

—EDITED TRANSCRIPT—



HUDSON INSTITUTE'S  
**BRADLEY CENTER**  
FOR PHILANTHROPY AND CIVIC RENEWAL  
*and*  
**CENTER FOR GLOBAL PROSPERITY**  
*present*

# “CREATIVE CAPITALISM”: Can It Meet the Needs of the World’s Poor?

Wednesday, January 30, 2008, 12:00 to 2:00 p.m.

Hudson Institute • Betsy and Walter Stern Conference Center • 1015 15th Street, NW • Suite 600

Noting in his recent address to the World Economic Forum in Davos, Switzerland that “we have to find a way to make the aspects of capitalism that serve wealthier serve poorer people as well,” Microsoft’s Bill Gates called for a new system of “creative capitalism”—“an approach where governments, businesses, and nonprofits work together to stretch the reach of market forces so that more people can make a profit, or gain recognition, doing work that eases the world’s inequities.”

Others are not so certain that development pursued by well-meaning experts working from the top down can ever make a dent in world poverty. Long-time critic of international aid **WILLIAM EASTERLY**, for instance, argues that: “We don’t know what actions achieve development, our advice and aid don’t make those actions happen even if we knew what they were, and we are not even sure who ‘we’ are that is supposed to achieve development.”

Can Bill Gates’ “creative capitalism” make significant inroads against world poverty? That was the question addressed on January 30 by Easterly along with Urban Institute Senior Fellow **EUGENE STEUERLE** and **ALLEN HAMMOND**, vice president for innovation at the World Resources Institute. Hudson Institute’s own **WILLIAM SCHAMBRA** served as the discussion’s moderator.

## PROGRAM and PANEL

12:00 p.m. Welcome by Hudson Institute’s **WILLIAM SCHAMBRA**  
12:10 Panel discussion  
Panelists: **WILLIAM EASTERLY**, Brookings Institution and New York University  
**EUGENE STEUERLE**, The Urban Institute  
**ALLEN HAMMOND**, World Resources Institute  
1:00 Question-and-answer session  
2:00 Adjournment

THIS TRANSCRIPT WAS PREPARED FROM AN AUDIO RECORDING and edited by Krista Shaffer. To request further information on this event or the Bradley Center, please contact Hudson Institute at (202) 974-2424 or send an e-mail to Krista Shaffer at [Krista@hudson.org](mailto:Krista@hudson.org).

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## PANEL BIOGRAPHIES

**William Easterly** is Professor of Economics at New York University, joint with Africa House, and co-director of NYU's Development Research Institute. He is presently on sabbatical as a visiting fellow at the Brookings Institution. He is also a non-resident fellow of the Center for Global Development in Washington, DC. Easterly spent sixteen years as a research economist at the World Bank. He is the author of *The White Man's Burden: How the West's Efforts to Aid the Rest Have Done So Much Ill and So Little Good* (Penguin, 2006), which was included in the Best Books of 2006 by *The Economist* and by the *Washington Post*. Easterly's areas of expertise are the determinants of long-run economic growth and the effectiveness of foreign aid, about which he has written numerous academic journal articles. He is an associate editor for the *Quarterly Journal of Economics*, *Journal of Development Economics*, *Journal of Economic Growth*, and *Journal of Comparative Economics*. He has worked in most areas of the developing world, most heavily in Africa, Latin America, and Russia. He has written for the *New York Times*, the *Wall Street Journal*, the *Financial Times*, the *Washington Post*, *Foreign Policy*, and the *Los Angeles Times*.

**Al Hammond** is vice president for innovation and special projects for the World Resources Institute. He also leads WRI's Base of the Pyramid Initiative, which works with foundations, development agencies, and a number of major corporations to further the use of pro-poor business strategies and digital technologies in development. Hammond has published extensively in the scientific, policy research, and business literature, including a seminal market study of BOP markets, *The Next 4 Billion* (joint with the IFC), as well as articles in *Foreign Affairs*, *Harvard Business Review*, and *Foreign Policy*. He has lectured widely, and has served as a consultant to the White House science office, to several U.S. federal agencies, to the United Nations, and to several private foundations. Hammond has written or edited ten books, most recently *Which World?: Scenarios for the the 21st Century*. Prior to joining WRI, Hammond created the "Research News" section of the international journal *Science* and went on to found or edit several national publications, including *Science*, *Issues in Science and Technology*, and the *Information Please Environmental Almanac*.

**Eugene Steuerle** is a senior fellow at The Urban Institute, co-director of the Urban-Brookings Tax Policy Center, columnist for *Tax Notes*, and the author or editor of 13 books and close to 1,000 reports, articles, Congressional testimonies, and columns. His latest books include *Contemporary Tax Policy*, 2<sup>nd</sup> edition, *Nonprofits and Government*, 2<sup>nd</sup> edition (edited with Elizabeth Boris), and *Nonprofits and Business* (forthcoming, edited with Joseph Cordes). He serves on the National Committee on Vital and Health Statistics and on advisory panels or boards for the Congressional Budget Office, the General Accounting Office, the Joint Committee on Taxation, the Actuarial Foundation, and the Independent Sector. His former posts include president of the National Tax Association, chair of the 1999 Technical Panel advising Social Security on its methods and assumptions, president of the National Economists Club Educational Foundation, deputy assistant secretary of the Treasury for tax analysis, and resident fellow at the American Enterprise Institute. Between 1984 and 1986, he served as economic coordinator and original organizer of the Treasury's tax reform effort. Steuerle also has undertaken various missions for International Monetary Fund to China, Singapore, and Slovakia, while the government of Barbados undertook a tax reform effort modeled after a report that he co-authored as head of another mission.

# PROCEEDINGS

WILLIAM SCHAMBRA: Good afternoon! I'm Bill Schambra, and I'm director of the Bradley Center for Philanthropy and Civic Renewal. Krista Shaffer and I, along with our co-sponsor, the Center for Global Prosperity directed by Carol Adelman, welcome you to today's panel entitled "'Creative Capitalism': Can It Meet the Needs of the World's Poor?"

The panel today takes its bearings from a remarkable speech delivered last week (January 24, 2008) by the founder and president of Microsoft, Bill Gates, at the World Economic Forum in Davos. He called therein for "creative capitalism" in which, as he put it, "governments, businesses, and nonprofits work together to stretch the reach of market forces so that more people can make a profit, or gain recognition, doing work that eases the world's inequities." Mr. Gates quietly acknowledged how profound a change in our thinking this might be by digging deeply into political philosophy and calling upon the teachings of Adam Smith for guidance. Smith, he pointed out, was not only the father of capitalism, the author of *The Wealth of Nations* and so a champion of self interest as the basis for material prosperity, he was also the author of *The Theory of Moral Sentiments*, wherein he argued that – and this was a passage that Mr. Gates quoted – "How selfish soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortunes of others." Mr. Gates' "creative capitalism" would thus be propelled by, as he put it, "a hybrid engine of self-interest and concern for others."

As much as we appreciate the depth of Mr. Gates' reflections on these matters, though, we might do well to remember that this would not be first effort over the past century to harness the energies and outputs of capitalism to meet the needs of the masses rather than of the privileged, or to combine self-interest and concern for others into one coherent vision which eliminates the evils while preserving the benefits of each. In other words, we might do well to subject creative capitalism to the trial by fire of a Bradley Center panel, which is what we do here today with our distinguished panel of experts.

We're particularly grateful to our panelists that they were willing to come together on such short notice – indeed, before the klieg lights in Switzerland have fully cooled down. We will hear today from Bill Easterly, first, professor of economics and New York University, on sabbatical this year at Brookings Institution; next, Al Hammond, vice president for innovation and special projects at the World Resources Institute; and finally, Gene Steuerle, senior fellow at the Urban Institute. And I believe Mr. Easterly has a PowerPoint presentation, right? (Easterly's PowerPoint slides have been incorporated into the text below where necessary.)

WILLIAM EASTERLY: Right. Good afternoon. The topic that I'm going to cover today is how creative capitalism is likely to do versus regular, pre-Bill Gates capitalism in fighting world poverty.

First of all, let's talk about the problem that Bill Gates correctly diagnosed about regular capitalism. Under regular capitalism, firms have no incentive whatsoever to supply the needs of anyone who doesn't have money, that is, the world's poor. They have no profit incentive to supply those needs. So, really basic needs of the poor go unmet while even the most frivolous

desires of rich people who have money do get met. So, for example – and this is something that Gates himself gave in his speech – there are tons of research on devising drugs and other medical means to correct male pattern baldness, which I could actually use a lot myself. There is comparatively little research on cures for malaria, which kills one to three million people a year. And that really is a tragedy – that something as frivolous as baldness is abundantly addressed by the market under capitalism while the much more tragic problem of malaria is underserved by the market.

Gates' creative capitalism is meant to be a solution to this problem. His solution is, he is going to offer recognition to corporate philanthropists who do supply goods to the poor. He also wants the government to offer sweetheart deals to these same corporate philanthropists who do meet the needs of the poor. And so in the Gates equation, he will dramatically change the incentives to meet the needs of the poor. We will have the same old profit motive that was there before, but we will have also the motive of philanthropic recognition and whatever incentives the government comes up with. Once creative capitalism is put in place with these new incentives, corporations will then meet the needs of the poor.

It's kind of humbling to be an economist and study the words and writings of the world's richest man and realize that he got rich without understanding any economics whatsoever. (Laughter.) He's about sixty billion times richer than I am, and yet I know economics better than he does. What does that say about the payoff in the market for economists?

There are two major problems with Mr. Gates' scheme. The first is that common sense and the historical record suggest that the incentives he is promoting are really very weak indeed. And the second major problem is that his scheme does not solve the problem of choosing which goods to supply to the poor. So let's go through these two problems quickly.

Weak incentives. Is recognition for philanthropy really as strong a motive as the profit motive? Well, I can look introspectively and talk to my fellow human beings and say from common sense, no, it's not. We can just appeal to the verdict of the way things are now, which is that there is a lot of for-profit activity – about \$10 trillion worth – while there is a comparatively tiny amount of corporate philanthropy. Surely if corporate desire for recognition for philanthropy were really so strong, we would see a lot more philanthropy than the tiny amount that we have now compared to the for-profit activity. So the record of the market itself tells us now that that incentive is really very weak. And that's really the main problem; Bill Gates is trying to apply an incentive that is just a terribly weak incentive to solve the problems of the world's poor. This actually would be a very pessimistic view for the world's poor – that their biggest hope is that the Gap will donate a few pennies per pair of low-rise jeans to AIDS victims. If that's their main hope, then the poor are in bad shape. That's the main problem with this scheme; it doesn't really fix the main incentive problem.

The second, somewhat less serious but still very grave problem is that the scheme doesn't decide which goods to supply to the poor. Recognition will mainly come through the media, but what makes a big media splash is very different – I know from watching the media and covering economic development for twenty-five years – from what the needs of the poor are. Let me give you an example. AIDS treatment, which is obviously a tragic cause and it's good that it's being

addressed, reaches a few hundred thousand people but gets tons more publicity than something so basic as a package of basic health inputs that could save the lives of ten million children a year. And these are very cheap health inputs – oral rehydration therapy, nutritional supplements, antibiotics, and vaccines. Together these things cost a couple of dollars whereas AIDS drugs cost a couple thousand dollars. So you can save millions of children’s lives with a package of basic health inputs, but that gets almost no recognition in the mainstream media. And so any corporation that was going to operate effectively by using this package would not get much recognition in the media. In short, the media is just not a good guide to tell us what the poor need.

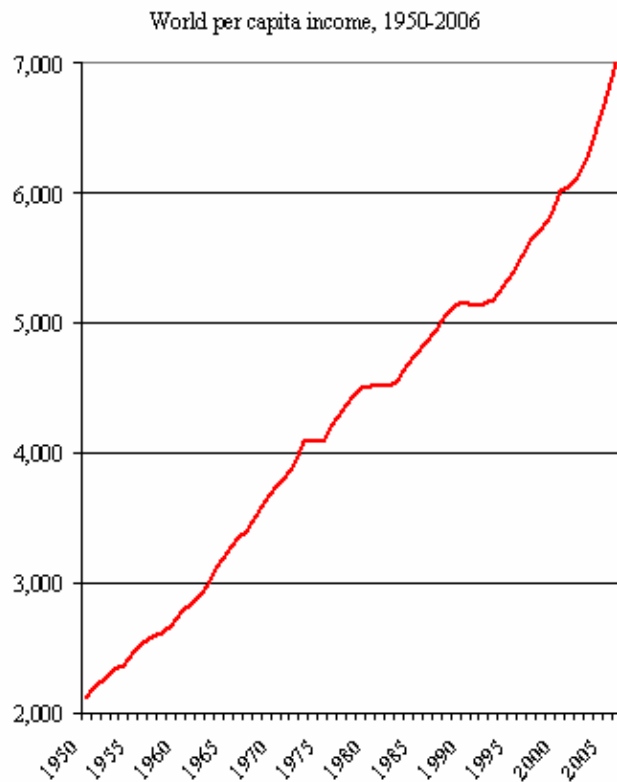
The best guide to tell us what the poor need is *the poor*. Here’s where Gates got it wrong. He thought the answer to poverty was convincing for-profit corporations with weak incentives to give goods to the poor. And he thought that which goods would be decided by whichever made the biggest PR splash. And we’ve seen the problem with that. He forgot about the other solution, which is the right answer. The right answer is to raise the income of the poor so that they themselves can decide what goods they wish to purchase, and they will be able to afford malaria drugs and nutritional supplements, and then corporations will have an incentive to supply those needs.

If you raise the income of the poor, then they will have money to be able to afford what they need. It’s just basic Economics 101. The problem is not trying to convince people to give goods to people without money for free. The solution is to raise the income of the people without money so that they do have money to convince the market to supply them goods. And this is exactly what regular capitalism does. It raises the income of the poor. And this is the answer – raise the income of the poor to make them less poor, not to depend on someone to give them goods for free.

So what is the historical track record about the best way to raise the income of the poor? Here we go back to Economics 101, again. Under regular capitalism, for-profit entrepreneurs invest in capital and they make lots of exciting technological discoveries that make everybody more productive, and those two things together – investing in capital and technological discoveries – make unskilled labor a lot more productive than it was before, which means that they get a lot higher wages than they did before, which means that they get lifted out of poverty. So the combination of investment and technological progress driven by capitalism lifts poor workers out of poverty until they are no longer poor. That is how the poor’s income has always increased, and how poverty has always been reduced wherever it has been reduced – through economic growth under the free market.

Just to back up that statement, here is what happened to world average income under capitalization and globalization during the last fifty-six years. The world’s average income went from \$2,000 per year to \$7,000 per year over the last fifty-six years. Of course, that’s average. The people we are most worried about are those at the bottom. But all of the evidence suggests that they were dragged up along with everybody else; as the world’s average income rose, the incomes of the people at the bottom also rose. (See PowerPoint slide, next page.)

56 years of  
regular  
capitalism  
raising  
average  
world income  
– when  
billions  
escaped  
poverty



The paradox about this sudden need to come up with a new kind of capitalism is kind of strange because we're actually living in a historical moment when in the last fifty-six years we've seen the greatest mass exit from poverty in world history. That's the track record of regular capitalism. And so it's a little strange that we would complain bitterly about something that has achieved something that has never before been achieved in history.

Now I'm ready to conclude. I'm sorry if I sound overly economics-professor-y here. I'll send these slides to Mr. Gates and see what he thinks. So in conclusion, regular capitalism – not anything creative, but just plain old regular – solves two problems much better than Mr. Gates' creative capitalism. It creates the incentives to supply goods to the poor whose income is rising under capitalism, and it does a much better job choosing which goods to supply because the poor themselves, when they have higher income, will choose themselves what they most want and need. It does this by raising the income of the poor, not by giving them goods for free.

Now, I'm not going to say that we should just forget about philanthropy and foreign aid and all of that stuff. There still is a role for philanthropy. Frankly, all of us are impatient and still very concerned that there are still a lot of poor people out there whom capitalism has not yet reached, whose income capitalism has not yet raised. And so there is still a role for both foreign aid and philanthropy to try to meet some basic needs of the poor. But this is not anything like a new economic system. This is just a stop-gap measure to try and directly meet the needs of the poor. This is not the grand solution to world poverty that Gates is trying to advertise his creative capitalism as.

So, actually, I'm going to agree with Mr. Gates on several things. I agree with critics like Gates; he said in his speech that one thing that makes him want to change things is that he is impatient. Poverty reduction under capitalism is slower and it is more uneven than we would like. I totally agree with that. I wish it were a lot faster. In fact, I agree that in many ways, when you think about it, because capitalism is so much slower and so much more uneven than we would like, it really must be one of the worst ways to reduce poverty – except for all of the other ways that have ever been tried.

(Applause.)

AL HAMMOND: I'm going to disagree with Bill Easterly's premise but agree very much with his conclusions. I understood Bill Gates' speech rather differently. I wouldn't put too much emphasis on the fact that he's trying to create a new label; when you give a talk at Davos, you have to have something new to talk about. But the fact is, if you look at what he has actually done at Microsoft, he has actually created two divisions that are developing products for low-income populations in developing countries. This is absolutely normal capitalism. Now, he's impatient because it doesn't go far enough. And I believe that his speech, in effect, is a signal that in his foundation he is going to find ways to try to stimulate business approaches to addressing poverty in a much more aggressive way.

I played some small role in the evolution of Mr. Gates' thinking. I ran a conference in 2000 at which he first had to confront the idea of private-sector approaches to poverty – and he rejected it publicly at the time, famously saying that poor people don't need computers. But he changed his mind. And then I helped organize a dinner at which he was placed next to C. K. Prahalad, an advocate of bottom-of-pyramid (BOP) business strategies whom Gates acknowledged as having influenced his thinking in this new direction – and led fairly directly to those two divisions at Microsoft.

The goal really is to introduce access to market and productivity-enhancing opportunities that raise the income of the poor – which is mainstream capitalism. I agree with Bill (Easterly) totally that that's ultimately the answer. The question is, how? And that's really the more interesting subject. We published a report about a year ago, jointly with the International Finance Corporation, in which we had access to the world's poverty data and we reanalyzed that as market data. This report, *The Next 4 Billion* (overview online at <http://www.wri.org/publication/the-next-4-billion#>) lays out how poor people actually spend their money – by income level, by sector, by country, and by region. And what we found is that it's a huge market.



I'm going to talk in purchasing-power-parity dollars, because it's the only sensible way to talk across many different countries. In effect, we're talking about four billion people whose incomes are less than \$3 a day. None of these people have what we would call secure, decent lives. They all have unmet, basic needs of one kind or another. That's two thirds of humanity. But collectively they have \$5 trillion in purchasing power. And if you even take sectors – let's take

one of the smaller sectors, which is Bill Gates' sector, information and communications technology – many of them do not have any access to information or communications opportunities. Even so, that market among this BOP population is already \$100 billion a year in spending. Now the last time I looked, even Microsoft thinks a \$100 billion market opportunity is significant. So does Intel, which has two emerging market divisions. And so does Vodafone, which is devoting all of its new capital investment into buying and building phone companies in poor parts of the world.

It's clear, as Bill (Easterly) says, that most of these four billion people have not benefited from the global economy. They simply have no access to it; they're not part of it. They don't have access not only to basic health care, they don't have access to communications, to financial services, to all of the things that enhance your productivity so that your income can rise. But what's the evidence that in fact if you could address these imperfections in the market, it would work?

Well, the best example actually comes from cell phones. There are now more cell phones in developing countries than there are in the rest of the world – about two and a half billion. And they're growing so fast, almost exclusively now in rural areas because everybody in urban areas already has a cell phone. So in India, for example, they're adding nine million new cell phone customers a month. Africa is actually growing faster than that, in proportional terms.

So poor people are buying cell phones. They don't get subscriptions; when they have cash, they buy time, and when they don't, they do without. Prepaid phone calling. Why? Because they find that it increases their productivity. If you paint houses for a living, and the way you get business is you stand on a street corner with a sign, what's on that sign? Your cell phone number. How else do people reach you? You don't have a real address, or mail isn't delivered. The only way you get business is if somebody can call you on your cell phone. And it raises your income enormously. Or, a member of your family is working someplace else for months at a time – that's very common – and you have a crisis; you need money. How do you tell them to send you some money? Cell phone. Or – a traditional one – you're in a village and there's no doctor there. Somebody is very sick. How do you get a doctor? You call them, or else you send someone to run ten kilometers. So phones make a huge difference to the economic life of poor people, and so they are buying them at unprecedented rates.

The next big thing that is going to happen is banking over cell phones. This is already commercial in South Africa, Kenya, and the Philippines, and it is becoming commercial very rapidly in many other countries. And just to give an example that underscores Bill (Easterly)'s point about technology, microfinance, as well all know, is one of the few things that actually works in the development space. But with all due credit to Mr. Yunus, microfinance has only reached about ninety million clients after thirty years of effort. I think we're going to add a billion people to the banking system in five years over cell phones. Technology can make a huge difference; if you can store your money and transfer it and pay bills and get a remittance on your cell phone, that's huge, and it's particularly huge for rural people.

I've been spending a lot of time in Vietnam recently, and if you're out on the streets of Hanoi after midnight, you see all of these motorbikes coming in from the country with so much produce



on them that you can't even see the driver. They're taking that produce to a stall, to somebody who runs a market stall. Then they go home. How do they get paid? The next time they come into town. Suppose they could get paid the next morning on their cell phones? Really huge. And in Africa, in many cases, if you go to market and you come home to a rural village, everybody knows you're carrying a lot of cash. Wouldn't it be nice if you could carry that digitally, so you couldn't get robbed? Again, huge increases in safety, productivity, and efficiency.

And let's take health care. We've spent quite a bit of time analyzing health care in these BOP communities, and what we find is that access is actually the most important problem – or if you want to think about it in other terms, distribution. Many people spend more money getting to health care – a pharmacy, a clinic, a hospital – than they do on the service itself. So they tend to put it off. If your tooth hurts, live with it. It's not worth losing a day's work. If it gets abscessed, then you have to go. And if you look at the public health systems, they basically fail at providing good distribution. Typically they run out of drugs. They just don't work very well. In fact, what most poor people do is they go to pharmacies; that's the frontline health care provider in rural parts of the developing world. But they're not everywhere they're needed; they're not well regulated; they're mostly all in the private sector; and many of them have fake drugs.

So suppose you could have a disciplined pharmacy chain, a franchise chain, a McDonald's kind of structure that not only had good drugs – generics, low-cost – but had them reliably, and there were enough of them that there would be one within walking distance of pretty much everybody. Actually, this has arisen spontaneously in four countries – Kenya, Ghana, India, and Mexico. We've studied these. And we see absolutely no reason why these can't be done in every developing country. There are regulatory problems in some countries and so on, but in principle we think it will work.

And furthermore, it turns out, that because of philanthropy and ordinary capitalism there are beginning to appear a new set of diagnostic devices, world-class diagnostic devices designed for the BOP. The first Gates Global Challenge to actually come up with a product is a DNA-based diagnostic system. It looks like a tape recorder. You put a drop, a sample of blood or something, on a cassette; you slide it in there; and in two minutes you have a DNA-based analysis of the five major fever diseases, or all of the STDs, or gastrointestinal diseases. The cost of the device is \$50. The cost of the test is 50 cents. No med tech needed. It's not temperature sensitive. You can run it off of a photo cell or a battery. And there are similar ones – dipstick technologies and others – that are also coming to market.

The problem is, how do you get those out where they're needed? Well, suppose you had a franchise pharmacy chain that covered a country, and they had these diagnostic devices, too. People could walk to a pharmacy; they could get a good class diagnostic; then they could get the drug needed for what they actually have. And besides, your pharmacy sells preventive commodities – bed nets, water filters, condoms. And it sells a few basic necessities – condensed milk, whatever. And suddenly you have huge increases in health outcomes. These pharmacies are profitable. The actual, individual franchises tend to be profitable in the first year. The mother franchiser, depending on the country, looks like it will be profitable in three to four years. So you can build a national health care distribution system through absolutely ordinary capitalism. We're in fact starting to incubate some of those.

I could give you other examples, but I think the point is that we are moving through a transitional phase. Traditionally, big companies have ignored the poor because they assumed the poor had no money. We've now altered that perception with this report, because we've pointed out that the poor actually, collectively, have quite a bit of money. We just have to have the business models that actually work for volume and thin margins – but we know about those kinds of business models. What is Wal-Mart, after all? It started in rural parts of the United States, the BOP business model. And it worked pretty well.

So I think that we're in a transitional phase. We have lots of people focusing in on social entrepreneurship, and we have some corporate philanthropy – not a lot, but some. But I think that those are all transitional measures until we actually bring the skills of the market to address the basic needs of four billion people.

The evidence is that they're willing to pay for those basic services, particularly those that enhance their productivity and therefore raise their income and create new opportunities for them. And the whole cycle works. It's just that we've neglected the market. Capitalism has neglected those four billion people. It was said that they are the province of the NGOs and the aid community, and maybe national governments. And I think we've seen that that doesn't get us very far. So we need to get the engines of capitalism to focus really on the opportunity that results from the aspirations of those four billion people, and find ways to meet their needs profitably. And I think we're actually well along that route. I interpreted Bill Gates' speech as a signal that he is going to try to do that through his foundation similar to ways that he has already been doing it through his company.

When you look what is needed, the key shortage is actually – sometimes it's called technical assistance, and sometimes it's called enterprise development activity. It's helping entrepreneurs get up and running, helping them get access to finance in the developing countries. Although big companies can do a lot, the companies that are closest to the poor are those that are local. And they need help. Entrepreneurs here can get quite a few sources of help. In developing countries, not. If you look at the enterprise development capacity, it's really much less equal than is equal to the task. It needs to grow by a factor of ten at the very least.

So it's about putting philanthropic resources into growing enterprise development capacity and growing investment capacity, although that's actually happening very rapidly. I personally have been approached by four new venture capital focusing on BOP opportunities in the past two months. There's an exploding interest. But the problem is, where are the deals? Again, it points to enterprise development capacity. So my sense is that we're actually moving very rapidly but it's going to take five or ten years at the very minimum to do that, and in the interval, philanthropy and social entrepreneurship and corporate assistance that's not strictly market driven are all going to play an important role. But they are transitional.

Thank you.

EUGENE STEUERLE: I, too, am trained as an economist, and actually as an economist I had to appreciate Bill Gates' statements recently in which he hearkened back to Adam Smith, but

hearkened back both to the Adam Smith of *The Wealth of Nations* and the Adam Smith of *The Theory of Moral Sentiments*, the first book, which most people ignore, where Adam Smith talked about this drive that we have to be caring. In my view, Bill Gates' speech is largely trying to reconcile his business side with his notion that he's got a lot of wealth and he can't spend it all himself, and so he wants to know how to develop his caring side.

I also see Gates speaking essentially from two perspectives – and this is independent of what he says. Let's think about what happens if we're sitting in Bill Gates' shoes. One is that you're coming from a world where you see the power of extraordinary economies of scale. He deals in industries with extraordinary economies of scale. Now that's not most of what occupies our economy. But increasingly it is, if you think – and I'll get back to this – about health care and information as the growing sectors of the economy. These are goods and services that have extraordinary economies of scale. Products that the developed nations consume now are very different from what they were before.

And the second aspect of his background is, of course, that he is engaged with some very bright and intelligent people. So he thinks that there is some way to harness – it's not just the money of these businesses, but the human capital of these businesses – to try to engage them in issues having to do with such things as third world development.

I'm going to argue that both of those tendencies actually are consistent with the historical trend. The one I've already mentioned is that we have more products than goods and services that have economies of scale. The second one is that we as individuals are no longer separated so much in the things that we do. Most of us now have skills or occupations or such that they can apply just as easily to the profit-making as the nonprofit sector. If you think about what we would think of perhaps in terms of doing charitable goods and services a hundred years ago, we might think of working in the steel mill during the day and then going home and helping out at the orphanage at night. Today, now, we're talking about people who have skills in advertising or information or health care, things like this. When you sit there at your computer screen and you're thinking of an idea, your world's not so easily divided anymore in terms of your ability, in terms of what you can do with the nonprofit or the for-profit sector. So I think that these are the two things that are driving Bill Gates.

I don't want to make too much of one speech at this point in time. That blows it up to too high of an importance. I see a man here who is struggling with, what am I going to do as a foundation with the money I have? And I think we as speakers or as members of the audience have to be modest, too. We all come at these issues from our own backgrounds. We have to be a little careful we're not too much like Chicago Cubs outfielder Andre Dawson, who said, "I want all 'dem kids to look up to me. I want all 'dem kids to copulate me." (Laughter.)

By point of reference, I first want to go through three issues. One, I want to throw out some numbers, just to put this in perspective in terms of what the Gates Foundation budget is relative to some of the issues we're talking about. The second one, and I've already alluded to it a great deal, is, what's happening in this evolving relationship of the government, business, and charitable sectors as this economy evolves into a very new world? And third, I want to tease out with you, or what I really want to pose with you and I hope you'll interact with us after we get

done with our talks in trying to think about what the Gates Foundation's relative advantage is. That's what Bill Gates is struggling with. What's its relative advantage, its small little piece of the pie. What's its relative advantage in this world?

So, first, let me talk about the budget numbers. And here, I guess I'm a little more sympathetic to the notion that we do need to worry about the size of – not just what we do with our foreign aid or what we do with our individual resources as foundations or as individuals. It's not just an issue of how we distribute it. It is an issue of what we do with it. And that largely comes from a budget perspective. We have money and we have to do something with it, right? You can only do four things with your money: you can spend it wisely on yourself; you can spend it foolishly on yourself; you can spend it wisely on someone else; or you can spend it foolishly on someone else. There's no other choice. You can say, ah-ha, when you spend it on someone else you're doing it foolishly, so therefore I should spend it all on myself. That's not much of an answer either, right? I can go out and buy cosmetics instead of giving aid to the world's poor. Maybe aid to the world's poor doesn't work, but it's not clear that I necessarily need to spend the money on myself.

And Bill Gates struggles with that even more than we do. But everybody in this room has that same struggle. We're probably in the top 5 percent or 1 percent of the world's wealth or income, and we're sitting around spending the vast majority of that money on ourselves. We're not at Bill Gates' level, but we have the same issues, right? If I make \$100,000 a year or \$50,000 a year or \$200,000 a year, how much do I really need to spend on myself? Once I get to the decision that I'm going to spend on someone else, I have to ask how to do it. And it doesn't matter if you're talking about the third world poor or your own children. And you might say, well, that's paternalism. But you'd ask the same question of your children, right? Should I spend it all on myself because I might be paternalistic towards my children and spend it foolishly? It seems to me that you still have to answer the question.

In that context, the numbers are: Our gross domestic product per household – this is when you add everything together and you dodge some problems that I won't get into with the census – is about \$120,000 per year in the United States.

In the United States, we spend about \$20,000 per year per household on our health care. Food away from home and entertainment, about \$6,000 on average per household per year. Alcohol and tobacco, \$800. Our charitable giving from all sources including corporations is about \$2,300 out of that \$120,000 of GDP.

Government international development and humanitarian assistance is down to about maybe \$125 per household out of that \$120,000. But by the way, if we were spending at the level we did during the Marshall Plan – and admittedly if we're talking about things like the Marshall Plan we're talking about more than just GDP development; we're also talking about how we create good will around the world. I firmly recall a photographer from Poland who came up to me once, and he wasn't speaking to what we had done for Poland in terms of development after World War II, but he said, you know, the people of the United States are remembered for what they did for Poland. At that time, there was not a family in Poland who doesn't tell stories about how the United States was there to help them. Now, did it help them? Did some of that money support

corrupt officials? Probably some of it did. But the aspect of good will is an important part of what we're talking about.

In this context, private international assistance per household is somewhere between \$75 and perhaps even \$275, if we take Hudson Institute's numbers (from the annual *Index on Global Philanthropy*). And if you take the Gates Foundation spending per household, it's about \$25. So here's \$25 out of \$120,000 per household. If we want to talk about it in terms of AI (Hammond)'s four billion people, then we're probably talking about, oh, \$5 per household around the world.

It's a tiny, tiny piece of the pie.

That gets us to the next question, which is, where does the foundation sector – that's the charitable sector – fit in this mix? What can it do that the government can't do, or that we as households can't do. And that's a tough issue. I'm not one of these people who comes out and says that government should do everything, or philanthropy should do everything, or individuals should do everything. Each sector has relative advantages and relative disadvantages (inaudible). Government is so big that it's hard not to involve it. So even the Gates Foundation, if you look through their projects like their malaria initiatives, immediately once they get going try to incorporate governments abroad and the U.S. government to get engaged in initiatives. I'm not saying you have to like that; I'm just saying that the government is so big in this context that that's what often happens.

Another aspect to think of about the sector is, good works are not public works, and we need to make the distinction. There are some things that government can do that private initiatives just cannot do. Private initiatives are not good at building roads. Private initiatives are not good in and of themselves at building those infrastructures. A lot of the things that Bill Easterly talks about as infrastructures that are so important in foreign countries, such as a justice system that works, and something that I learned when I was in China and I won't go into it, but accounting systems that work. It's amazing how badly you can allocate things if you don't have good accounting systems. All of the things that many people in this room probably work on on the side. Government is good at that; the private sector often is not.

The private sector is very good at being innovative, but it's often very bad at coordinating its innovation. The private sector is often good at getting out of bad projects. It's often very bad in the sense that it often gets out of good projects before it has ever fulfilled the missions of those projects.

I mentioned at the beginning also in terms of thinking about these sectors this very large growth by industry and employment. I've done a couple of books at the Urban Institute. One was called *Nonprofits and Government*. The latest one is *Nonprofits and Business*. We're trying to think through these relationships, which are interesting and dynamic. One thing that is driving them so much is this economy that's moving more and more towards goods and services where the breakdown between what's profit and what's nonprofit is really harder and harder to distinguish. In the United States we have this distinction "charitable purpose." It's information, health, education, and so on and so forth. More and more, those products can be provided by either

sector. That's more and more what we do. It's a larger and larger portion. That actually makes this breakdown between what sector does anything interesting.

We also see that governments more and more have decided they can't do things directly, and they contract out, more and more. And so the large growth in the charitable sector in recent decades has not come from increased charitable contributions, which has been pretty steady as a percentage of GDP. It has actually come from government contracting out; that's the largest source of growth in nonprofit both employment and revenues. It actually dominates – especially what they get through contracts. Think of health and education. Think of higher education and hospitals.

Contracting out has actually been an extremely important part of international assistance from the beginning, because often when the United States or AID or any group decides it wants to go abroad, they need to know who knows things over there and who is going to help them figure it out.

Let me go to the last part of my talk, in the interest of time. So, given that background and the numbers in terms of what the sectors can do, now we want to think about what the Gates Foundation's relative advantage is. Again, I don't want to make too much of one speech. A speech made by somebody like Albert Einstein at Princeton probably wasn't very important relative to his musings back in that little patent office, back when he was in Europe. And Joe Theismann once said that you don't need to be a genius to play football; a genius is someone like Norman Einstein. (Laughter.)

So Gates is trying to figure out what to do with his money. I view this speech as nothing more than his musing out loud. And we may say, gee, we'd have better ideas. But you know, he has the \$60 billion and we don't. I guess I'd rather he spend the money on someone else than spend it on himself, so I'm happy to let him muse out loud and try to figure out what he is going to do, and the rest of us can kibitz and hopefully pass on some good ideas either to him or his staff.

Let me give you a couple of ideas in terms of where I think the Gates Foundation may have relative advantages – and relative advantages I don't think the foundation is necessarily using at this point. Now, unlike government, Gates doesn't have to worry as much about long-term diplomatic relationships. It seems to me that's a major problem with the government, and it's a major problem with the World Bank. At some point, once you're doing large institution to large institution, like government, you're compelled to have to put the money through the governments. And often these governments have significant problems, quite honestly, with corruption – sometimes outright corruption, often petty corruption in terms of just supporting huge bureaucracies. And it's hard for government institutions to do those types of negotiations. Gates really can interact in different ways: by the information it provides, and by using the symbolism of the business, of the Gates Foundation.

Gates can probably do a little better job in some of these health areas, contracting with entities the government never could. I'd love to do a study – maybe someone here is already doing one – in terms of the contracting that is going to go on in terms of the AIDS money that is going to go abroad, what the government is going to do versus what Gates could do. It may be that private

foundations can do a better job of contracting in a third world country to develop generic drugs than the United States government ever could because of its dealing with its own companies at home. But I think Gates still needs government to operate, because he is going to need the cooperation of government to deal with the distribution of what the foundation is doing.

Let me also add a few more ideas about where I think the Gates Foundation can make a move. And one of them goes back to the second idea that I said Gates dealt with, this notion that there are these bright businesspeople out there whom he needs to engage to leverage up this tiny bit of money he has and this tiny bit of prestige he has. How, really, can he engage them? I think in many ways that the question of whom to leverage up is probably understated. To me, Gates should start thinking about how to leverage up all people who are involved. The business, as business, is probably only interested in promoting its own business logo; but the businesspeople as well as the people who aren't in major businesses – the households, the individuals – are the people who might be caring. And there are a lot of them around, and it seems to me that the foundation with its prestige could leverage up these people.

I'll take one of Bill Easterly's favorite charities as an example – GlobalGiving, if I remember correctly from his book. Suppose the Gates Foundation were to say, I'll take charities like GlobalGiving or Save the Children, and I'll do a challenge grant. Per year I'd like to give, oh, ten thousand for households, businesses, or giving circles that would devote \$50,000 to some development project abroad. I don't know if it would work or not; probably a lot of them would be failures. But challenge the individuals, the households, the businesses to really put money on the line, and then engage with these intermediary organizations to try to actually do something. It's a gamble – it's more of a bottom-up, democratic approach. I don't claim it solves the problems I raised earlier about governments and public works. But it seems to me *that's* the way to really engage people. It's not just talk. I think things like challenge grants and trying to engage the public would really, really make a difference.

And I should say, by the way, that I think people-to-people activity does more than just help solve problems of development. I've been working with groups for a long time that really believe it also solves issues like terrorism. Organizations like Terror Free Tomorrow (<http://www.terrorfreetomorrow.org/>) argue that if you look at why terrorism hasn't really succeeded in the United States versus other countries, it's because the community doesn't support it. So when you do aid abroad and you really engage people in those types of activities, you actually reduce the possibility that people abroad will provide the moral support, the community support, for those types of terrorist activities.

And on the information and technology side, it seems to me that there's also the issue of not just the great examples that Al (Hammond) raised, but also the issue of, can this technology, this information system, help create a better accountability system – because we do have the major problem that local governments and national governments in many cases are not accountable, and they are a major, major source of our problem in dealing with the problems of the poor. Just as an example, research funded by an Urban Institute team in Uganda showed how villages where citizens had more than one source of information about their level of education got better service. Some research in Russia showed that where there was more than one news outlet, corrupt inspectors often were able to prey less on firms. It seems to me that the Gates Foundation

could do a substantial amount in this technology area, I don't know if it would be by using cell phones or what they would use, to bring a better system of accountability for what's going on.

Those are only a couple of examples. I really hope that you in the audience will also think about it. Let's think about it. The Gates Foundation wants our advice. What is its relative advantage, and really, how can it make the best use of it. And let's take Bill Gates' speech as just his own effort to try to solve that problem.

(Applause.)

WILLIAM SCHAMBRA: Before we go to the audience, Mr. Easterly, I must say that it seems to me there is a compelling case here that we have the ingredients for something new. We have four billion possible customers as the basis for a different kind of capitalism. And we have, on the other hand, the Gates Foundation's \$60-something billion of assets that, as Mr. Steuerle pointed out, is immensely flexible and able to do things that governments can't do or are constrained from doing in various ways, as are corporations. Why can't this combination of ingredients change the way we think about capitalism? What impediment constrains us to stay in the path of the old capitalism?

WILLIAM EASTERLY: In your question, Bill (Schambra), and what Al (Hammond) and Gene (Steuerle) said, part of the argument is that we shouldn't take these big-think ideas too seriously because they don't matter so much; what really matters are the details of implementing things on the ground. And actually, I would disagree with that. I think that the big ideas debate is still very important and very relevant in the world today.

There are a lot of countries that are sitting on the fence, trying to decide between some kind of statism that is mainly going to benefit political elites and capitalism. And so when we have debates on whether regular capitalism works and brings a lot of benefits to people, I think those debates really do matter. They really do affect the well-being of an awful lot of people because it influences the values and the political decisions of people around the world who are still hesitating between statism and capitalism. And statism, right now, frankly, seems to be winning most of the argument in places like Latin America, Russia, the Middle East, Thailand. Everywhere you look, there are statist politicians who seem to be winning the argument. And so when somebody like Gates, who is the world's all-time single greatest beneficiary of capitalism ever, says that capitalism doesn't work and we need to come up with an alternative, I think that it does a disservice to this big debate that is now going on between capitalism and statism.

And I think it's very important for the poor that the thing that has the best track record at actually reducing poverty is not corporate philanthropy or foreign aid, it's capitalism. It's economic growth. If even the capitalists themselves start apologizing and criticizing that system that has worked for so many people over the past fifty years and lifted billions of people out of poverty, I think that does a disservice to the next few billion who are going to be lifted out of poverty, as we'll see, by the ongoing march of capitalism and globalization.

Second, let me respond to this bottom-of-the-pyramid argument. There is a lot about it that is promising; it's a very promising and creative idea itself. In fact – it's always in bad taste to



reference your own work, but I'll say it – in my book (*The White Man's Burden: How the West's Efforts to Aid the Rest Have Done So Much Ill and So Little Good*) I actually gave an extended example of a great bottom-of-the-pyramid initiative in India in which Unilever sold antibiotic soap to the poor, and it made a profit for Unilever and reduced disease through hand-washing with antibiotic soap. So it's a win-win situation. That's good.

But is it big enough to affect that fate of the four billion people Al (Hammond) was talking about? Well, he says that those four billion people are not being addressed by the market right now. And as an economist I have to ask, why is that? An economist's first instinct is always to say, well, don't try to outsmart the market; it must be happening for a reason. What could be the reason? Well, probably the reason why it's not serving those four billion people more than it is now, even though collectively they might have a lot of income, their per household amount of income – \$3 a day or much less – means that they have very tiny transactions. They make very tiny transactions in the market. And one thing we know about markets is that they have very high transaction costs. There are costs of transport and advertising and searching for customers and the storefront and all kinds of fixed costs that you incur to meet the needs of your customers. Markets have high transaction costs, and that's a very good reason why they're not doing a very good job meeting the needs of those who make very tiny transactions. It is happening for a reason. And we don't help ourselves by ignoring those reasons and promising that the market will suddenly discover that there are four billion people out there that it previously overlooked. I don't think that that's going to happen, frankly.

Now, I do think that there are some modest but very positive and tangible gains to be made from the kind of philanthropic and bottom-of-the-pyramid things that Al (Hammond) and Gene (Steuerle) were talking about, and that can put a nice shine on capitalism, as Bill (Schambra) is suggesting. But let's not kid ourselves. The main debate that we're facing in the world today is really the big one, statism versus capitalism. And that's the debate that I want to see capitalism win – not because I'm an ideologue or grew up in free markets. I actually have to confess that I've never voted for a Republican in my life. I just look at the track record, and what has actually lifted people out of poverty is free market capitalism.

WILLIAM SCHAMBRA: Mr. Hammond and Mr. Steuerle, just to follow up on that, in an earlier speech – Bill Gates' commencement speech this year at Harvard – he mentioned that resolving the problem of human inequity is the highest human aspiration. This would seem to suggest that this issue of statism versus markets does in fact have a certain bearing on this question. How do you wrestle with this? Does this creative capitalism point us toward a renewed argument on behalf of statism, or is there some way to resolve this problem within the market paradigm?

AL HAMMOND: I would agree with Bill that there are a lot of places in the world – not the majority, but places like Venezuela and others – that in effect have said, capitalism hasn't helped us. And if you look at the data, it's true, pretty much. So people are rejecting it, or at least they're being seduced into rejecting it because of demagogic leaders. And that's a serious problem. But if normal capitalism has a bad name because it hasn't delivered precisely because of statist governments or cultural systems that are extremely inequitable – which is what most of Latin America has – then how do you make an argument that says, what we need is more capitalism?

So I would see labels such as “creative capitalism” as simply repackaging capitalism in politically acceptable ways in those kinds of places.

And let’s be fair about it; markets aren’t perfect. And one of the reasons that large companies have pretty much ignored the poor is the way we train our business executives. What have we been teaching MBAs for the past twenty years? Focus on the luxury market. Throw lots of capital at the business. And focus on those high-margin businesses where you can get lots of capital back. Why was Wal-Mart able to grow in a stealth mode until it became the biggest retail organization on Earth? Because nobody was interested in small towns in rural America. That’s where they started. That wasn’t what the business schools were teaching. So I think that a redirection of the energies of capitalism to these low-income markets is necessary, and it’s starting to happen. And markets in fact often miss things like that. It’s not just automatic that if somebody isn’t picking up that twenty dollar bill, then it isn’t there.

And I think that there is an important issue here. If we don’t find ways to make markets work for poor people, then why is it not logical for them to reject the markets despite the evidence that Bill (Easterly) gathers and we all know and in some sense agree with? The reality on the ground is, if I’m not getting goods and services and I have no hope for improvement, I’m going to try something else. So it’s quite important that we make markets work for poor people – for their own good and for our good whether we think in market terms or in terrorism and social stability terms.

So I think it’s absolutely critical. In that sense, I actually think it’s quite clever to repackage capitalism under slightly different labels – a friendlier capitalism – because it essentially says, look, we haven’t done it very well yet, viewed in terms of those four billion people, but we’re going to do it better. I would see that as a useful political strategy, but fundamentally what we’re at is harnessing the engines of philanthropy and of leaders to catalyze more capitalism in ways that work for poor people. And despite the high transaction costs in low-income markets, everything is relative. These four billion people are already spending that \$5 trillion for goods and services. Almost every poor household pays cash or labor for most of the goods and services that they consume. Subsistence agriculture really is a vanishing practice. Everybody is in the market. But the problem is, they have no access to information, and there’s one store and one person who buys their crops, and so they get a bad deal. They are not competitive markets. If we can change that, then people can get a better deal. And you have to ask yourself, if a corporation comes in and creates a more competitive market, isn’t that actually going to benefit poor people quite a bit compared to being ripped off by their local vendors, which are monopolistic? That’s the real condition on the ground, for most people.

So I think that the processes of introducing real competition into low-income markets using technology – after all, transactions on a cell phone are a lot less expensive than storefronts – presents opportunities for companies of all sizes and for the nonprofit and philanthropic communities to really redirect the attention of the market to the needs of these people, and the motive may in fact only partly be profit. The motive is partly a broader kind of self interest. If we really want health communities around the world that don’t harbor terrorists, then it’s in our interest to try to make that happen.

But the mechanism that at least I'm suggesting is that we have to actually work hard to make competitive markets happen in poor communities, because they aren't there yet. And whether or not it ought to work automatically, the fact is, it isn't. And that's why this debate about whether or not the market works is gaining traction in Latin America in a few countries – not most of them – and it is rejected in some of the Middle Eastern governments. And there are certainly tendencies that way in every region – with lots of counterexamples, too.

So I do think that there is a problem we have to solve both on the political reputation of capitalism – because it hasn't met the needs of poor people so far – and in terms of actually introducing capitalism into those markets in a useful way.

EUGENE STEUERLE: There's almost nothing Bill Easterly said in his last comments that I disagree with. And I'm not sure any of the three of us would disagree, although I think I would reframe the issue. I really don't like dichotomous debates between 'isms – statism versus capitalism. It's not because if you made me choose, I wouldn't choose capitalism. It's because I think the labels themselves tend to get misused and not applied very well. So for some people capitalism only means private ownership versus public ownership. And what we've discovered again and again around the world is that private ownership, if that for instance means monopoly ownership, may be no better than public ownership that's monopoly ownership. And some public ownership can be ownership that is spread among people in ways that is very diffuse, that's not really so much monopolistic, and be better than private ownership. So I don't like the 'isms.

How I would frame it, going back to more fundamental Adam Smith, is to try to create markets where real competition can work. That's the reason why I had problems with the word "capitalism" – because capitalism has often been used as an excuse to have very large holdings of wealth by people because they have achieved economies of scale, which I think is one of the results. If I look at the history of the industrial revolution and the more modern, technological revolution, I view it as largely being driven by these economies of scale that led to acquiring large masses of capital in particular areas, and single, sometimes almost monopolistic ownership because that's how you achieve these economies of scale. And then the question was, how do we then counteract that with competition, (inaudible) alternative goods and services?

So I think the more fundamental issue is, how do we create the institutions for growth in these countries? And these institutions – sometimes we symbolize it with simply things like "democracy," but it's not just democracy. I mentioned good accounting systems, good justice systems, good systems of distribution, and somehow or another breaking the cycle of corruption. All of these types of things, which I think democracy and competition and other things help enormously, are what we need to work on. And I think the label "capitalism" and even the relabeling, "creative capitalism," that Bill Gates has put on it is a turn-off to a lot of people because that term, "capitalism," often doesn't mean what I think a lot of us mean when we talk about creating these more democratic, competitive institutions. I'll agree, in the end, that that's ultimately where growth comes.

That doesn't necessarily mean that we need to throw aside the issue, again, as I say, of what we do with our money. Whether it's you or me or Bill Gates or anybody else, even if all I give is

assistance and it doesn't create growth at all – I've just saved a couple of lives and people live a little bit longer even if they're not in that great of a system – that would still be maybe a better use of our money than somebody else. And if Bill Gates' \$3 billion that he is probably going to spend, of which maybe \$2 billion or \$1.5 billion might be abroad, is able to generate \$5 or \$10 billion worth of good abroad, that's not growth by any of our standards but I still think that's a good thing and something that we'd want him to work on.

Where I saw an intersection between these two thoughts was, are there ways in which one can think about technology to enhance the institutions I think all of us favor? Al (Hammond) has given some examples, and Bill (Easterly) has given some, and I've tried to give some in terms of just simply the issue of how can we through information systems in particular enhance the ability to create these competitive systems or create their ability to have information to deal with the corruption and other problems we deal with in major institutions.

I just can't put all of that framework into a simple one-'ism-versus-the-other type of debate.

WILLIAM SCHAMBRA: Let's go to our audience.

ROGER REAM, The Fund for American Studies: It seems to me that you do a disservice, Bill (Easterly), when you say that "poverty reduction under capitalism is slower and more uneven than we would like," and that "capitalism is one of the worst ways to reduce poverty except for all the other ways ever tried." While you've qualified that remark and you say it in relative terms, it seems to me that capitalism isn't that slow at moving people out of poverty. If you look at the last twenty-five years, we've seen the greatest movement of people out of poverty through immigration – when poor people leave poor countries and come to the West, particularly the United States, whether they are from Eritrea or Venezuela or wherever – and countries like China and India adopt the institutions of the market and their people begin to be lifted out of poverty. So it seems to me that it works pretty fast. It has only been around for 250 years, and it has made great changes in that short time.

And finally, I would just say, too, that it seems to me that the difficulty and the reason what Gates said perhaps bothers me is that there is this debate of big ideas going on, and when we hear criticism of capitalism coming from the world's most successful capitalist, it plays into what I've picked up on in meetings I've gone to with NGOs, a hostility towards capitalism among people who work in the NGO sector. And when you see Bill Gates saying it, as someone moving into that sector with feet in both sectors – maybe you could comment on that.

WILLIAM EASTERLY: Thank you for providing a position that is even more pro-capitalist than mine was, making me seem like the moderate! (Laughter.) Obviously my sympathies are with everything you said. It's all relative, how fast. What is the correct expectation for how fast people escape poverty? Al (Hammond), you were saying that the market is failing the poor, and then you're saying (Roger Ream) that the market is doing a great job of uplifting the poor. We have these very different perceptions of what's going on. It's way too slow for some people, and it's remarkably fast for other people by historical standards.

I have to really disagree that the market is failing the poor. The poor have seen their incomes increase by 3.5 times over the last fifty years – in my lifetime. I don't think that can be called failing the poor. It's historically without precedent. And I agree with you, Roger, that one way to gauge expectations is history. This system has delivered something that has never before been delivered in history. Now that should be counted as doing pretty well. And yet for a lot of people, for all of the reasons that Al (Hammond) and Gene (Steuerle) said, it's still not fast enough.

WILLIAM SCHAMBRA: If I may introduce a thought, I think, Mr. Hammond, your argument introduces an element that seems to be lacking from the long-range historical point of view, which is, there is not only markets, but there's politics. The long-run argument for markets may be fine for you economists, but that doesn't answer, as you suggested earlier, the concerns of people in Venezuela who have not benefited from that system. When you introduce the element of politics, you have another kind of dynamic going on. I didn't mean to preempt your response, but I'm hoping you'll address that, too.

AL HAMMOND: Averages are a good way to lie. Things are much more patchy than that. You have to look country by country. But I don't argue that the secular trend is that in fact, incomes are rising faster than any time in human history. On the other hand, the reality on the ground is that people in low-income communities mostly don't have many opportunities. Mostly they're ill-served by the markets that they participate in because they're not competitive. And they are easily exploited because don't have any access to relevant information, and that happens all the time.

I'll give one example. About twenty-five years ago in India, the government for its own reasons mandated local auction markets, nominally to protect farmers. And the way those markets worked was that there is a group of middlemen who ran the markets. They were of a different caste than the farmers. The middlemen became millionaires, literally, in dollar terms. The farmers were still poor. And the companies that bought the produce from the middlemen were getting cheated because the middlemen had all the information; they had the scales, which weren't always honest; and they didn't pay the farmers in full at the time. They said, we'll pay you half now and then when you come back in three months we'll give you some more. And so an Indian company, ITC (Indian Tobacco Company), a rather large company, got permission to introduce a different way of doing things. They set up things called the *e-choupals*, or e-marketplaces (see <http://www.echoupal.com/> for more information). They put computers with internet access in farmers' homes. They situated them strategically so that they serve six to ten villages, and they made the farmers who were going to have the computers take a public pledge to provide access to anybody in their group of villages. It was free for the farmer; the company paid for everything. And what it did was essentially give the farmers access to the closing price of the commodities they were interested in every day as well as some access to agricultural extension information. And the company told the farmers that they could also sell their produce to the company directly at yesterday's closing price and avoid the auction market.

ITC is in four or five different commodities now and scaling fairly rapidly, but soy is where they've had the most. And in areas where this has been deployed, within a fairly short time 70 or 80 percent of the sales of soy from farmers was going directly to the company. And the farmers

get an honest weight. They get paid to take the produce to the company's warehouse. They get paid in full. They get a premium for a better quality crop. And they get about a 2.5 percent higher price. The company, on the other hand, is saving about 2.5 percent – so that gives you some idea of how big the margins for the middlemen were. And suddenly there is a competitive market. You're still free to take your stuff to the auction market, or you can sell it via the *e-choupal*.

Competition has transformed the opportunities of those farmers, and it's not doing so badly for the big companies either. Furthermore, they were smart enough to hire some of those former middlemen as their field agents, so they sort of bought off a source of political opposition to some extent, although in some other states the middlemen got armed ahead of time and resisted them coming in. So in fact, they've introduced technology; they've introduced competitive markets; and it turned out to be a win-win. And that needs to happen in many of these low-income markets if people are actually going to see benefits other than some small secular change that may or may not actually translate down where they live.

And so I won't argue with the secular trend; in fact, I'm not an economist. All I'm saying is that in practice, low-income communities especially in rural parts of the world do not have competitive markets and people do not see much real benefit from all of the marvelous things that are being invented and marketed around the world. And that needs to change. And if it changes, I think you will see truly dramatic gains in people getting out of poverty, even faster than the ones we have seen. And it's precisely in those countries that have made some effort to introduce markets, China being a good example, that we have seen dramatic movement of people out of poverty. And where that hasn't happened, the poverty numbers haven't budged much. So I think it's much more patchy, and not a simple either/or.

EUGENE STEUERLE: I still don't understand the debate. We Americans are also ten times richer than we were a century ago. So that means that we have ten times the opportunity to do – I don't understand the debate. We can always react against things that are done badly or done poorly or could be done better. That's what we're all about. But I don't know what the debate tells you. You still have resources; you still have to do something with them. Bill Gates is struggling with that, and I hope you're struggling with that when you decide you're going to buy automatic steering as opposed to feeding some poor person. I hope all of us struggle with that every day. It's just natural. We're richer; we can do more. And sometimes there are problems abroad, and sometimes there aren't, and there are anecdotes of places that work and anecdotes of places that don't work. And we try to deal with them. I guess I'm really having trouble understanding what the debate is all about unless – and this is my fear – unless it becomes an excuse for inaction. That's my bigger fear. It's not that I disagree with Bill (Easterly) on most of the things he cites as being inadequate or poorly done. It's that I'm bothered when that then becomes an excuse for inaction.

WILLIAM SCHAMBRA: Just to pick up on one element of Roger (Ream)'s question, which I think does bear on this, the question of the hostility of the NGO sector, the nonprofit sector, to capitalism. I think if you were to look at the mission statements of an awful lot of these groups, the critique of capitalism contained therein would be considerably sharper than Bill Gates' speech. Is that something we need to worry about, concern ourselves with? Does that present a subtle threat to this –

EUGENE STEUERLE: Sure. I'd hope that people who work in NGOs would be much better trained in economics. I can't disagree with that. I wish they would understand the importance of markets. And I've indicated that I think the institutions that need to be developed in countries – I mean, I agree with Bill (Easterly). How I reframe it is not capitalism versus statism, so much, although that's certainly part of it. It's institutions – stable institutions, competitive institutions within these countries, the institutions of justice, accounting, and all of these other things that we know will make things work. I agree; that's where a vital amount of work has to be.

MAX SINGER, Hudson Institute: I think this debate has been relatively positive, but I want to bring in some other points. One is, the NGOs, in addition to being anti-profit-making and anti-capitalist, are also doing harm. The malaria case that Bill Gates cites is the case where the market and science developed ways of largely eliminating malaria, and it was NGOs and idealists who worked against it and prevented – and prevent – the distribution of DDT, which properly used is the way to kill malaria. You have in the United States a billion-dollar-a-year industry which depends upon scaring people and doesn't have a good record – I'm talking about the so-called environmental protection organizations. There is a lot of people whose living depends upon scaring people, and I don't think they have a good record with regard to when the scare them usefully and when they scare them unusefully – harmfully – as with malaria and other cases.

I agree, certainly, Gene (Steuerle), that capitalism is a big label that's not so useful. What you need is competition. But if you ask what stopped competition, my impression is that in most places it's the government. Some government or political thing is preventing people from doing the competitive and effective thing, whether it's through a license requirement or regulation or some procedure or something that the government sets up. The politician makes a profit out of it, makes a deal with a private capitalist, and together they exploit ordinary people and work against efficiency. And so we need more (inaudible) in recognizing who are the villains and potential villains, and we need (inaudible) the spread of the benefits of competitive enterprise.

And by the way, on the market reaching the bottom of the pyramid, it seems to me that what's happening is not that capitalism didn't recognize those people so much as that new technology is changing the possibility of working in the market. Computers and cell phones, for example, are reducing transaction costs and making profit possible where it was not possible before. Where there are competitive openings, business moves in and does it. It could do it better, but –

EUGENE STEUERLE: There are so many issues we can talk about. Competition is not just competition in the private sector. I have friends who have also worked at the World Bank who talk about the importance of federalism, because if you create strong local governments it creates sources of competition with the national government. And then they go further and say, but the local governments then need their own revenue source, because if they're dependent upon the federal revenue source then the corruption often works its way down the system. Then there's the question of, do you have a press that provides competition in terms of information systems and what goes on in local government. So there are a lot of aspects of this we're not getting into. But I think what we want to think about is, when NGOs are involved on the ground, are there also ways of thinking about how they engage the institutions and strengthen the institutions along the way? But again, I'm back to my dilemma. NGOs have resources. We have resources. We're

going to do something with the money. They will still make many mistakes, but giving me examples of what they do badly doesn't tell me what they should be doing, and that, to me, is what we really should be engaging as well.

JILL LACEY, Capital Research Center: The population I'm most familiar with is rural villages in Cambodia. Their income tends to be a dollar to two dollars a day. It's like time travel when you go there. There are people who gather sticks and have no access to clean water. They do have capitalism, but it's on such a small scale; their transactions are buying charcoal or maybe buying water. I just wonder, how does their pie get larger? How does capitalism increase, for those people? What hope do they have? Because as I say, they do have capitalism, but it's on such a small scale. Are these just the poorest of the poor who will always be among us? You know, you can barely get there by roads, and I cannot imagine these people paying fifty cents for a medical test. It takes a lot of education to get them just to filter their own water. So what hope do you see for that kind of population?

AL HAMMOND: I think that, as other people have noted, there is still a role for governments, for philanthropy, and for development aid. When we charted the income in \$500 PPP increments, the very bottom segment – the dollar-a-day folks – do not have much income compared to the size of the population. Above that, there is quite a bit of spending power. And so I think it's not simple to really address the poorest of the poor. I also think that the development community, though, has tried to focus perhaps too exclusively on that group and has not, therefore, generated more robust economies in low-income communities. But the answer from economics is, you have to increase those people's productivity. That's the only way to raise incomes, in the end.

And so what are the things that we know can make a difference? Access to financial services – micro-loans, whatever; access to information – low-cost communications; access to health care so that you can actually work more days a year and not be laid up with malaria so much; and, ultimately, access to education. There are a few others. Roads to them would help. In fact, I was in Cambodia three weeks ago discussing the development of a very low-cost, rural communications system that we hope cell phone companies will deploy. Because if you look at the cell phone coverage map, it's pretty patchy, and most of those rural communities are not covered. This is a WiFi VoIP system that requires about a tenth as much capital to build as a cellular system. Therefore it could serve communities like that and still be profitable even if they use it much, much less.

Will that change their lives utterly? No, but it will help, because some of those people have a family member working in a sweatshop in Phnom Penh, and so remittances are important. It helps them to know what a fair price is for the commodities they grow, and increase what they get for them. It helps them to know that there is an NGO they could call if there was something wrong – yes, we have land mines in our area, so would you please come and dig for them here, too? All of these things help.

So I think basically you have to look at how we can get more services that increase productivity into these communities, and hope that that gives people more avenues to bootstrap themselves up. And it seems to work in a number of places. It's hard for people who are at the very bottom



of the pyramid, and that's where a combination of creative capitalism, development aid, and philanthropy really makes a big difference. But we think that giving people affordable access to communications, financial services, and health care is a really incredibly important starting point – affordable in their terms.

People are willing to pay for those things even when their incomes are incredibly small. We actually charted the percentage of household income that people spend by sector as their incomes go up. By far the biggest elasticity of demand, if you want to put it that way, was in communications – and eightfold increase from the bottom to the top of the BOP in willingness to spend on communications. The next biggest was transportation; when you buy that first motorbike, your productivity goes up a lot. And smaller things – with health care, people tend not to increase their spending as a proportion of household income until they get pretty close to the top of the pyramid. But there is evidence that they will spend on health care, and they will spend on communications if they have the opportunity that's affordable. And they're spending because they see it making a difference in their lives.

I'm afraid that's the best answer I can give you.

WILLIAM EASTERLY: Al (Hammond) has given the non-market solution. The market solution is that they can migrate from those poor villages to the factories producing for export in the capital and get higher-paying jobs than what they had back in the villages. At the beginning, because where they start from is a dollar a day, those factories will be sweatshops because firms can get away with it because the workers' only alternative is a dollar a day back in the village. But more investment will keep pouring in to take advantage of this cheap labor, and this will drive up their wages and until we're out of the sweatshop range and we're into making people a lot less poor than they were before. This is not theory; this is actually happening in Cambodia and Thailand and Indonesia and Bangladesh. All over Asia.

JESSICA PICKETT, Center for Global Development: I presume that many of us here have read Gates' speech, and I think it's really fascinating how many different interpretations of it there seem to be. Having read it myself, my take-away wasn't really that it was an appeal to overthrow capitalism in favor of corporate philanthropy, nor was it really a mission statement of the foundation's potential role. Instead, the two main points I took away were that he was encouraging corporate leaders to identify and explore opportunities at the bottom of the pyramid, existing markets there where shifts in their business models could potentially yield substantial profits. That's what Mr. Hammond spoke to quite eloquently.

The second point that I took away, which I haven't yet heard addressed, was an appeal to donors and national governments to look for opportunities to reduce barriers to market entry and create new markets that would benefit the poor. Gates cited both the recent passage of an FDA priority review voucher for neglected diseases and – in the speech itself but not in the transcript – advanced market commitments for pneumococcal vaccines.

I'd be very interested to hear what the panel thinks of these and other pull mechanisms as an effort to capture the market and existing forces of capitalism for the poor.

AL HAMMOND: They're good.

(Laughter.)

AL HAMMOND: Okay, to go further (laughter), the IFC has been publishing a series of reports, the *Doing Business* series (<http://www.doingbusiness.org/>), that track how much capital it takes to open a business legally, how long it takes, how easy it is to close a business and fire workers – all of the sort of technical market conditions. And it's really amazing how much the embarrassment of being low on the list is actually having an effect on people's willingness to make changes, not in every country you would think – in fact, it turns out that Brazil is remarkably low on that list. It's very hard to open a small business in Brazil. Vietnam was near the top of the list for a couple of years and is doing a good job of opening to the market.

So there are some efforts to both stimulate that and to track it so that you hold governments, in some sense, accountable. And I do think those are critical issues, because if you make it impossible for people to start businesses formally, then they do it informally and there are no worker protections; you can't have big companies as customers; you can't get investment; you can't scale. And enormous proportions of the economies in most developing countries are informal. And so getting that shifted over to the formal economy so that the capital parts of capitalism can play a role is actually a very important part of the process, and that's something at the institutional level that is really in the province of government. It would be a really useful place for development dollars to focus, because it then unleashes entrepreneurship and investment, particularly in small businesses, which in fact create most of the jobs. I couldn't stress how important that aspect of it is. But the other side of it is to actually help markets be competitive enough so that people have options.

EVELYN GONZALES, Uplift Community Foundation: I'm a consultant with the Uplift Community Foundation, and I wanted to delve in a little bit more about the idea of capitalism and how under Bill Gates' model it can overcome hindrances to economic competition, and whether or not one would have to leave his or community, i.e. migrate, in order to achieve greater levels of productivity if under creative capitalism people could not stay where they are, as you (Easterly) suggest, and develop competition. Wouldn't that be a more equitable distribution of the wealth in economies in the world, as opposed to monopolizing it under capitalism?

AL HAMMOND: I think there are several things confused in that question. In some sense, people are going to make their own choices about whether they want to migrate and work in the city because, as Bill (Easterly) says, they can get more money, or whether they want to stay in their own communities. It's clear that socially it would be better if everyone didn't move into the city, because the cities can't cope. So there's a broader sense in which if you can provide productivity options in rural communities, countries might be better off as a whole. The migration happens a little more gradually. My sense is that the new communication technologies and some other things like that are making that more possible than it was before. The *e-choupals* example I gave is precisely that. Farmers could in fact increase their incomes quite a bit; their kids got on the internet with those computers; the wives found out what NGOs were offering, and government programs; everybody was having fun and they didn't have to go someplace else to do it; and their incomes went up substantially. So it's possible, but it's not going to happen

everywhere immediately, so you are going to see lots more people going to the city to work in factories. But I think that's something people are going to make their own choices about, and there's not much we can do about it except that if we provide more access to productivity-enhancing services everywhere, then people can make choices to stay or to go and have more options. And in some sense, poverty, in my view, is really about not having options, right? If you create more options, people make whatever choices they want to make.

EUGENE STEUERLE: This is just a footnote. I mentioned earlier that if you look at the development of industrial countries ourselves, we had exactly the same issue. We started off with basically farm women moving to the early factories to make clothes and other things. And it's largely because there was a greater return for moving to the factor than there was for staying on the farm. And of course, later on there were other developments which had to do with what happened to the distribution of income and how it was monopolized or whether or not we had competition. There are certain economic forces you can't stop. If there is a greater return from working together with other people in larger-scale industries, then you want to let people do it. And what you want to do, it seems to me, is develop the institutions that are going to allow people to get their fair share of the return, and institutions to create the competition among industries, which are most likely to allow that to happen. But I don't think that making designs to stop people from being able to move – it just seems to me that you can't do it. You're stopping real forces of progress.

EVELYN GONZALES: (inaudible, off-mike) ...rural capitalism, and by now, having so much money and being so rich, we certainly should have been able to distribute the wealth within the United States as well as around the world. But that hasn't happened. Aren't there forces that sometimes hinder that free competition from taking place?

EUGENE STEUERLE: I think there are, but we don't have time to get into it. My very simple view of world economic development is that two things happen. One, you have these enormous economies of scale which actually encourage more monopolistic control over certain things. But in point of fact, to get people to buy goods and services you actually need a more equal distribution of income so that they can buy them. And these things sort of wax and wane depending on developments. That's probably beyond what we can get into here today. You don't want to stop the development from economies of scale because that's where a lot of the growth comes from.

WILLIAM SCHAMBRA: We have time for one last question.

BEN KAUFFELD, USAID: In a related but slightly different vein, I work with USAID in our global development alliance office, and the focus of our office is to seek to identify and help facilitate global development alliances and a form of public-private partnership, too, between the foundation world or the corporate sector. Philanthropy and corporate social responsibility (CSR) are very important initiatives within the private sector, and we do link with that, but I think we try to prioritize trying to find a correspondence between the development objectives we're working towards and core business practices. But beyond that, there seems to be an explosion of interest within the public sector about public-private partnership; you see it with the President's Emergency Plan for AIDS Relief (PEPFAR/Emergency Plan), the Millennium Challenge

Corporation, and domestic branches of the government. So I wanted to ask what your views are about recent initiatives for public-private partnership.

WILLIAM EASTERLY: You said there has been an explosion of demand in the public sector for public-private partnerships. (Off-mike comment from Kauffeld.) I'd be a lot happier if there had been an explosion in the private sector for public-private partnerships. Until that happens, then I think we – you know, development fads come and go, and this is not to dismiss this idea entirely, but the latest fad in aid is public-private partnerships. And you have to ask, exactly what are the incentives of the people involved, and what are their objectives. Do they really have the same objectives? You can easily envision things that you have to be very worried about. Is the private sector only getting involved because they get some cheap publicity stunt that doesn't do good for the poor? Is the public sector just trying to escape responsibility for something that the voters have really commissioned it to do but it is now trying to dump it on the private sector because it is trying to cut its own budget? I think that in all of these things, it's great that new things come along, but we have to be aware of faddism as well.

EUGENE STEUERLE: I don't think there's any one answer to that. I think that public-private partnerships work if each of the partners involved has a different relative advantage and there is some advantage to working together. Most of the people in this room are probably engaged with applying to foundations for money, or applying to different organizations, and often they find that they are writing ten proposals instead of one because no one organization is willing to take responsibility. That's often very inefficient. So I think it varies.

The one question I'd have back to you, and I don't think there's time for you to answer it, is the issue I raised, whether a foundation like Gates can challenge households and businesses to engage pretty entrepreneurial efforts. I gave one example – put up a ten thousand challenge grant for groups that would do \$50,000 development projects that I'm afraid places like AID couldn't do because there'd be this government fear of how to live with a 50 percent failure rate, and how to monitor it, and what to do when the inspector general came in and said that this project over here didn't work. It seems to me that there might be a case, an example, of where maybe the public doesn't work. Some of these people I've mentioned have tried to do things like this. And they were actually called in by Karen Hughes' office in the State Department as a (inaudible) of the stuff they might do, but we couldn't figure out how to engage the State Department or the government to finance it without actually removing some of the advantages we have with household-to-household involvement.

And another question back to you is, what can the foundation sector do that you can't do in AID?

AL HAMMOND: If I may comment as well, also briefly. I should say that I have a GDA with AID, so in some sense I am a beneficiary of this kind of activity. But it's my observation that USAID, despite being more interested in these kinds of things recently – it's sort of the current trend, still doesn't know how they actually use the profit motive effectively. It tends to think of the private sector as somebody who will give away from computers, not see that their role is actually to open markets. But it can work.

I'll give you an example. In Vietnam we are deploying this new, low-cost, rural connectivity network. It's on the ground right now. To do that, we got money from USAID and from AusAID, because USAID didn't have enough on their own. We have Intel and other equipment suppliers involved, and we have a local mobile company involved, a Vietnamese company. We have the provincial government involved. We have a rural development activity involved. It took about two and a half years to get all of the parties together and to get it agreed and to get the money to flow. But it wouldn't have been possible without the development money, because this is a new, untried technology. The carriers are skeptical. The equipment suppliers don't know how to put all of these pieces together to make it work. It took, essentially, a public-private partnership to make that work. We now have ten of the largest multinational mobile companies in the world coming to see this pilot. And if, in fact, it succeeds in the way we hope, we will catalyze hundreds of millions of dollars of investment of private sector money in countries like India, Mexico, Brazil, Vietnam, and maybe Cambodia into building out rural networks, which are both internet access and voice access.

And so that catalytic role of what was a very complicated public-private-government partnership was critical. Ask me in a year for that bottom line, and I can tell you. So I think there is a role. What I find is that the capacity of USAID to actually build these kinds of partnerships that can actually stimulate market activity could be improved. And we all know why that's difficult from inside the government. But without the development money, this pilot could not have happened, and so I think there is a role for bringing several players to do things no one player can do alone.

WILLIAM SCHAMBRA: We always end promptly at two o'clock, which it just about is. Let's thank our panelists for a terrific presentation.

(Applause.)