which once propelled men such as Henry Ford into the stratosphere of wealth. It's the world of finance. In 2004, the top 25 hedge fund managers together earned more than all the CEOs of the companies listed in the S&P 500. Among people earning more than $100 million a year, Wall Street investors outnumbered executives of publicly traded companies nine to one.

Two practices central to the financial industry drive the skyrocketing incomes: "going short on volatility" (betting against unlikely swings in market prices) and "moving first" (being faster than the competition when new information emerges, sometimes by seconds or less, in a winner-take-all system).

Going short on volatility involves betting against unlikely events—such as a collapse of the mortgage bond market. The returns can be steady and unspectacular, until one starts using other people's money and taking riskier bets. And if you bet wrong, "what's the worst that can happen? Your bosses fire you, but you will still have millions in the bank and that MBA from Harvard or Wharton." Add the safety net of government bailouts, and you've got an industry in which many of the top earners do not have much to lose.

It's worrisome "from a social point of view," Cowen argues. In normal times, society suffers as many of the most talented people choose the financial sector over fields such as medicine or education. But more dangerous, says Cowen, is that when their bets flop, as they did during 2007–09, "everyone else pays the price"—particularly those lower on the income ladder, who can spend months unemployed in the wake of a financial crisis and don't have a fancy degree and valuable social network to fall back on.

Cowen says we must "find a way to prevent or limit major banks from repeatedly going short on volatility at social expense." The catch? No one knows how to do so. It remains to be seen whether the new financial regulation law will have a positive effect.

"For the time being, we need to accept the possibility that the financial sector has learned how to game the American (and UK-based) system of state capitalism," Cowen writes. "It's no longer obvious that the system is stable at a macro level."

ECONOMICS, LABOR & BUSINESS

A Higher Capitalism

THE SOURCE: "Creating Shared Value" by Michael E. Porter and Mark R. Kramer, in ***Harvard Business Review***, Jan.–Feb. 2011.

For too long, businesses have pursued narrow, short-term strategies that maximize quick profits and don't address society's greatest needs. They are squandering an incredible opportunity, argue Harvard Business School professor and management strategy guru Michael E. Porter and Mark R. Kramer, cofounders of the social impact consulting firm FSG. Business leaders believe that all profits are equal, but Porter and Kramer argue that "profits involving a social purpose represent a higher form of capitalism." By investing in communities, a clean environment, and a healthy and well-paid work force, companies will reap big profits over the long haul, they say.

When it comes to addressing problems such as housing and health care affordability, and assistance for the elderly, companies have relegated helpful initiatives to peripheral social-responsibility units.

By exploring business solutions to such problems, managers can create what Porter and Kramer call "shared value," meaning, simply, everybody wins—society will benefit from the innovation business can bring to bear, and businesses will be more productive and more efficient, and over time will create greater markets for their goods. "The purpose of the corporation must be redefined as creating shared value, not just profit per se," the authors write.

They contrast their plan with well-intentioned strategies such as fair trade, which attempts to see that farmers in the developing world are paid more than the prevailing rate for their crops. In a shared-value approach, companies would train farmers in more productive techniques and supply them with better tools, seeds, and fertilizer, improving productivity and output. Preliminary evidence indicates that such

a strategy can boost farm incomes more than fair trade does.

When a company's link to one specific community is tight, as with the computer industry in Silicon Valley or the diamond-cutting trade in Surat, India, the benefits of a "shared-value" approach will be bigger and more obvious. For example, Nespresso, a Nestlé brand, located the procurement facilities for its coffee beans near the farms where the beans grow. This allowed it to assess the quality of the product on the spot and pay growers a premium for superior beans.

Social entrepreneurs and companies in the developing world have led the way in making societal improvement central to their business plans. The challenge now is to do so across the business community, in every decision companies make.

Capitalism has long been "an unparalleled vehicle for meeting human needs, improving efficiency, creating jobs, and building wealth," Porter and Kramer say. New opportunities await.

ECONOMICS, LABOR & BUSINESS

How to Save the Euro

THE SOURCE: "The Euro's Never-Ending Crisis" by Barry Eichengreen, in ***Current History***, March 2011.

EVERY BROKE COUNTRY IS broke in its own way. At least that's true of the European countries that have come to the brink of default since the global financial crisis unleashed waves of economic panic. In Greece, the cause was a love affair with "enormous, unsustainable government budget deficits." In Ireland, it was large homes and a real estate bubble that dwarfed that of the United States. With such different proximate causes, what can the European Union do from on high, "beyond encouraging member states to tend to their gardens"?

It can begin by examining one commonality: At base, both countries were experiencing credit booms that began in 2002, just three years after the introduction of the euro. (Seventeen of the 27 EU member countries have embraced the euro.) European technocrats hoped the euro would create "cohesion" through a rise in per capita incomes in "peripheral" countries such as Ireland, Greece, Portugal, and Italy, bringing them closer to parity with "core" countries such as France and Germany. But instead of converging, the core and periphery grew further apart; Germany enjoyed an export boom, while on the periphery, foreign capital financed consumption, not investment.

> The euro was supposed to increase European cohesion. Instead, it has pulled the core and periphery further apart.

Though it's unclear whether these booms were caused by the euro, argues Barry Eichengreen, an economist at the University of California, Berkeley, there is no doubt that the EU needs to undertake serious reform to prevent future boom-and-bust cycles. He prescribes several measures, all of which would strengthen the hand of the EU relative to national governments.

First, the EU must strengthen the Stability and Growth Pact, through which it monitors the fiscal policies of member countries and ostensibly subjects offenders to sanctions and fines. Some steps have already been taken: In the past, sanctions could not be imposed absent a vote by the EU Council of Ministers. Now they proceed unless a vote overturns them.

Eichengreen's second recommendation is meaningful stress tests for Europe's banks. There are big obstacles to administering such tests: National governments are more interested in preventing their banks from losing market share than in making an honest assessment. Supervision of the stress tests will have to be delegated to a supranational authority. "If Europe has a single currency and a single financial market, it is going to need a single bank regulator," Eichengreen says.

Finally, the EU should create a permanent emergency financing vehicle. "Crises will happen," Eichengreen writes. "Not establishing a properly funded facility capable of providing emergency assistance is the macroeconomic equivalent of driving without a seat belt."

These steps will not be easy politically, but if Europe's leaders do not take the necessary precautions, "not just the euro but the EU itself could be at risk."