrutiny at various points throughout its years of operation. Legal issues have surfaced. Fake news headlines have accused the company of foul play. By and large, the GK team maintained integrity in all circumstances at a company culture level. Remaining truthful ultimately prevails.

Core values should be embedded into a company's culture. Compassion, for example, can drive your efforts in society. When carried out well, there is a multiplying effect. Those who have been helped turn and look for ways to give back in their own way.

While it can be easy to see needs in developing nations, it is not always clear how best to provide help. Working with an experienced organization that understands the deep struggles of developing countries can be a first step toward implementing real change. By investing together, lives can be touched, futures can be painted, and hope can be instilled.

GK has sought to act ethically in their business practices. They have looked to collaborate with nonprofits. They have

improved conditions for workers. In these ways, GK has strived to paint a brighter future for upcoming generations.

You can too. Incorporate social strategies into your business plan. Keep a clean record to avoid getting bogged down with legal struggles in developing countries. Then look for organizations to act as partners. Collectively there are opportunities to do more for society.

Businesses have the power to affect real change in the lives of people. Health conditions can be improved, education standards can be raised, and income levels can be increased. These results are possible if your next business venture and your next investments focus on fragile economies.

Efforts that center on a circular economy are based on helping people, the communities where they live, their cities, and their countries. The desire is to uplevel the human living condition.

Wherever you are, in some way there will be opportunities to help others. Whatever way it happens, lives can be touched, improved, and impacted in a way that won't be forgotten. Through it all society collectively climbs out of poverty. People enjoy a higher quality of life. They look to the future and think about the next generation. And then they, in turn, extend a hand to those in need.



Yusuf Amdani is the Chairman of GK, a globally-recognized presence in textiles, real estate, technology, agriculture, and lifestyle solutions. A heritage brand with a 50-year footprint, GK is a leading force for economic development in Latin America. His GK Foundation targets the areas in which it can make the greatest difference in the lives of employees and the world that surrounds them. Just in Honduras GK has created over 28,000 direct jobs impacting over 125,000 people and large number of communities its business operates.

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