

June 19, 2007

COMMENTARY

## Bill Gates's Charitable Vistas

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Bill Gates is the richest man in the world, helped create a revolutionary computer software company, and earlier this month collected an honorary degree from Harvard University. But he may not understand the vital role wealth creation plays in society.

In collecting his degree, Mr. Gates delivered a commencement address that focused not on the information age, the rise of personal computers or the relentless efficiency his software has brought to nearly every industry. Instead, he focused on his own personal philanthropy. His implicit theme was that so far what he has accomplished may have been good for him and Microsoft shareholders, but it has been no great contribution to society. He suggested that with a personal fortune of about \$90 billion (including what he has transferred to his foundation) it is time for him to give something back.

I find this perspective hard to understand. By any reasonable calculation Microsoft has been a boon for society and the value of its software greatly exceeds the likely value of Mr. Gates's philanthropic efforts.

Here is a sketch of a simple model of Microsoft's social value. The market value of the company's stock recently hit \$287 billion. In 2006, its revenue was \$44 billion, with earnings of \$13 billion. This money was generated by creating something consumers value. Only Microsoft's competitors could believe that this much market value, revenue and earnings would have been created by delivering products that have little value to society.

Suppose that a copy of a new version of Windows sells for \$50 (and is typically charged as part of the price of a personal computer). Microsoft's revenue from Windows would then equal \$50 multiplied by the number of copies consumers snap up. Microsoft's earnings are the revenue less production and development expenses. But that's not the social value. That comes from the increase in productivity created when businesses and households use the software. The social benefit equals the value of the extra product, less the total paid for the software. Almost by definition, the benefit has to be positive. Otherwise, why would consumers willingly pay for

Windows?

A conservative estimate, in a model where software serves as a new variety of productive input, is that the social benefit of Microsoft's software is at least the \$44 billion Microsoft pulls in each year. When capitalized with the same ratio (22) that the market applies to earnings, this flow corresponds to a valuation of \$970 billion. Thus, through Microsoft's future operations, Mr. Gates is creating a benefit to the rest of society of about one trillion dollars -- or more than 10 times his planned donations. And this counts only the likely future benefits, giving no weight to the past.

Mr. Gates has pointed out that it's difficult to give away such a large sum of money in a productive way. This isn't exactly true. He could cut a \$300 check to everyone in the U.S., or donate the money to the U.S. Treasury with the aim of reducing the national debt. The last method is easier but has different effects on income distribution.

But Mr. Gates's plan is, instead, to use the Bill and Melinda Gates Foundation to reduce world poverty, with an emphasis on advances in health. This is a noble goal. But it will likely just supplement the much larger existing programs of aid and debt relief that have been carried out for many years by international organizations and governments. These programs have, at best, a checkered record. Although Mr. Gates is probably smarter and more motivated than the typical World Bank bureaucrat, he likely won't do much better.

To find policies that are likely to alleviate poverty, it is best to look at actual successes and failures. In recent decades, the biggest single accomplishment is the post-1979 (post-Mao) economic growth in China. Xavier Sala-i-Martin ("The World Distribution of Income," *Quarterly Journal of Economics*, May 2006) finds that the number of persons below a standard poverty line fell in China by about 250 million from 1970 to 2000. This massive poverty reduction occurred despite an increase in the Chinese population of more than 400 million and rising income inequality within China. The second-best story is the economic growth in India, where the poverty count fell by around 140 million people from 1970 to 2000.

Also illuminating is the greatest tragedy for world poverty -- the low economic growth in sub-Saharan Africa. In this case, the number of people in poverty rose by around 200 million from 1970 to 2000.

These examples suggest that the key question for poverty alleviation is how to get Africa to grow like China and India. An important clue is that the triumphs in China and India derive mainly from improvements in governance, notably in the opening up to markets and capitalism. Similarly, the African tragedy derives primarily from government failure. Another clue is that foreign aid had nothing to do with the successes and did not prevent the African tragedy.

One reason for this is that foreign aid is typically run through governments and, thereby, tends to promote public sectors that are large, corrupt and unresponsive to market forces. Perhaps the Gates Foundation will run more efficient aid programs than we've seen in the past, but I wonder.

Ironically, Mr. Gates's inspiration to "give back" apparently comes from the world's second richest person, Warren Buffett, who recently promised to donate much of his fortune to the Gates Foundation.

I say ironic because one can make a much better philosophical case for a give-back of Mr. Buffett's \$52 billion than for Mr. Gates's \$90 billion. Mr. Buffett's money came mostly from being a good stock picker. Whether his fortune is the product of luck or skill, the social benefits are hard to pin down. These benefits have to derive from improving company management practices or investment decisions.

Of course, Mr. Gates is free to do what he wishes with his \$90 billion. But I think he is kidding himself if he believes that the efforts of the Gates Foundation are likely to provide society anything like the past and future accomplishments of Microsoft. And, frankly, I would have preferred to get the \$300 per person "Gates Grants."

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