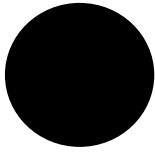


Muhammad Yunus, founder and managing director of the Grameen Bank, was awarded the Nobel Peace Prize in 2006 for developing the concept of microcredit as “an important instrument in the struggle against poverty.” He is the author, with Karl Weber, of Creating a World Without Poverty (Public Affairs, 2008).



Economic Security for a World in Crisis

Muhammad Yunus

Capitalism is in serious crisis. Even so, no one is calling for it to be abandoned in favor of some other system, such as socialism, because everybody is convinced that, with all its faults, capitalism is still the best economic system known to humanity. As every student knows, Adam Smith provided the conceptual framework of capitalism. It has been improved and elaborated throughout its long history, and though the world has changed enormously, the fundamentals described by Smith have remained largely intact.

The need for reviewing the basic structure of capitalism has seemed appropriate on many occasions, but never so clearly as it is today. Indeed, in light of the current global economic crisis, there is strong support for a major overhaul of the system. In my view, one major change in the theoretical framework of capitalism is necessary—a change that will allow individuals to express themselves in multi-dimensional ways and address the problems left unsolved or even intensified by the existing conceptual framework. And although my proposal may be viewed as a significant change in the structure of capitalism, it is actually very consistent with what Adam Smith elaborated so brilliantly in his *Theory of Moral Sentiments* in 1759. Some 250 years later, however,

some of Smith’s lessons still have not been learned adequately.

Until the current economic crisis, observers around the world shared a remarkably optimistic view of the future of civilization. In the early years of the twenty-first century, we were living in a time of unparalleled prosperity, fueled in part by revolutions in knowledge, science, and technology. This prosperity had dramatically improved the lives of many; yet billions of people still suffered from poverty, hunger, and disease. In the developed world, a handful of economists and social scientists had been clamoring to draw attention to their plight. Many people, however, took a complacent view, assuming that the spread of free markets would bring eventual prosperity even to the world’s poorest peoples.

The twenty-first century began with high hopes and idealistic dreams, encapsulated in the United Nations initiative known as the Millennium Development Goals. These eight goals, to which the international community pledged its support, included several economic objectives (such as eradicating extreme poverty and developing a global partnership for development) as well as other humanitarian objectives (such as reducing gender inequality and achieving universal primary education). Taken together,

er, these goals would carry us a long way toward the broader objective of greatly reducing the gulf between the rich nations of the global North and the poor nations of the global South. Many of us were convinced that the coming decades would bring unprecedented wealth and prosperity, not just for a few, but for all people on this planet.

Now the mood of optimism has changed. Several major crises that few people foresaw—the financial crisis, the ever-worsening environmental crisis, and crises over food and oil prices—have converged to bring even greater misery and frustration to the world's bottom three billion people. And these crises have also driven many in the developed world to question the solidity of the foundations on which they had assumed their future security and prosperity were being built.

A Rude Awakening

The crises we face in food, energy, and the environment have a host of immediate economic and physical causes. But they all have one thing in common. They all reflect the inadequacy of the current economic system. In each case, we confront social problems that cannot be solved solely by the free market as it is traditionally understood.

On top of all this has come the biggest crisis of all. In the past few months, we've witnessed perhaps the greatest evaporation of wealth in history. The crushing collapse of large sectors of the global financial system, first in the United States, then in other nations of the developed world has doomed giant financial institutions, bankrupted major manufacturing firms, and nearly shuttered entire domestic industries, now kept alive only with unprecedented government bailout packages. Many reasons have been suggested for this historic economic collapse: excessive greed in the marketplace, the transformation of investment markets into gambling casinos, and the failure of

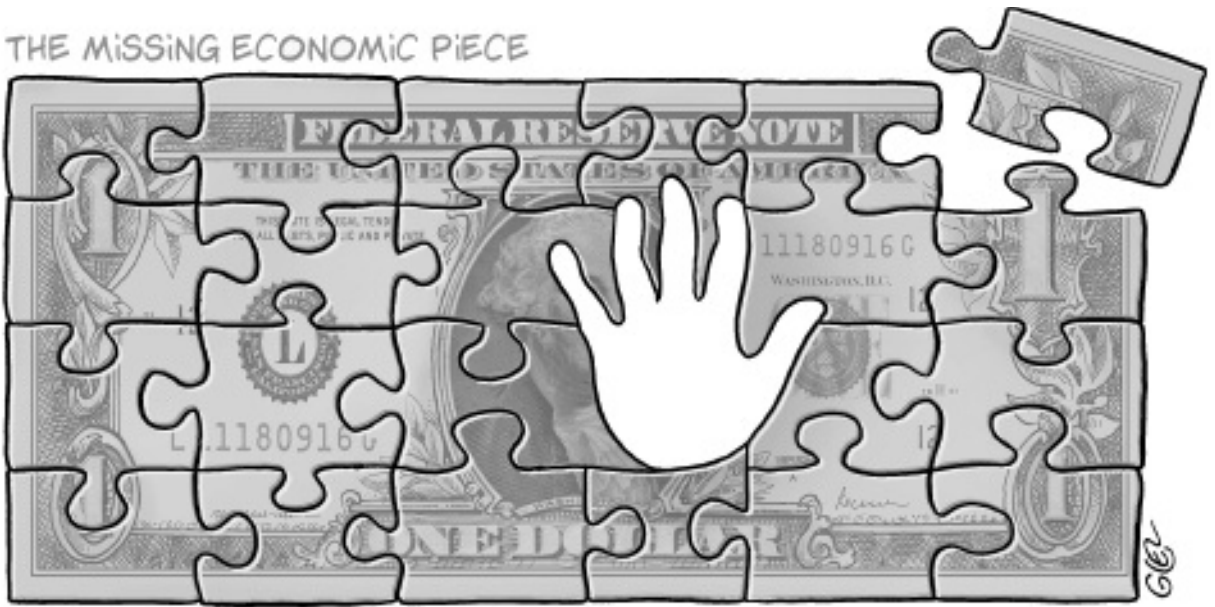
regulatory institutions. But one thing is clear. The financial system has broken down because of a fundamental distortion of its basic purpose.

Credit markets were originally created to serve human needs—to provide business people with capital to start or expand companies. In return for these services, bankers and other lenders earned a reasonable profit. Everyone benefited. In recent years, however, the credit markets have been distorted by a relative handful of individuals and companies with a different goal in mind—to earn unrealistically high rates of return through clever feats of financial engineering. They repackaged mortgages and other loans into sophisticated instruments whose risk levels and other characteristics were hidden or disguised. Then they sold and resold these instruments, earning a slice of profit on every transaction. All the while, investors eagerly bid up the prices, scrambling for unsustainable growth and gambling that the underlying weakness of the system would never come to light.

In time, the inevitable happened. The house of cards came tumbling down. Because of the degree of globalization in financial markets, this economic tsunami has spread across the world. Stock markets around the globe have suffered losses in the billions, even trillions of dollars. But the rich will not be the most affected by this financial crisis; rather it will be the bottom three billion people on this planet who will truly suffer, despite the fact that they are not responsible in any way for creating this disaster. While the rich will continue to enjoy a privileged lifestyle, the poor will face job and income losses that, for many, will make the difference between life and death.

The impact is already beginning to be felt. As levels of global trade decline, exports from the developing nations are down. Foreign direct investment in development

THE MISSING ECONOMIC PIECE



by the wealthy nations is expected to drop by 20 percent this year. Funds for lending have dried up, as have aid flows and remittances from citizens working abroad.

We have only seen the beginning of these crises. We are in for a long and painful period ahead. The combined effects of the financial, food, energy, and environmental crises will continue to unfold in the coming months and years, affecting the security of the bottom three billion with particular force. One example: the World Bank has estimated that unless the financial crisis is quickly resolved, an additional 1.4 million to 2.8 million children in the developing world will die of malnutrition between 2010 and 2015.

The troubles of the world's poorest will have an impact on those in developed nations, too. Social unrest, border clashes over scarce resources, increasing instances of state failure, and vast migrations by populations desperate for relief from poverty and environmental disaster will create political and military hot spots around the globe that will threaten world peace and strain the budgets of established and emerging powers struggling to cope with these challenges.

Over the past several months, world leaders have been particularly focused on financial emergencies. This is quite understandable. But it should not be seen as a problem of high finance only. This narrow view of the financial crisis is likely to intensify our global social and political problems. The human aspect of the financial crisis must be integrated into a holistic solution to the problems that we all face.

So far, governments have kept themselves busy coming up with super-sized bail-out packages for the institutions responsible for creating the financial crisis, yet little is being done to bail out the most vulnerable victims. Still, the decision in early April by the leaders of the G-20 Summit to "recapitalize" the International Monetary Fund (IMF) to the tune of \$750 billion is a welcome start. These funds will enable the IMF to help stabilize threatened banks in troubled regions of the world, such as eastern Europe. In a global crisis like the one we face today, relief to any region helps the whole world by reducing the chance that economic collapse will continue to spread.

Yet, in the face of all this dire news, it is possible that this mega-crisis could be a

mega-opportunity—to redesign our existing economic and financial systems so that they can become the foundations for lasting global security.

Capitalism: a Half-Built Structure

Even if we can overcome the immediate crises we face, we will still be left with fundamental questions about the effectiveness of capitalism in tackling such unresolved problems as persistent poverty, lack of access to health care and education, and epidemic diseases. In my view, the theoretical framework of capitalism that is widely accepted today is a half-built structure—one that prevents Adam Smith’s “invisible hand” from operating as he believed it should, transforming the pursuit of individual gain into general social benefit through the workings of the marketplace.

In a sense, we have chosen to disregard half of Smith’s message. His landmark book, *The Wealth of Nations*, has drawn all the attention, while his equally important *Theory of Moral Sentiments* has been largely ignored.

The present theory of capitalism holds that the marketplace is uniquely for those who are interested in profit only. This interpretation treats people as one-dimensional beings; but people are multi-dimensional, as Adam Smith saw so clearly two and a half centuries back. While we have a selfish dimension, we also have a selfless dimension. The prevailing theory of capitalism, and the marketplace that has grown up around the theory, makes no room for the selfless dimension of people. If the altruistic motivation that exists in people could be brought into the business world, there would be few problems we could not solve.

Smith took the view that people are born with a moral sense, just as they have inborn ideas of beauty or harmony. Our conscience tells us what is right and wrong. That conscience is something innate, not something given to us by lawmakers or by

rational analysis. And to bolster it we also have a natural tendency to care about the well-being of our fellow men and women, an apparently universal feeling which Smith calls “sympathy.” Between them, these natural senses of conscience and sympathy ensure that human beings can and do live together in orderly, beneficial social organizations.

With these ideas in mind, we can see that Smith’s *Wealth of Nations* has generally been misinterpreted. His thesis in that book is generally summarized as an argument that all will be well if people are allowed to follow “self-interest,” which has been equated with selfishness and profit maximization. But with human beings as they are—driven by conscience and sympathy as well as the desire for profit—“self-interest” includes both profit maximization and social contribution. *The Theory of Moral Sentiments*, which attached great importance to justice and other moral virtues, is thus an important corrective to the widespread but simplistic understanding of Smith’s intentions in *The Wealth of Nations*.

However, the present structure of economic theory does not allow this latter dimension to play out in the marketplace. In the absence of such an opportunity, people have tended to express their selflessness through contributions to charities. Charitable efforts have always played a role in our society and economy. They are noble, and they are needed. But business has a greater capacity than charity to innovate, to expand, and to reach more and more people through the power of the free market. If the efficiency, competitiveness, and dynamism of the business world can be harnessed to deal with specific social problems, the entire world will be a much better place. Imagine what we could achieve if talented entrepreneurs and business executives around the globe devoted themselves to goals such as ending malnutrition, providing shelter for the homeless, and eradicating disease.

With this in mind, I have proposed a new type of business that would operate in the same market along with existing profit-maximizing enterprises. I call these new entities “social businesses,” because they exist for the collective benefit of others.

Missing Element: Social Business

A social business is one whose purpose is to address and solve social problems, not to make money for its investors. It is a non-loss, non-dividend-paying company. The investor can recoup his investment capital, but beyond that, no profit is to be taken out as dividends by the investors. These profits remain with the company and are used to expand its outreach, to improve the quality of the product or service it provides, and to design methods to bring down the cost of the product or service. In effect, social business will represent a third economic sector alongside the free market and government.

It is important to distinguish the concept of social business from the well-known idea of “socially-responsible business.” The latter refers to traditional for-profit companies that choose to modify their business activities so as to promote social goals, or, at least, to minimize the social harms they cause. Socially-responsible businesses may use environmentally-friendly methods, provide generous benefits to employees and their families, and donate a portion of their profits to worthwhile causes. Today, many companies try to promote themselves as being socially responsible, and specialized investment funds exist to channel money toward such companies and away from others that are polluters, abusers of their employees, or exploiters of the poor.

The difference between a social business,

as I define it, and a socially-responsible business is that, for the latter, profit-maximization remains the primary goal. When the goal of increasing profit is seen as conflicting with the goal of helping society, the managers of the socially-responsible business must favor the pursuit of profit. During bad economic times, a socially-responsible business is likely to cut back on its charitable giving and cut corners on its other social commitments. A social business cannot

“Business has a greater ability than charity to innovate, expand, and reach people through the power of the free market.”

make such a choice. Its whole reason for existing is to promote social benefits. Therefore, there can be no conflict between this goal and the goal of earning a profit, which the social business doesn't recognize at all.

The concept of social business crystallized in my mind through my experience with Grameen—a family of companies, 25 in all, founded by Grameen Bank over the past 27 years in an attempt to address different problems faced by the poor in Bangladesh. These companies vary widely in their goals and business models. Grameen Shakti, for example, produces and sells low-cost, renewable energy systems, including solar panels and bio-gas converters that turn otherwise valueless farm wastes into cooking fuel. Grameen Health Care runs health clinics and provides affordable health insurance to rural families. Grameen Fisheries and Livestock operates fish farms and provides vaccination and veterinary services to help small farmers in Bangladesh improve profitability. Grameen Bank itself is a social business. Owned by poor people, mostly women, who are its depositors and borrow-

ers, it pays part of its profits back to the owners in the form of dividends, and invests the rest in expanding services to more villages and families throughout the country. All of the revenues that flow through Grameen Bank go to help the poor in one way or another. In each case, the companies address a specific social need. We designed these businesses to be both self-sustaining and expanding, but only to ensure that the products or services they provide can reach more and more of the poor, on an ongoing basis. Any surpluses generated by these companies are reinvested to expand operations, rather than enrich investors. This is the model of a social business.

The concept of social business got international attention when Grameen Bank launched a joint venture with Danone, a multinational company headquartered in France. In February 2006, Grameen teamed up with Danone to bring nutritious fortified yogurt to the undernourished children of rural Bangladesh. The aim of this social business was to fill a nutritional gap in the diet of these children. Today, we sell the yogurt to poor families at an affordable price, charging just enough to make the company self-sustaining. In the process, we stimulate the local economy, since the yogurt is distributed door to door by a small army of village women who earn a commission on each cup of yogurt they sell. Furthermore, all the milk and other ingredients in the yogurt are purchased from local suppliers, such as small dairy farmers in the vicinity of the factory. Beyond the return of the original investment capital, by agreement, neither Grameen nor Danone will ever make any money from this venture. We have one yogurt plant already operating in Bangladesh and, in time, hope to have 50 such plants throughout the country.

We also have built an eye-care hospital that operates along social business principles and a joint venture with Veolia of France to

deliver safe drinking water to rural villages. This partnership is building a small water-treatment plant to bring clean water to 50,000 villagers in an area of Bangladesh where the existing water supply is highly contaminated with arsenic. We will sell the water at an affordable price solely to make the company sustainable, but no financial gain will come to Grameen or Veolia. The success of these enterprises has encouraged other companies to come forward and partner with us to set up new social businesses.

Teach a Man to Fish

Some people are still skeptical, however, when I describe the concept of social business. “Who will create these businesses?” they ask. “Who will run these businesses? And, more important, why would anyone devote time, energy, and money to projects with no hope of personal gain?”

To begin with, there is no dearth of philanthropists in the world and no dearth of donor countries giving grants. People give away billions of dollars every year, as do donor countries. But imagine if, instead of those billions of dollars going to supply one-time aid, they could be used by social businesses to help people. The money would then be recycled again and again, and the social impact could be that much more powerful. In the same manner, money allocated by companies to corporate social responsibility projects could easily go into developing social businesses. Each company could create its own range of social businesses or pool donations from many sources in Social Business Funds (SBF), comparable to private equity pools that operate in the for-profit world. There’s a danger here, of course, given the lessons we’ve learned from the global financial crisis. But since investment in an SBF would be driven by social objectives rather than profit, it is reasonable to assume that rampant market ills would be less likely to affect them.



Waiting for a Grameen shareholders' meeting.

The opportunities for launching social businesses are limitless. Even profit-maximizing companies can be social businesses when owned by the poor. This constitutes a second type of social business. Grameen Bank falls under this category of social business. It is owned by its poor borrowers. The borrowers buy Grameen Bank shares with their own money, and these shares cannot be transferred to non-borrowers. A committed professional team does the day-to-day running of the bank. Every year, dividend checks are sent to the borrowers, representing their share of the bank's profits.

What I would like to propose here is that bilateral and multilateral donors support economic development by creating social businesses of this type. When a donor wants to give a loan or a grant to, say, build a bridge in a recipient country, it could create instead a bridge-building company owned by the local poor. A committed management company would be given the re-

sponsibility of running the company. Following the established model, part of the profits earned would go to the local poor as dividends, the remainder towards building more bridges. Indeed, that bridge would likely be the first of many. An array of infrastructure projects, such as roads, highways, airports, seaports, and utility companies, could be built in this manner. Because the social business model demands that the company generate ongoing revenues through its activities—for example, by charging tolls or usage fees on its bridges (usually with special lower rates for the poor)—the initial grant should lead to a continuing, ever-replenished revenue stream, ultimately producing more social bang for the donor's buck.

Currently, inertia is the problem. Once the concept of social business is included in economic theory and taught in business schools around the globe, thousands of people will come forward to invest in social

businesses. To connect investors with social businesses, we will need to create a social stock market to trade shares of these entities. An investor would come to this stock exchange to find a social business, which has a mission to his or her liking—just as someone who wants to make money goes to the existing stock market. Investors motivated by the desire to promote particular social goals would use this market to channel funds into social businesses that promote these ends. The values of shares in specific social businesses would rise and fall along with the results, both financial and social, of the underlying businesses. Social businesses that gain a reputation for producing powerful social benefits—operating schools for at-risk kids in poor neighborhoods, for example, or providing affordable, high-quality health care to families in low-income communities—while also generating strong, sustainable revenue flows through astute, creative management will become the equivalent of blue-chip stocks, attracting abundant investment money.

To help a social stock exchange perform properly, we will need to create ratings agencies, standardization of terminology, definitions, impact measurement tools, reporting formats, and new financial publications (perhaps even *The Social Wall Street Journal*?) and electronic media to provide up-to-the-minute information about news and financial developments affecting social businesses.

Worst Crises, Best Opportunities

The crises we face offer us all a valuable lesson in the inter-connectedness of the human family. In a world where economic development in the South is driven, in part, by stable financial markets and thriving economies in the North, the fate of Lehman Brothers and of poor sisters working in the garment factory in Bangladesh are linked.

In a world where agricultural markets are global, the fate of a rice farmer in Bangladesh, a maize farmer in Mexico, and a corn farmer in Iowa are all intertwined. And while the past few decades may have benefited a few at the expense of many others, in the long run, only policies that allow all the peoples of the world to share in the progress will produce long-term security for anyone.

Poverty is not created by poor people; it is an artificial imposition on individuals and families with fewer resources than others. Poor people are endowed with the same unlimited potential for creativity and energy as any human being in any station of life, anywhere in the world. It is only a question of removing the barriers faced by the poor so that they can unleash their creativity and intelligence in the service of humanity. They can change their lives—if only we could give them the same opportunities that we have. Social business and creative, sympathetic economic actors—across all sectors—are the quickest avenue to this end.

Poverty does not belong in civilized society. It belongs in a museum where our children and grandchildren will go to see what inhumanities people had to suffer, and where they will ask themselves how their ancestors allowed such a condition to persist for so long. We've accomplished so much thus far: eradicating diseases, outlawing slavery, raising crop yields dramatically. Eliminating poverty is our next great challenge. Now is the time to face these deeply linked global, economic, and social crises in a well-planned and well-managed fashion. This is a unique historical moment. From the ashes a new society can be built, and the present crises allow us the opportunity to design and build a new economic and financial architecture so that this type of catastrophe will never recur. Only by achieving this can we lay a solid foundation for the security and peace of future generations. ●