1-1-2010

Making Capitalism More Creative: The Tempestuous Marriage of Sentiment and Self-Interest

Sumeet H. Chugani
*Diaz, Reus & Targ, LLP*

Xingjian Zhao
*Diaz, Reus & Targ, LLP*

Follow this and additional works at: [http://digitalcommons.mcgeorge.edu/globe](http://digitalcommons.mcgeorge.edu/globe)

Part of the [Law and Economics Commons](http://digitalcommons.mcgeorge.edu/globe)

Recommended Citation
Available at: [http://digitalcommons.mcgeorge.edu/globe/vol22/iss2/11](http://digitalcommons.mcgeorge.edu/globe/vol22/iss2/11)

This Article is brought to you for free and open access by the Law Review at Pacific McGeorge Scholarly Commons. It has been accepted for inclusion in Global Business & Development Law Journal by an authorized administrator of Pacific McGeorge Scholarly Commons. For more information, please contact msharum@pacific.edu.
Making Capitalism More Creative: The Tempestuous Marriage of Sentiment and Self-Interest*

Sumeet H. Chugani** and Xingjian Zhao***

I. THE EPIPHANY: CHINA KING BUFFET

We sipped our certified Starbucks® fair-trade coffee. Weren’t we benevolent? It had been five straight hours of writing about the potential at the “bottom of the socio-economic pyramid.” It had been five straight hours of talking about the value that recognition could bring to agents who may partake in changing the face of capitalism, and in turn, the face of poverty. We wrote the last line before stuffing our stomachs with food: “Living in America, this ‘rational nature’ may be further stonewalled by the sight of irresponsible actions and habits of what we label as ‘poor people.’” . . .

We arrived “starving.” The realization that we had just eaten five hours earlier did not cross our minds. We still used the verb “starving” with the belief that this was what starvation entailed. Even with this “starvation” hitting our guts, we scrutinized the buffet to ensure that it met our strict capitalistic ideals about “getting our bang for the buck.” We decided, “good enough.” By our third plate of food we were joking about how full we were, shoving more noodles into our mouths. “Getting our bang for the buck.” Fulfilled we were.

The door swung open. The narrative changed. We fell silent, only to hear jumbled phrases and a slurred monologue. This jumbled speech slowly made its way to our table. IT stood there. First, staring intently at our full

---

* This article is part of a Symposium issue containing papers originating in a conference entitled, “Critical Intersections for Energy & Water Law: Exploring New Challenges and Opportunities.” The Conference, which was held in Calgary, Alberta, May 20-21, 2009, was co-sponsored by the University of Calgary Faculty of Law, the Pacific McGeorge Institute for Sustainable Development, and the UNESCO Centre for Water Law, Policy, and Science, University of Dundee. Additional papers from this conference can be found elsewhere in this Symposium issue as well as in a companion volume to be published by the International Bar Association in the Journal of Energy & Natural Resources Law.

** Sumeet H. Chugani is an associate at Diaz, Reus & Targ, LLP and concentrates his practice in international litigation and cross-border transactions. Mr. Chugani holds a law degree from the University of North Carolina at Chapel Hill and a bachelor of arts from North Carolina State University.

*** Xingjian Zhao is a law clerk at Diaz, Reus & Targ, LLP and focuses his research on issues of international commercial litigation. Mr. Zhao attends law school at the University of North Carolina School at Chapel Hill and holds both a bachelor and master of arts from the State University of New York at Binghamton. The authors would like to thank Professor Saule T. Omarova of the University of North Carolina School of Law for her mentorship and guidance throughout their law school career and for inspiring them to pursue this timely topic.

The authors reserve their deepest gratitude to Bill Gates, whose transformative visions nearly surpass his purchasing power—but not quite.
plates, then moving to our eyes. We shifted our gaze, fearing direct eye contact, fearing understanding, fearing the truth. With a sigh of relief we looked up and *it* was gone. The 5'3” dark obese frame had moved on to the next table. For the next four minutes we ate in peace. "*Carrboro man . . . either get hippified or mugged.*" "Damn, right." Less than five minutes later, *it* returned. This time the slurred speech could be made out. "Give me your plate so I can get som’n to eat." One of us had the audacity to respond, "*there is a full buffet right there.*" We both had an extra fifty bucks in our wallets. Fifty bucks of *our* money, not for *it*. The Chinese waitress intervened, threatening to call the police. *It* stated that she was with us. We kept silent. We thought she "*must be a regular at this joint . . . ha ha ha.*" Seemingly, the waitress knew exactly how to handle the situation. She yelled, "*You want food, you give me money.*" Capital. Capital. Capital. She yelled repeatedly to the face of what we connoted as a "poor person" seeking to tap into our benevolence. *Yah, right.* She got kicked out. Fifty bucks still sat in our wallets. Undisturbed. Still got enough for a wild night out. Never enough for *it*. *What the hell just happened?*

At this very moment, despite our idealist rhetoric of the past two and a half months, we were nothing more than stonewalled, free market, exploitation-driven capitalists. We had failed to realize the intrinsic values of recognition, benevolence, or human dignity. Instead, we succeeded in realizing only the value of cold-hard capital. We defended it with our might, our ink, and our tongue. We sacrificed more than seventy hours of research, believing in the efficacy of Bill Gates’s vision for a more "creative capitalism." Believing that we were different—that we were about to make an impact. Damn. We failed.1

II. ABSTRACT

Writing in the depth of the Great Depression, John Maynard Keynes astutely noted:

The decadent international but individualistic capitalism, in the hands of which we found ourselves after the War, is not a success. It is not intelligent, it is not beautiful, it is not just, it is not virtuous—and it doesn’t deliver the goods. In short, we dislike it and we are beginning to

1. Receipts from: China King Buffet, 301 E. Main St., Carrboro, NC.
despise it. But when we wonder what to put in its place, we are extremely perplexed.²

Recently, criticism of traditional free-market capitalism has regained social and political salience as the global financial markets descended into a winter of discontent. Although the ideological debate over capitalism has withstood the Iron Curtain’s fall, the arguments presented by both sides have since evolved. This debate has experienced a paradigm shift as the financial markets of emerging Asian and Eastern European economies struggled to attain the maturity and self-sufficiency of their Western industrialized counterparts. Both viewpoints are no longer—and can no longer be—mutually exclusive and diametrically opposed. Capitalism’s triumph and communism’s demise been thought to constitute the end of history.³ Now, efforts are being made to stem capitalism’s negative externalities.

This article discusses one such means of rectifying capitalism’s adverse impact on the world’s “bottom billion.” Microsoft founder and former CEO Bill Gates, together with many prominent economists, have conceptualized this rectification as the delicate balance between our rational self-interest for profitable returns and our inherent sentiment for benevolence through the capitalization of positive “recognition.”

III. DEFINING CAPITALISM

The definition of capitalism has evolved over time. Capitalism, as it is understood today, encapsulates Adam Smith’s notion of rational self-interest guided by “an invisible hand” to direct industry in a profit-maximizing manner. Although the selfish individual intends to promote his own gain, by doing so, he frequently dictates an end that benefits society as a whole.³ Or, to put it another way, “to promote an end which was no part of [the agent’s] intention . . . by

³. See, e.g., FRANCIS FUKUYAMA, THE END OF HISTORY AND THE LAST MAN 51 (1992) (“[I]f we are now at a point where we cannot imagine a world different from our own, in which there is no apparent or obvious way in which the future will represent a fundamental improvement over our current order, then we must also take into consideration the possibility that History itself might be at an end.”). Here, Fukuyama further argues that “liberal democracy may constitute the ‘end point of mankind’s ideological evolution’ and the ‘final form of human government,’ and as such constitute[s] the ‘end of history.’” Id. at xv. Additionally, he asserts that liberal democracy helps further “the logic of modern natural science,” which is in turn “an economic interpretation of historical change” leading to “capitalism rather than socialism as its final result.” Id. Consequently, Fukuyama directly links liberal democracy with capitalism. This synergy represents the endpoint for the evolution of economic systems.
pursuing his own self-interest he frequently promotes that of the society more effectually than when he really intends to promote it."\(^6\)

Nearly a century later, Karl Marx dismissed the notion that capitalism allows a society to thrive.\(^7\) Marx criticized Adam Smith’s conjecture. Marx deemed Smith’s “invisible hand” theory a zero-sum game that imprisons the individual within the institutions of labor, shocking workers to the factory floor to perform profit-maximizing labor from which they derive no self-interest beyond necessities for sustenance and reproduction.\(^8\)

At the height of the Cold War, Milton Friedman defined and defended capitalism by associating it with the political ideals of social democracy and individual liberty.\(^9\) For Friedman, capitalism acts as “…the organization of the bulk of economic activity through private enterprise operating in a free market—as a system of economic freedom and a necessary condition for political freedom.”\(^10\) During Ronald Reagan’s presidency in the 1980s and under his trickle-down “Reaganomics” reform policies, author Ayn Rand echoed Adam Smith’s ideas. Rand argued that capitalism is and always will be “the only system consonant with man’s rational nature, it protects man’s survival qua man, and its ruling principle is: justice.”\(^11\)

The modern definition of capitalism has shed its former ideological veil in exchange for practicality. “Freedom” and the “rational nature of man” gave way to “a system for organizing production which is based upon the institutions of private property and the market, and which relies upon the pursuit of private

---

6. Id. at 184.

7. See generally KARL MARX & FREIDRICH ENGELS, THE COMMUNIST MANIFESTO (Penguin Classics 2002) (1888), available at http://www.marxists.org/archive/marx/works/1848/communist-manifesto/ (arguing that capitalism, like formerly prevalent socioeconomic systems, will produce internal tensions that will lead to its eventual destruction. Just as capitalism replaced feudalism, capitalism itself will be naturally displaced by communism, a classless society which emerges after a transitional period—socialism—in which the state would be nothing else but the revolutionary dictatorship of the proletariat).

8. See KARL MARX, THE ECONOMIC AND PHILOSOPHICAL MANUSCRIPTS OF 1844 73 (Martin Milligan Trans., Prometheus Books 1988) (1844), available at http://www.marxists.org/archive/marx/works/1844/manuscripts/preface.htm (“It is true that labor produces for the rich wonderful things—but for the worker it produces privation. It produces palaces—but for the worker, hovels. It produces beauty—but for the worker, deformity. It replaces labor by machines, but it throws one section of the workers back into barbarous types of labor and it turns the other section into a machine. It produces intelligence—but for the worker, stupidity, cretinism.”).

9. See MILTON FRIEDMAN & ROSE FRIEDMAN, CAPITALISM AND FREEDOM 4 (University of Chicago Press 2002) (1962) (arguing that out of political necessity, the U.S. capitalized on the seemingly incestuous relationship between democracy and capitalism to suggest that capitalism is the sole path to freedom.) This argument is questionable. Modern empirical evidence suggests that capital markets can thrive in the absence of genuine democracy and that the presence of democratic institutions do not necessarily give rise to capitalism. Different economic and political regimes, including the democratic socialism of Scandinavian states, the consensus politics of Japan, and the state-sponsored industrial growth of China and South Korea, all coexist with capitalism.

10. Id.

Near the end of the Cold War in 1989, American political economist Francis Fukuyama conjectured that “no other path towards full economic modernity has proven to be viable.” In Fukuyama’s view, capitalism has won and has inevitably emerged as the dominant system of production for all nations.

Unlike Marx, who believed that capitalism is a primitive stage in our inevitably Hegelian social advance towards communism, Fukuyama labels capitalism as the “end of history.” Due to the current global economic crisis, many are, once again, expressing their disenchantment with capitalism’s harsh negative externalities. The forum for debate over capitalism’s efficacy and viability has once again been opened. However, the adversaries in this new ideological battle no longer consist of the polarized ideologies of communism versus capitalism.

The question is no longer whether capitalism will stand the test of time, but how it must alter with the times.

IV. WHY ALTER THAT WHICH WORKS?

Capitalism is a double-edged sword. While empowering the modern “bourgeois,” it has also aggravated the world’s inequities. While parts of East Asia prospered, inhabitants of Sub-Saharan Africa led lives “barely worth living” by Western standards. Are these inequities necessary evils for the benefit of the majority leading lives “worth living?” Today, the one billion people who subsist on less than one dollar a day make up no more than 1.5% of the world’s purchasing power. If everyone in this “bottom billion” died tomorrow from poverty-related causes, would we acknowledge that capitalism has failed? Would we dismiss the fundamental premise under which our markets run as futile? Perhaps. But how many days would it take the Dow to rebound? How many trades would go through without impact? What if a “mere” 25,000 people

13. Fukuyama, supra note 3, at 97. But see KARL MARX, DAS KAPITAL VOL. I (1861), available at http://www.marxists.org/archive/marx/works/1867-71/ (arguing that capitalism is destined to fail, giving way to socialism and finally communism).
15. Fukuyama bases this phrase on the Hegelian lectures on the philosophy of history, where “[w]orld history... represents the development of the Spirit’s consciousness of its own freedom and of the consequent realization of that freedom.” GEORGE W.F. HEGEL, LECTURES ON THE PHILOSOPHY OF WORLD HISTORY 138 (1975).
17. See, e.g., id.
perished? This is the number of people who perish everyday due to malnutrition, disease and other poverty-related causes.

**FIGURE 1**

![Share of world's private consumption, 2005](image)

Bill Gates called attention to this “bottom billion” at the 2008 World Economic forum in Davos, Switzerland. During his speech, Gates outlined a new approach to capitalism that synergizes sentiment and self-interest for the benefit of those who are inevitably left behind by the current capitalist norms. Gates coined this new approach as “creative capitalism,” defining it as “an approach where governments, businesses and non-profits work together to stretch the reach of market forces so that more people can make a profit and gain recognition doing work that eases the world’s inequities.” Gates believes that well-capitalized corporations with the ability to reach “untapped” market forces can not only profit from these markets through traditional capitalist means, but can also maximize returns through the positive recognition that they receive from

---

20. *Id.*
21. *Id.*
conscious consumers who perceive the corporation’s acts to be benevolent. Through such incentives, Gates believes that corporations, driven by sheer self-interest, will produce positive externalities that benefit the bottom billion. This results in a “system where incentives for both profit and recognition motivate self-interest and caring for others.” Under creative capitalism, profit-maximization and the alienation of labor need not coexist as profane twins.

For example, in the absence of government intervention, remote villages that have never had telephone wiring or the infrastructure to build land lines can bridge the digital divide through the widespread promotion of cell phone use. Marketing cell phones to low-income consumers creates a new, profitable market for the phone company. Under C.K. Pralahad’s “single-serve revolution,” a product can be adjusted, by making unit packages that are small, so that it is more affordable for the low-income consumer and conforms to these individuals’ sporadic use. This reduces costs on both sides, while new markets — and new profit potentials — emerge.

Another approach involves government intervention into the pharmaceutical market. A pharmaceutical company could develop a drug to treat a long-neglected disease of the poor, or engage in tiered pricing by selling drugs to third-world consumers at cheaper rates. The companies could do this in exchange for an expedited government review process for other more profitable drugs that they produce. For example, the FDA can offer pharmaceutical companies expedited approval for a more market-salient commercial drug of their choice (e.g. one aimed at reversing baldness) in exchange for keeping the prices of malaria vaccines in sub-Saharan Africa artificially low. This would all be in conformity with the pharmaceutical companies’ rational self-interest and motives for profit maximization.

Gates’s idea is not new. Four years before Gates’s speech in Davos in 2008, Pralahad envisioned an “approach to help the poor, an approach that involves partnering with them to innovate and achieve sustainable win-win scenarios where the poor are actively engaged and at the same time the companies

---

22. Id.
23. Id.
26. See id. (noting that even in remote areas the cell phone towers handle thousands of calls a day).
29. See id.
30. See, e.g., PRALAHAD, supra note 27. See generally, STUART L. HART, CAPITALISM AT THE CROSSROADS xi (2007) (defining “sustainable global enterprise” as “the potential for a new private sector-based approach to development that creates profitable businesses that simultaneously raise the quality of life for the world’s poor, respect cultural diversity, and conserve the ecological integrity for future generations.”).
producing products and services to them are profitable.” Gates’s “creative capitalism” attempts to achieve the same goal. Under Pralahad’s model, however, the role of government is at best negligible, for he is more wary of increasing government intervention in the capital markets. Gates claims that Microsoft has used corporate philanthropy for the past twenty years as a means of bringing technology to the people who do not have access to it. By donating three billion dollars in software and cash to bridge what he deems “a digital divide,” Gates has sought to use technology to “create solutions” for the bottom billion.

One example of Microsoft’s philanthropy is a special text-free user interface being developed to help illiterate or semi-literate people use computers with minimal training or assistance. Other companies have created similar programs in attempts to maximize profit by capitalizing upon the public’s increased recognition of their benevolent acts. It remains to be seen whether the benefits of such recognition will outweigh the cost of attainment, and whether such acts, in the aggregate, hold the potential to make capitalism more creative. However, to attain a deeper understanding of the cost-benefit structure of making capitalism more creative, one must analyze all arguments for and against Gates’s theory in a critical light.

V. THERE IS HOPE . . . HOW THYMOTIC PRIDE WILL TRANSFORM CAPITALISM

Adam Smith, the father of laissez-faire, “dog-eat-dog” capitalism, conceded that human beings are driven to act upon more than rational self-interest alone. He explains that “[however] selfish man may be [], there are evidently some principles in his nature, which interest him in the fortunes of others, and render their happiness necessary to him, though he derives nothing from it, except the pleasure of seeing it.” Gates’s theory centers on these very principles of our nature by capitalizing upon the fact that consumers recognize and derive “pleasure” from what they perceive to be benevolent corporate altruism and social responsibility. The harsh realities of market forces, combined with private corporations’ fiduciary duties to maximize shareholder profit by catering to the wealthier classes, have created an unmovable ceiling for the bottom billion.

With the bottom billion accounting for a mere 1.5% of the world’s purchasing power, it would be a violation of fiduciary duty to partake in the risk of catering to the impoverished participants of this negligible market at their shareholders’ expense. Under traditional capitalism, markets without commerce

31. PRALAHAD, supra note 27, at 3-4.
32. See id. at 7.
34. Id.
35. Id.
36. ADAM SMITH, THE THEORY OF MORAL SENTIMENTS 3 (1853).
have zero potential. This self-defeating cycle contravenes capitalism's core principles. Bill Gates's theory effectively reverses this cycle. Without doing so, Fukuyama's claim that capitalism's triumph is the "end of history" cannot be justified on account of the billions who are "left behind" and who will never be capable of rooting themselves in a competitive marketplace.

Fukuyama's claim that capitalism is the "end of history" does not include the end of social change. Instead, Fukuyama believes that people have "thymotic pride" in their own self-worth, and cannot be contented by the lures of non-democratic market-oriented authoritarianism. Individuals, through an evanescent "struggle for recognition" which transcends hedonistic temptations, have a perpetual thirst for freedom. Corporations, as artificial entities, cannot possess thymotic pride; but their officers, shareholders, and customers do possess it. Corporations can transmute this pride into capital by conducting themselves in ways deserving of public recognition. Whether selling cheap electronics to the bottom billion or in making vital vaccines more accessible and affordable in Sub-Saharan Africa, corporations can profit from their sales, but also through shareholders' and customers' recognition of their commendable acts. This process can succeed because the thymotic pride of shareholders and consumers is not limited to liberal economic principles; it involves "irrational forms of thymos as well."

In the global marketplace, evidence suggests that sentiment and self-interest can coexist to maximize corporate profit without undue risk to corporate welfare or undue reliance by the beneficiaries. For example, in developing nations such as India, the poor often cannot use cash to inventory convenience, or to purchase in bulk the way the rich can. Entrepreneurs recognized this problem and began a marketing movement known as the "single-serve revolution," where the same upscale products that the rich purchase in bulk are sold to the poor in small satchels. And because "the poor are just as brand-conscious as the rich," the corporation profits from reaching into an untapped market while consumers' purchasing power is strengthened by their obtaining much-desired access to goods and services. Such mutual relationships can lead to information

38. See generally FUKUYAMA, supra note 3, at 31 (describing social change in Russia after the fall of communism).

39. Id. at 165 (describing thymos as "something like an innate human sense of justice: people believe that they have a certain worth, and when other people act as though they are worth less - when they do no recognize their worth at its correct value - then they become angry.").

40. See id. at 31.

41. See id. at 145-46.

42. Id. at xx (this irrational form of thymos can conceivably include the increased sense of self-worth attained through knowledge of one's association with an entity that engages in benevolent acts).

43. PRAHALAD, supra note 27, at 16 (observing that the poor do not have sufficient purchasing power to buy products in bulk and are thus unable to take advantage of bulk pricing or enjoy the reduced costs of transporting goods less frequently).

44. Id. at 17.

45. ADAM SMITH, THE WEALTH OF NATIONS, supra note 5, at 23. Adam Smith puts forth a pessimistic
efficiencies, as well as increased incentives for consumers to self-capitalize. Through this self-capitalization, the bottom of the pyramid ("BOP") poor are elevated in status to viable consumers in the global marketplace.

The social significance of this form of empowerment extends beyond the economic calculus. For example, when Amul, an Indian dairy company, introduced ice cream at a very low price, not only were the BOP consumers able to afford and purchase the ice cream, but they also benefited physically from the nutritional value of the milk. BOP consumers also acquire privileges formerly reserved for the middle and upper classes. As Prahalad notes:

The traditional approach to creating the capacity to consume among the poor has been to provide the product or service free of charge. This has the feel of philanthropy . . . [Charity] might feel good, but it rarely solves the problem in scalable and sustainable fashion . . . By focusing on the BOP consumers' capacity to consume, private-sector businesses can create a new market.

A critical requirement of creating this new capacity to consume is the "ability to invent ways that take into account the variability in the cash flows of BOP consumers that makes it difficult for them to access the traditional market for goods and services oriented toward the top of the pyramid." Bill Gates does not seek to detract from the fundamental capitalist principles of competition, profit maximization, and free markets. Instead, he seeks to add the dimension of sentiment, part of man's rational nature as recognized by Adam Smith. Sentiment leads to recognition. Recognition leads to capital. Capital fulfills the ends of capitalism. If capitalism is to persist to eternity as "the end of history," then there must be an everlasting search for untapped potential. This untapped potential now bears the deceptive countenance of impoverishment. When corporations fail to acknowledge this treasure trove—the untapped potential—at the bottom of the socioeconomic pyramid, they in turn fail as profit-maximizing free market capitalists. When capitalism is made more creative, capitalism will flourish.

---

view of the prospect of transforming the impoverished into a vibrant consuming class. He argues that "[a] very poor man may be said in some sense to have a demand for a coach and six; he might live to have it; but his demand is not an effectual demand, and the commodity can never be brought to market in order to satisfy it." *Id.* at 49. *But see* Prahalad, supra note 27, at 17 (noting that a product must be marked in accordance with the purchasing power of the target consumer. The poor man may not be able to buy a coach and six, but be might be able to buy a simple wagon).

46. Prahalad, supra note 27 at 18-19.
47. *Id.*
48. *Id.* at 16-19.
49. *Id.* at 19.
VI. BUT WE LIVE IN REALITY: WHY CREATIVE CAPITALISM WILL NOT WORK

Recent corporate scandals, economic downturns, and extensive conflicts of interest among labeled “guardians of the market” are forcing individuals to ask whether there are two paths in the market economy: one for the rich and one for everyone else. We are living in the midst of a dangerous hangover, the morning after the ecstasy of a boom. Many feel betrayed by what they have determined as capitalistic ideals gone awry. This hostility towards capitalism is seeping into the masses and disparages any rational judgment that one may place on capitalism’s actual economic and social benefits. This “after-effect” also spotlights the already pervasive claim that the existence of one billion starving individuals makes capitalism unjust. Despite its negative externalities, however, capitalism has not only survived, but thrived.

According to Fukuyama, capitalism has emerged victorious after the collapse of the Soviet Bloc and the corresponding failure of communism. For Fukuyama, capitalism now stands as the “end of history,” where “the unfolding of technologically driven economic modernization creates strong incentives for developed countries to accept the basic terms of the universal capitalist culture . . . [n]o other path toward full economic modernity has proven to be viable.” Our innate rational self-interest can only be compatible with capitalism. Adam Smith would designate capitalism as the economic system based on competitive markets best suited to represent human nature and provide the vital route to material advancement. This designation holds true for both developed and developing nations. The economic revitalizations of South Korea and India illustrate that capitalism is the best system for achieving economic advancement. Capitalism and free markets have proven to be more effective at

50. To play devil’s advocate to a man which seeks to help the bottom of the pyramid, and alter the hard-fast capitalistic ideals which he believes has put more than one billion people in a detrimental state, may portray the writers of this piece as hard-fast conservative, Fox-News only, equal-tax payment, type of individuals. This is not the case. Although our ideals represent moderation on the political scale, we do not consider benevolence to be a negative instrument either on the social or capitalistic side. Nor do we believe that we must eradicate social justice and equality for capitalism to thrive. However, Bill Gates’s concept contains several fundamental flaws and overlooks many of the positive effects of laissez-faire capitalism. These flaws must be elucidated in order to create a formulated capitalism that would not only conform to the fundamental premises of Adam Smith, but complete Fukuyama’s theory that Capitalism will withstand future attacks. The first premise necessitates that we query whether capitalism is in need of repair; whether capitalism is in fact broken.


52. See generally GEORGE REISMAN, CAPITALISM: A TREATISE ON ECONOMICS 1-7 (1995) (discussing various criticisms of capitalism).

53. FUKAYAMA, supra note 3, at 26-33.

54. Id.

55. Id. at 96-97.


57. Allan H. Meltzer, Professor of Political Economy at Carnegie Mellon University, 2008-2009
social development and poverty reduction than any other economic planning system. As Friedman aptly noted, the "invisible hand has been more potent for progress than the visible hand for retrogression."9

This is true whether capitalism is implemented by a democratically elected government, like India, or by an authoritarian regime such as China or the former Soviet Union.60 Sustained and widespread economic growth is absent from genuinely communist or socialist regimes.61 As Posner states, "China and India were able to lift themselves by their bootstraps once they got rudiments of competent and market-friendly government in place...[while] Africa’s development slowed when the colonial governments were replaced by less efficient indigenous ones."62 The great experiments in non-capitalist economies have failed. With few exceptions, practitioners of alternative market systems have abandoned those systems in favor of some form of capitalism. Furthermore, the natural shift towards capitalist ideals, such as China’s new legislation protecting private property ownership, is indicative of capitalism’s resilience.63

Within the United States, progress continues. Americans are now better fed, better clothed, and better housed; class and social distinctions have narrowed and traditionally discrete and insular minority groups have become less disadvantaged and more empowered.64 This has been the “product of the initiative and drive of individuals cooperating through the free market.”65 Nations following suit reaped similar benefits.

Bradley Lecture Series: Why Capitalism? (Mar. 9, 2009), available at http://www.aei.org/speech/100022. Fukayama, however, would disagree with this assertion, rather arguing that capitalism must exist in conjunction with liberal democratic ideals; the people’s struggle for recognition will not cease and their thymotic pride will not falter until they are free. FUKAYAMA, supra note 3, at 26-33.

58. Meltzer, supra note 57.
59. FRIEDMAN, supra note 9, at 200.
60. See Meltzer, supra note 57.
61. Id. Such regimes include Cuba, Laos, North Korea and Vietnam. Due to the implementation of a market economy in the late 1970's and the recent constitutional protection of private property rights, China does not constitute a genuine communist regime. See FRIEDMAN, supra note 9, at 3-4 (stating that the world’s advances are driven by capitalism - “[t]he great advances of civilization, whether in architecture or painting, in science or literature, in industry or agriculture, have never come from centralized government. Columbus did not set out to seek a new route to China in response to a majority directive of a parliament, though he was partly financed by an absolute monarch. Newton and Liebnitz; Einstein and Bohr; Shakespeare, Milton, and Pasternak; Whitney, McCormick, Edison, and Ford; Jane Addams, Florence Nightingale, and Albert Schweitzer; no one of these opened new frontiers in human knowledge and understanding, in literature, in technical possibilities, or in the relief of human misery in response to governmental directives. Their achievements were the product of individual genius, of strongly held minority views, of a social climate permitting variety and diversity.”)
64. FRIEDMAN, supra note 9, at 199.
65. Id. at 200.
In *Capitalism and Freedom*, Friedman argues that “[e]quality of opportunity is equality before the law.”[66] Consequently, undue governmental interference in private enterprise disturbs the delicate balance through which businesses can independently prosper. Although well-intentioned, Gates’s “creative capitalism” envisions an institution in which government intervention is the norm rather than the exception. By injecting collectivized welfare into the private sector, Gates risks creating a disturbing state of entropy where social status is not determined by merit, but by mere entitlement based on class characteristics. Consequently, placing socialist ideals into private enterprise is not only economically unsound but socially regressive. Such a system alienates the individual from his or her “natural” freedom to choose.[67]

A recent study comparing growth across nations according to an index of “freedom” suggests that per-capita income is rising rapidly in “freer” nations, while such income in nations that are “not free” were stagnant.[68] By assessing the size of government, legal structure, access to liquidity, openness to trade and regulation, the study determined that per-capita income rose at a compound rate of 3.44% in the “freest” nations, as compared to an average growth of 0.37% in nations that are “not free.”[69] The study notes that the “freer” nations had higher investment activity, greater productivity, more foreign direct investment, and respect for the rule of law.[70] It can be argued that wealth creation is the sole catalyst for “freedom,” or that the relationship between “freedom” and capitalistic ideals is either coincidental or caused by an outlier. Nonetheless, Friedman would assert that these findings indicate that leaving the “ethical problems for the individual to wrestle with,” as envisioned in a free and capitalistic society, enables a nation to flourish.[71] That is, if political reform gives “people the [right to] vote, they would do [what’s] good for them, which [is] to vote for laissez-faire.”[72]

---

66. See id. at 195.
67. See generally Isaiah Berlin, Professor of Social and Political Theory, Lecture at the University of Oxford: Two Concepts of Liberty (Oct. 31, 1958) (Under Berlin’s model, freedom is denoted as a synergy between both positive liberty (freedom to) and negative liberty (freedom from)).
68. Meltzer, supra note 57.
69. Id.
70. Id.
71. FRIEDMAN, supra note 9, at 12
72. Id. at 10 (emphasis added).
As Figure 2 indicates, freedom appears to correlate with capitalism. Practically all nations denoted as “free” are capitalist. For the few nations that are capitalist but “not free,” Fukuyama notes that their citizens will continue to struggle for recognition. Such a struggle and corresponding social betterment will not cease until freedom and capitalism coexist. Under Gates’s model one of two scenarios are possible. Under one scenario, no freedom of choice is deprived if businesses determine, through rationally self-interested deliberation, to “accept subnormal monetary returns in exchange for getting a good reputation as do-gooders.” However, absent government coercion, no rationally self-interested business would make this exchange in the free market. Therefore, the second alternative is government intervention into the private sector.

In this scenario capital is artificially diverted from corporate shareholders, customers, and employees and given to outside “stakeholders” merely because they are part of “the bottom of the socioeconomic pyramid” within a nation that is “not free.” However, these stakeholders do not derive sustainable benefit

74. See id.
75. See Fukuyama, supra note 3, at 145-146.
76. Gates, supra note 4.
77. Richard Posner, What’s so Bad About Poverty?, in Creative Capitalism, supra note 62, at 297-304 [Hereinafter “Posner II”].
78. Gates, supra note 4.
79. Prahalad, supra note 27.
from this form of benevolence. In the long-run, their purchasing power in the
global economy will remain stagnant. The solution is more complex.

In order for these individuals to stay out of the “bottom billion,” a radical
change in underlying institutional structure is needed. Gates’s theory will not be
enough; it may even reduce the pressure to reform within these respective
nations.

In a capitalist market, no player is an island. Corporations must be cautious
of the impulse to gain recognition from benevolence at the expense of violating
fiduciary duties. Corporations cannot use the banner of benevolence to recklessly
infringe on their shareholders’ freedom to invest in objects of their choice.
Milton Friedman stated that the sole responsibility of a corporation is to increase
profits and maximize value for its shareholders. Whenever the corporation
abandons profit maximization in favor of benevolent acts the corporation is
effectively spending someone else’s money to promote nebulous social interests.
“Insofar as [the executives’] actions raise the price to consumers, he is spending
the customer’s money. Insofar as his actions lower the wages of his employees,
he is spending their money.” In addition, the “justification for permitting the
ultimate executive to be selected by the stockholders is that the executive is an
agent serving the interests of his principal.”

Gates’s theory, if implemented solely for eleemosynary reasons, creates
negative externalities. Even if creative capitalism leads to increased profits, any
opportunity costs arising from the neglect of more lucrative endeavors still
constitutes a breach of fiduciary duty. Claiming to defend free enterprise while
preaching that “business is not concerned ‘merely’ with profit but also with
promoting desirable ‘social’ ends; that business has a ‘social conscience’ . . . [is]
preaching pure and unadulterated socialism . . . [which undermines] the basis of a

80. See generally MIRIA PIGATO, THE WORLD BANK, AFRICA REGION WORKING PAPER SERIES NO. 15,
wp15.pdf. At this time, institutional barriers may present insurmountable obstacles to creative capitalism’s
success. For example, there are considerable variations in FDI and import-oriented legislation across Africa. For
example, “[i]n the Republic of Congo, investors from outside the Central African Customs and the Economic
Union (UDEAC) region have to deposit 1% of invested capital. In Gambia, investors have to go through several
government departments to get their applications approved . . . Mozambique reserves several activities for the
public sector and encourages local equity participation, even in EPZs . . . In Uganda, potential investors have to
establish that the project generates economic benefits like foreign exchange, employment, use of local raw
materials, or technology transfer.” Id. Even if the foreign governments allowed entrance into these “backward”
and unstable nations, many nations support some form of taxation, which could defeat Gates’s purpose of
getting low cost items to the citizens of these impoverished nations. Before corporations can implement Gates’s
theory, there must be stability within the import regime in Africa. See id.

81. See generally THOMAS MERTON, NO MAN IS AN ISLAND (1955) (a general discussion on the need for
human social interaction and happiness).

82. Milton Friendman, The Social Responsibility of Business is to Increase its Profits, N.Y. TIMES, Sept.
13, 1970 [hereinafter Friendman II].

83. Id.

84. Id.

85. See Gates, supra note 4.
Friedman argues that stockholders, customers, and employees can independently invest in charitable causes. Benevolent action undertaken by a corporation on behalf of these individuals, and consequently spending their money, deprives them of the freedom to fund their preferred benevolent ideals. A corporation's by-laws and articles of incorporation clearly outline the roles and responsibilities of the "Executive Committee." A delicate balance is disturbed if an executive deviates from his or her fiduciary duties by overindulging in philanthropy. By deviating from those duties "the executive is exercising a distinct 'social responsibility' rather than serving as an agent of the stockholders, customers or the employees ...." Divesting stockholders of their freedom to choose how to participate in the marketplace is effectively taxation without representation.

Richard Posner agrees with this critical view. In his most recent criticism of creative capitalism, Posner argued that "[a] corporation [making] charitable donations that are not profit maximizing is not only breaking faith with its shareholders ... but also weakening itself in the competition with profit-maximizing firms." Posner contends that corporations are successful because they strictly adhere to the principles of profit maximization. According to Posner, profits are not maximized once the government intervenes or the corporation unduly undertakes charitable functions in place of capital-intensive aims. "Private sector is private sector," and profit maximization must be its sole objective. Sentiment has no place in the corporate arena aside from facilitating this profit maximization.

Bill Gates's "marriage of sentiment and self-interest will inevitably be a stormy one. Although "recognition" for benevolent acts may lead to some profitability, the opportunity cost of acquiring such sub-optimal profit margins is at odds with a corporation's self-interest." As Adam Smith stated "[i]t is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own self-interest."
According to Smith, individuals' self-interest produces collective growth that benefits all—the "Invisible Hand" at work. This contradicts Gates's theory because individual self-interest actually assists in bringing about socially desirable outcomes. Sentiment is not only dispensable, but actually hinders social progress with its presence.

According to Smith, social growth is achieved not through unintended Pareto-improving outcomes driven by self-interest—not government intervention. This analysis arguably leads to a simple but powerful conclusion: capitalism is a system capable of maximizing social welfare while minimizing government intervention in the free market. Bill Gates's success illustrates that self-interest in the absence of government intervention can and will lead to social growth—millions continue to benefit from the fruits of Microsoft's success.

By engaging in "creative capitalism," businesses will not only experience reduced profit margins; but risk being out competed by corporations acting in sheer self-interest. Consequently, taking the "high road" of philanthropy may lead to a corporation's demise.

---

98. SMITH, supra note 5.
99. Id.
100. Given any set of alternative allocations (e.g., goods or income for a set of individuals), a change from one allocation to another that can make at least one individual better off without making any other individual worse off is called a Pareto improvement. An allocation is Pareto efficient or Pareto optimal when no further Pareto improvements can be made. This is often called a strong Pareto optimum (SPO). Named after Italian economist Vilfredo Pareto, Pareto Optimality represents situations where economic resources have been allocated in such a way that none can be made better off without making at least one person worse off. Conceptually, Pareto acknowledges that there is no such thing as a free lunch. The cost of pulling up one individual at the bottom of the socio-economic pyramid will put a strain on another, in this situation it may come at the cost of suboptimal corporate profit and deficits to shareholder earnings. However, to gain total social welfare, the allocation of resources must increase the welfare of one person without reducing that of another. For this reason, the Pareto Principle not only derails, but conflicts with Gates' approach. For further information on this principle see generally Harold M. Hochman & James D. Rodgers, Pareto Optimal Redistribution, 59 THE AM. ECON. REV. 542-57 (1969).
101. The lifeblood of capitalism is capital itself. It is not the instrumentalities of capital—the internet, fast-food franchises, or as Gates's theorizes, the entanglement of caring within the markets. Only capital provides the means to support specialization, production, and exchange of assets in the markets. It is capital that is the source of increased productivity, assembly lines, and thereby the wealth of nations. See Posner II, supra note 77, at 298-301.
102. One example of this deadly effect is AT&T's failed "global manufacturing plan" designed to preserve worker dignity and uphold human rights in Mexico's maquiladoras. When corporations elect to prioritize benevolence over profit, they are faced with a Prisoner's Dilemma as to whether other corporations will soon follow. AT&T adopted corporate policies designed to preserve worker dignity, human rights, and pay all employees a sustainable wage. Engaging in this type of philanthropy allowed its competitors to produce cheaper products. When the U.S. consumer realized that a less socially benevolent competitor's phone costed three dollars less, that consumer based her purchase on self-interest and not compassion. Sheer self-interest keeps those three dollars in the consumer's pockets and out of AT&T's hands. William C. Gruben & Sherry L. Kiser, Federal Reserve Bank of Dallas, NAFTA and Maquiladoras: Is the Growth Connected? (Jun. 2001) http://www.dallasfed.org/research-border/tbe_gruben.html.
Creative capitalism will only work if “recognition” of corporate benevolence can be converted into profit. If this recognition is truly profit-maximizing, then Gates’s theory is superfluous, for there would be an automatic economic incentive to tap into those income streams.

Winston Churchill once stated: “The inherent vice of capitalism is the unequal sharing of blessings; the inherent vice of socialism is the equal sharing of miseries.” Creative capitalism will not solve the inequalities that exist within our capitalistic structure, because capitalism is by definition hierarchical and not egalitarian. According to Jagdish Bhagwati, “[C]apitalism flourishes, in the teeth of inevitable inequality.” This is a fundamental flaw of capitalism, but a necessary evil of competition-driven economics. If all members of the “bottom billion” (green strip in Fig. 1) are freed from poverty, this group will inevitably be replaced. Thymotic pride will disallow perfect equality. Even Karl Marx believes that by virtue of our envious nature, there will always be a “bottom billion.” Marx warned:

A house may be large or small; as long as the neighboring houses are likewise small, it satisfies all social requirements for a residence. But let there arise next to the little house a palace, and the little house shrinks to a hut. The little house now makes it clear that its inmate has no social position at all to maintain, or but a very insignificant one; and however high it may shoot up in the course of civilization, if the neighboring palace rises in equal or even in greater measure, the occupant of the relatively little house will always find himself more uncomfortable, more dissatisfied, more cramped within his four walls.

The “bottom billion” can never be emancipated because our rational nature will always form an enslaved underclass.

By fulfilling the needs of the “bottom billion” within developing nations, does creative capitalism simply lead to a new underclass? Will those unable to purchase the products disbursed into “emerging markets” form the new bottom billion? Understanding that creative capitalism cannot operate under Pareto-optimal situations, is creative capitalism ultimately a losing zero-sum game?

105. THE WORLD BANK, supra note 16.
106. See FUKUYAMA, supra note 3, at 165.
107. Understanding that Marx is a communist, the authors use his quote in the context of illustrating that the rational nature of mankind will always allow inequality to persist.
109. See THE WORLD BANK, supra note 16.
By inviting the bottom to be over-reliant on the benevolence of the top, the beneficiaries become vulnerable to a new kind of moral hazard. This moral hazard acts to eliminate incentives for foreign governments to reform. Corrupt governments will continue to rely on foreign aid, and now creative capitalism, to exploit the ignorance and apathy of the bottom billion. Indeed, "they gain a free move in the slow war of attrition they wage against their people." Consequently, any benefits from creative capitalism will be outweighed by its negative externalities.

VII. CONCLUSION

Are we so macho in thought and mired under a culture of exclusivity that we fail to recognize the exploitative value at the bottom of the pyramid? Have free-market participants exchanged rational self-interest for a materialistic climb to hegemony? If so, this is self-defeating. This mindset blinds us to the more optimal potentials in new, capital-intensive markets. Ideally, our egocentric nature should drive us to maximize our own well-being (i.e. to make more money). By ignoring the potential of emerging markets, the "best" capitalists are in fact the worst capitalists. The untapped potential that Gates, Prahalad, and Hart have exposed are branded with being useless and unprofitable. This stigma against underclass countenance is not capitalist, it is irrational.

Our nation's hegemonic status deludes us into making unwarranted cultural perceptions that quantity of wealth directly correlates with level of knowledge. It must be the guy from Harvard that knows the answers; No way would it come from the employee behind the liquor store counter. His knowledge ceases to surpass which Merlot goes with a steak. We recently asked that person behind the liquor store counter this question: Is it the rebels who change the times, or change with the times, while we, the rule followers or laissez-faire capitalists, grasp vainly at the straws of sameness? We acknowledge that this question is flawed and not fundamentally sound. Nevertheless, he answered:

Well this statement doesn't seem to be representing the market. Rather, it seems to be comparing, the knowledgeable, creative, education-driven person who seeks to go against a government full of corruption and drives himself to uncover truths versus the financier who has found one way to make money and continues to exploit that market (i.e. mortgage securities) as well as the uneducated, ill-informed public that follows these bigger, larger than life 'characters' into the markets that they create.

110. Eric Werker, Yes, But Weak States Can be Coaxed Creatively, in CREATIVE CAPITALISM, supra note 62, at 170-71.
111. One of the authors is a vegetarian and does not approve of this message; the other is a struggling law student and has not had steak in over 3 years.
The markets do alter with the times, if this is your statement. The times also alter the markets. For instance, in our current example, our markets dropped and as such they altered the current times and how people behave and act. So in fact the markets controlled the way people spent and saved. It seems now we are in a position where the times control the markets. The population is now in control and can alter the markets how they deem fit to bring back economic growth to the country.

The markets must alter with the times when a certain percentage does not control the market. But where is that percentage now? They've been amassed with the rest of the public who now choose to invest more wisely. Still, we had a great depression before. At a point the rejoicing will start, the spending will begin, and down the road there will be another bubble bust. Thus, is the economic cycle.112

We have no evidence that the children running around the garbage dumps of Guangzhou, China possess more innate potential than the kid in the exclusive British prep school. Nor do we have any evidence that they cannot become the next Bill Gates. We do not know whether the employee behind the counter who answered the above question possessed sufficient potential to change the nature of our financial markets. Such persons are undiscovered gems.

Will we, as free-market capitalists, dismiss this individual as a lost cause? Adam Smith stated that “[t]he real tragedy of the poor is the poverty of their aspirations.”113 Will the liquor store employee’s aspirations ever rise above that of his inextricable liquor-encompassed climate? If his aspirations rise, will society dismiss them? Is this the nature of capitalism? Has the irrational exuberance of laissez-faire capitalism, one that transformed the lives of many from tragedy to triumph and created the most powerful nation on Earth, allowed us to believe that this path must be correct? Arguably so. Ayn Rand may suggest that we rejoice at capitalism’s success in the United States since we continue to be a world superpower.114 However, this concept has caused us to turn our cheek to the inequities and deficiencies in our economic system. Our “rational nature” numbs us to these inequities. Living in America, this “rational nature” may be further stonewalled by the sight of irresponsible actions and habits of what we label as “poor people.”115

112. INTERVIEW WITH JAIPAL CHUDASAMA, SALES CLERK, BROADWAY LIQUORS, NASHVILLE, TENN. (Mar. 2009).
114. See generally RAND, supra note 11.
115. See The Epiphany: China King Buffet, supra part I.
Bill Gates now asks corporations, and in turn, individuals, to revolutionize their view of capitalism and the "rational nature" of man, or man \textit{qua man}\textsuperscript{16} by assigning monetary value to recognition of benevolent acts.\textsuperscript{17} If a corporation uses the banner of "creative capitalism" as a less stigmatic way to engage in philanthropy, then the deceit will be unveiled during these tough economic times. If economic value can truly be derived from the recognition of benevolent acts, then these times will illustrate the benefits of creative capitalism. However, if rational self-interest demands keeping the economy at the \textit{status quo} or ensuring that a company stays afloat, then the mere risk of entering "emerging markets" may prevent capitalism's alteration. If Gates's theory is contingent upon the economic climate, then self-interest may not be the sole motivator in reaching out to the bottom billion. Sentiment, rather than self-interest, would play the crucial role.

Only time will tell whether creative capitalism will fall on deaf ears, or whether the synergy of benevolence and recognition will become an everyday part of how we do business.

\textsuperscript{16} Ayn Rand Institute, Essentials of Objectivism, \url{http://www.aynrand.org/site/PageServer?pagename=objectivism_essentials} (last visited May 1, 2009) (describes Ayn Rand's theory of man \textit{qua man}).

\textsuperscript{17} Gates, \textit{supra} note 4.