

Entrepreneurship and Philanthropy in American Capitalism

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ABSTRACT. American capitalism differs from all other forms of industrial capitalism is its historical focus on both the creation of wealth (entrepreneurship) and the reconstitution of wealth (philanthropy). Philanthropy is part of the implicit social contract that continuously nurtures and revitalizes economic prosperity. Much of the new wealth created historically has been given back to the community, to build up the great social institutions that have a positive feedback on future economic growth. This entrepreneurship-philanthropy nexus has not been fully explored by either economists or the general public. The purpose of this paper is to suggest that American philanthropists – especially those who have made their own fortunes – create foundations that, in turn, contribute to greater and more widespread economic prosperity through knowledge creation. If we do not analyze philanthropy we can understand neither how economic development occurred nor what accounts for American economic dominance.

I. Introduction

It is widely recognized that much of the success of the American economy in recent years, is due to its entrepreneurial spirit. Individual initiative and creativity, innovation and wealth creation are indelible parts of the American spirit. As a result of the recent technological revolution and economic restructuring both the general public, and government officials, are keenly aware of the role of the entrepreneur in job and wealth creation

(Hebert and Link, 1989). This crucial role of the entrepreneur in economic development has fostered efforts by government at all levels to promote entrepreneurship (Hart, 2001).

However, what is increasingly recognized is that there is another crucial component of American economic, political and social stability, that is, the role of philanthropy. Writing in 1957, Merle Curti advanced the hypothesis that “philanthropy has been one of the major aspects of and keys to American social and cultural development” (Curti, 1957, p. 353). To this we would add that philanthropy has also been crucial in economic development. Further, when combined with entrepreneurship, the two become a potent force in explaining the long run dominance of the American economy.

What differentiates American capitalism from all other forms of capitalism (Japanese, French, German, and Scandinavian) is its historical focus on both the creation of wealth (entrepreneurship) and the reconstitution of wealth (philanthropy).¹ Philanthropy remains part of an implicit social contract stipulating that wealth beyond a certain point, should revert to society (Chernow, 1999). Individuals are free to accumulate wealth, however, wealth must be invested back into society to expand opportunity (Acs and Dana, 2001). In this essay we cast the United States as the first new nation, the product of a shift in human character and social role that produced the English Revolution and modern American civilization. It was the working out of this new character type, the agent, who possessed unprecedented new powers of discretion and self-reliance yet was bound to collective ends by novel emerging forms of institutional authority and internal restraint (Hickman, 1998).² Therefore, much of the new wealth created historically has been given back to the community to build up the

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great social institutions *that have a positive feedback on future economic growth*. For example, John D. Rockefeller gave back 95% of his wealth before he died.

Though it has been recognized that the philanthropists of the nineteenth century made possible the basis for wealth creation and social stability, this has not been quantified and placed within the framework of private and social costs and benefits (America, 1995). Take as an example the difficulty in calculating the *ex post* benefits of the creation of the University of Chicago by the Rockefeller family. The number of Nobel Prize winners at the University of Chicago is one measure of the social benefits that have been reaped by the Rockefeller family investment. Certainly, there was no immediate private benefit to the Rockefeller family, since the contributions occurred several generations later. Therefore, the entrepreneurship-philanthropy nexus has not been fully understood by either economists or the general public. This is in part due to a narrow view of self-interest as a fundamental institution of capitalism.

The purpose of this paper is to suggest that American philanthropists – especially those who have made their own fortunes – create foundations that, in turn, contribute to greater and more widespread economic prosperity through opportunity, knowledge creation and entrepreneurship. This was Andrew Carnegie's hope when he wrote about "the responsibility of wealth" over a century ago, and it still inspires entrepreneurs today, though they usually express it in terms of a duty to "give something back" to the society that helped make their own success possible. In the new global economy philanthropy offers the promise to usher in an era of renewed growth and prosperity that will sustain the U.S. and global capitalism well into the 21st century. As we enter the twenty-first century the new rich have the opportunity to shape America and the world just as profoundly as Andrew Carnegie and others shaped the last century. The founders of modern American philanthropy tried to provide answers to problems that were national in scope, at a time when national governments were weak. Today's philanthropists have a chance to address problems that are global in scope, at a time when global institutions are even weaker (Soros, 1988). We suggest that if we do not analyze philanthropy, we

can understand neither how economic development occurred nor what accounts for American economic dominance.

In the next section we examine the economics of philanthropy and altruism focusing on the role of individual behavior. In the third section, we provide a brief background on the origins of this philanthropy in American history, and discuss some of its early contribution to economic prosperity. The fourth section focuses on the strengths of American capitalism, namely entrepreneurship, innovation, and wealth creation. The fifth section examines philanthropy in the new "Gilded Age" and asks how well the institutions of the philanthropic sector are meeting the goals of creating economic opportunity. The sixth section discusses the future of global capitalism, and a conclusion is provided in the final section.

II. The economics of philanthropy and altruism

Economists from the time of Adam Smith (1937 (1776)) have recognized the power of self-interest in the creation of wealth. However, critics of capitalism, notably Karl Marx (1967 (1867)), emphasized the negative aspects of capitalism, especially its maldistribution of the wealth created. Though the wealthy entrepreneurs in the nineteenth century created large mansions for themselves and provided the impetus for Thorstein Veblen's (1899) description of the "leisure class," at the same time, they were also great philanthropists (Sugden, 1982).

The word philanthropy literally means "love of mankind." Philanthropic acts manifest the generosity of the giver. In this paper we do not want to give a definition of philanthropy, since there are competing interpretations, however we would like to describe the concept. In this paper what we mean by philanthropy is *giving money or its equivalent away to persons and institutions outside the family without a definite or immediate quid pro quo for purposes traditionally considered philanthropic*. Solomon Fabricant stated the relationship of philanthropy to economic development (Dickinson, 1970, p. 8):

... in this broad sense philanthropy is a necessary condition of social existence, and the extent to which it is developed influences an economy's productiveness. For decent conduct pays large returns to society as a whole, partly in

the form of a higher level of national income than would otherwise be possible. Underdeveloped countries are learning that, despite their hurry to reach desired levels of economic efficiency, time must be taken to develop the kind of business ethics, respect for the law, and treatment of strangers that keep a modern industrial society productive. Widening of the concepts of family loyalty and tribal brotherhood to include love a man "in general" is a necessary step in the process of economic development.

Most economists assume that self-interest is the underlying motivation behind human exchange. When economists confront philanthropic behavior, they look for the *quid pro quo* behind the act. Hence, economists conclude that behavior that appears to be altruistic, is fundamentally consistent with self-interest behavior. Contemporary economic theory has largely ignored the possibility of altruistic behavior, though with notable exceptions (Margolis, 1982; Sugden, 1982). Contrasted to the view of economists, a survey of theory and research on altruism by sociologists concluded that the evidence points to the existence of altruism as a part of human nature (Pilavin and Charng, 1990).

Economists try to explain altruism as enlightened self-interest, but we argue it is more than that. Altruism is different.³ To quote Adam Smith, the founder of modern economics, in *The Wealth of Nations*: "It 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 interest" (Smith, 1937 [1776], p. 14).

But economists have largely ignored the Adam Smith of *The Theory of Moral Sentiments*, which predates *The Wealth of Nations* by nearly two decades. Smith opens the former with the passage (Smith, 1969 [1759], p. 47):

How selfish soever man may be supposed, there are evidently some principles of his nature, which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it, except the pleasure of seeing it.

On one level, economists could claim that the behavior described by Smith in the above passage is consistent with modern day economics. After all, modern economics postulates that each individual derives "utility" from the choices available on which to spend one's income. The "rational" consumer will allocate his/her money so that the marginal utility of each dollar is the same across

all uses. As Kenneth Boulding expresses it (Boulding, 1962, pp. 57–58):

It is tempting for the economist to argue that there are really no gifts and that all transactions involve some kind of exchange, that is, some kind of *quid pro quo*. If we drop a dime in the blind man's cup, it is because the blind man gives us something. We feel a certain glow of emotional virtue, and it is this that we receive for our dime.

Economists, starting from this premise have postulated interdependent utility functions, so that the utility ("happiness" or "satisfaction") one person receives is dependent upon the utility of another (Ireland, 1969; Kaufman, 1993; Sugden, 1982; Danielsen, 1975).

However, Boulding points out that such an approach – that philanthropy is no different from self-interest behavior – seriously misleads us because there is nothing in utility theory that requires all motivations to be alike. Indeed, in Boulding's view, the motivation which leads to philanthropic behavior – where there is no *quid pro quo* – "may be very different from that which leads us to build up a personal estate or to purchase consumption goods for our own use" (Boulding, 1962, p. 61). Boulding concludes that if we regard philanthropic donations of an individual as an expression of a "sense of community with others," then behavior, which seems irrational or mysterious to economists becomes less so (Boulding, 1962, p. 62).

Boulding develops his hypothesis further by drawing a parallel between the individualistic, self-interested orientation of modern economics and its development of a theory of the firm – a collection of individuals – with philanthropic behavior of an individual and a theory of philanthropic foundations. There are two basic approaches of the foundations. One, like the Ford Foundation, would give money a variety of individuals and projects and would presumably allocate their dollars so that the marginal benefit is equal across all units. However, Boulding also speculates that such behavior as the Rockefellers' establishment a single strong University of Chicago may have done more for higher education than the Ford Foundation with a larger number of grantees (Boulding, 1962, p. 65).

Echoing the views of Boulding is Nobel Prize winner Herbert A. Simon, known for his theory of

bounded-rationality, who noted that (Simon, 1993, p. 158):

Neoclassical economics assumes that people maximize utility but postulates nothing about what utility is. With only this assumption, it is impossible to distinguish altruism from selfishness.

Simon proposes to define altruism as “sacrifice of fitness.” It then becomes possible, in principle, to determine which choices are selfish and which are altruistic by examining the effect of a million dollar gift, for example, on the number of progeny of the donor (Simon, 1993, p. 158). Simon concludes that economic theory has treated economic gain as the primary human motive, but an empirically grounded theory would assign comparable weight to other motives, including altruism and the organizational identification associated with it (Simon, 1993, p. 160).

Is philanthropic behavior always self-interest motivated, i.e., is there always a *quid pro quo*? Is there also behavior, as Boulding argues, where there is no *quid pro quo*? If there is only the former, then the self-interest approach of economics is justified. If there is not, then the question that arises is whether the returns to society are greater where the philanthropic behavior requires no *quid pro quo*. We argue that the vitality of American capitalism is testament to the importance of non-self-interest motivated behavior, hence an economic theory which ignores altruistic behavior can not adequately explain the real world. We suggest that altruism is superior to enlightened self-interest. Hence, economic theory must explicitly introduce altruistic behavior into its models of individual behavior (Simon, 1993; Budd, 1956; Giddings, 1893). We believe that U.S. history provides an example of the superiority of altruism over enlightened self-interest, and that this is crucial to U.S. economic prosperity.

III. The contributions of the nineteenth century philanthropists

Philanthropy and economic prosperity is not a new idea. In *Corruption and the Decline of Rome*, Ramsay MacMullen (1988) discusses how charitable foundations were partly responsible for the flourishing of Rome, and their decline coincided

with the loss of the empire. The roots of American philanthropy can be found in England in the period from 1480–1660. By the close of the Elizabethan period, “it was generally agreed that all men must somehow be sustained at the level of subsistence” (Jordan, 1961, p. 401). Though the charitable organizations at the beginning of this period in England were centered around religion and the role of the Church, by the close of sixteenth-century, religious charities comprised only 7% of all charities (Jordan, 1961, p. 402).

How is this philanthropic behavior explained? According to Jordan, there was the partly religious and partly secular sensitivity to human pain and suffering in sixteenth-century England (Jordan, 1961, p. 406). Doubtless, another important motivating factor was Calvinism which taught that “the rich man is a trustee for wealth which he disposes for benefit of mankind, as a steward who lies under direct obligation to do Christ’s will” (Jordan, 1961, pp. 406–407).

The real founders of American philanthropy were the English men and women who crossed the Atlantic to establish communities that would be better than the ones they had known at home (Owen, 1964). The Puritan leader John Winthrop forthrightly stated their purpose in the lay sermon, “A Model of Christian Charity,” in which he preached on the ship “*Arabella*” to the great company of religious people voyaging from the old world to New England in the year 1630 (Bremner, 1960, p. 7). These Puritan principles of industry, frugality and humility had an enduring impact on America (Tocqueville, 1966 (1835)).

Beginning with the Puritans who regarded excessive profit-making as both a crime and a sin (and punished it accordingly), there is a long history of Americans who have questioned the right of people to become rich. In view of the popular prejudice against ostentatious enjoyment of riches, the luxury of doing good was almost the only extravagance the American rich of the first half of the nineteenth century could indulge in with good consciences (Tocqueville, 1966 (1835), p. 40; Veblen, 1899). To whatever extent it is true that donating was the only luxury allowed the rich in the first half of the nineteenth century, things had certainly changed by the second half of the century when Carnegie, Mellon, Duke et al. were making their fortunes.

Andrew Carnegie exemplified the ideal Calvinist. Carnegie put philanthropy at the heart of his "gospel of wealth" (Hamer, 1998). For Carnegie, the question was not only, "How to gain wealth?" but, importantly, "What to do with it?" *The Gospel of Wealth* suggested that millionaires, instead of bequeathing vast fortunes to heirs or making benevolent grants by will, should administer their wealth as a public trust during life (Carnegie, 1889). Both Carnegie (at the time) and Jordan (as a historian) suggest that a key motive for philanthropy is social order and harmony. It is plausible that philanthropists like Carnegie took a longer term approach and realized that their interests necessitated assisting the worthy poor and disadvantaged: enlightened self interest as opposed to altruism.

In the past, the malefactors of great wealth were also benefactors of extraordinary generosity (Myers, 1907). In the U.S., much of the new wealth created historically has been given back to the community; to build up the great social institutions *that have a positive feedback on future economic growth*. For example, it was precisely the great private research universities of Stanford, MIT, Johns Hopkins, Carnegie-Mellon, Duke, Chicago, among others that were created over a century ago by American philanthropy that played such a critical role in the recent American successes (*The Economist*, October 4, 1997).

One of the greatest nineteenth-century philanthropists was George Peabody. Peabody, a man of modest beginnings, who, through canny investment gained a fortune and through impeccable honesty, gained a reputation for flawless integrity. He developed a philosophy of philanthropy. Two considerations seem to have been most influential in his philanthropies. One was a deep devotion to the communities in which he was reared or in which he made his money. The other was a secular vision of the Puritan doctrine of the stewardship of riches – his desire, in the simplest terms was to be useful to mankind. In his lifetime, he donated over \$8 million to libraries, science, housing, education, exploration, historical societies, hospitals, churches and other charities (Parker, 1971, p. 209).

Peabody's most enduring influence, however, lies in the precedents and policies formulated by the Peabody Education Fund Trustees. This fund

not only paved the way for subsequent foundation aid to the South after the Civil War but also influenced the operational patterns of subsequent major foundations including John D. Rockefeller's Education Board, the Russell Sage Foundation, and the Carnegie Foundation. The thesis that George Peabody was the founder of modern educational foundations was best expressed in the *Christian Science Monitor* (as cited in Parker, 1971, p. 208).

George Peabody was in fact the originator of that system of endowed foundations for public purposes which has reached its highest development in the United States. . . . It is interesting to consider the many ways in which the example set by [George Peabody] has been followed by visioned men of means in the United States. . . . In a sense the Peabody Fund was not the only monument to George Peabody, for the example he set has been followed by a host of other Americans.

In 1867 Peabody met with Johns Hopkins, Baltimore merchant and financier. Peabody explained the basis of his philanthropy to Hopkins, "to place the millions I had accumulated, so as to accomplish the greatest good for humanity." Hopkins donated his entire fortune of \$8 million, an extraordinary amount of money at that time, to the founding of the Johns Hopkins University, Medical School and Hospital (Brody, 1998). Each institution, which would have separate but closely inter linked boards of trustees, was given \$3.5 million to establish itself. It was at the time the largest philanthropic bequest in U.S. history. Thus Peabody, apart from his own charities, may honorably stand in the shadow of what has been achieved by Hopkins (Offit, 1995).

The American model of entrepreneurship and philanthropy in the nineteenth century was followed by a period of progressivism (increasing role of government) in the early twentieth century and then World War I. Though the period of the 1920s was one of technological change and prosperity, underlying economic problems resulted in the collapse of the world economy into the Great Depression of the 1930s. This period, together with that of World War II, changed the role of the government and the philanthropic activities of the entrepreneur. It is not our point here to argue that the role of philanthropy was to provide social welfare – health insurance, social security, unemployment insurance. Indeed, the rise of the state

in the twentieth century was in some ways a rise of social welfare provided by government.

This function, however, is distinct from the pure function of philanthropy that arises from issues of wealth. The rise of the welfare state with its high marginal taxes, high inheritance taxes, anti-trust laws, and the abolition of private property in some societies, tried to eliminate the role of private wealth altogether. In fact, in a socialist state the only role for philanthropy might be religious giving. What is interesting is that in the United States the rise of the welfare state did not coincide with a decline in philanthropy. In fact, according to a study by the National Bureau of Economic Research (Dickinson, 1970) total private domestic philanthropy as a percentage of Gross National Product between 1929 and 1959 increased from 1.7% to 2.3% respectively. It averaged 2.1% during the period as seen in Table I. This figure is not significantly different from the 2.5% that Americans contributed to philanthropic causes in 1997. According to the Johns Hopkins nonprofit sector project, this figure is the highest in the world followed by Spain, Britain and Hungary.⁴ In the United States, almost 80% of donations are by individuals. Why did Americans continue to fund philanthropy at least at a constant level even as the Federal Government stepped into the business of social security? According to *Newsweek* (September 29, 1997, p. 34):

There's no escaping the brutal truth: the nation famous for capitalism red in tooth and claw, the epicenter of the heartless marketplace, is also the land of the handout. It's not really such a paradox. Both our entrepreneurial economic system and our philanthropic tradition spring from the same root: American individualism. Other countries may be content to let the government run most of their schools and universities, pay for their hospitals, subsidize their museums and orchestras, even in some cases support religious sects. Americans tend to think most of these institutions are best kept in private hands, and they have been willing to cough up the money to pay for them.

However, as we will see in the next section, the elimination of opportunities for wealth creation has social consequences that go far beyond philanthropy.

TABLE I
Gross national product and private domestic philanthropy
(millions of dollars)

Year	Column 1 Total	Column 2 GNP	Column 3 Total (column 1/2)
1929	1,787	104,436	1.711
1930	1,735	91,105	1.904
1931	1,547	76,271	2.028
1932	1,415	58,466	2.420
1933	1,238	55,964	2.212
1934	1,405	64,975	2.163
1935	1,430	72,502	1.972
1936	1,647	82,743	1.991
1937	1,771	90,780	1.951
1938	1,765	85,227	2.071
1939	1,925	91,095	2.113
1940	1,992	100,618	1.980
1941	2,326	125,822	1.849
1942	2,779	159,133	1.746
1943	3,379	192,513	1.755
1944	3,669	211,393	1.735
1945	3,938	213,558	1.844
1946	4,203	210,663	1.995
1947	4,772	234,289	2.037
1948	5,238	213,558	2.019
1949	5,248	258,054	2.034
1950	5,825	284,599	2.047
1951	6,726	328,975	2.045
1952	7,365	346,999	2.123
1953	8,091	365,385	2.214
1954	8,219	363,112	2.263
1955	9,082	397,469	2.285
1956	9,776	419,180	2.332
1957	10,403	442,769	2.349
1958	10,792	442,546	2.427
1959	11,512	482,704	2.385

Sources:

Column 1: Dickinson, F.G., *The Changing Position of Philanthropy in the American Economy*, 1970, p. 42. Table 2-1 Sources of Private Domestic Philanthropy, 1929–1959.

Column 2: 1929–1955: U.S. Income and Output, Department of Commerce, 1959, pp. 118–119.

1956–1959: Survey of Current Business, July 1964, p. 8.

IV. The strengths of American capitalism

In *The Theory of Economic Development* (1934 (1911)) Joseph A. Schumpeter unveiled his concept of the entrepreneur against the backdrop of economic development. The function of the entrepreneur is to reform or revolutionize the patterns of production by exploiting an invention

or more generally, an untried technological possibility for producing a new commodity or producing an old one in a new way.

Six decades after the original publication of *The Theory of Economic Development* it is the large corporation that draws attention to Schumpeter's gloomy prospects for economic progress in *Capitalism, Socialism and Democracy*. The large corporation, by taking over the entrepreneurial function, not only makes the entrepreneur obsolete, but undermines the sociological and ideological functions of capitalist society. As Schumpeter himself wrote in a classic passage (1950 (1942), p. 134):

Since capitalist enterprise, by its very achievements, tends to automatize progress, we conclude that it tends to make itself superfluous – to break to pieces under the pressure of its own success. The perfectly bureaucratized giant industrial unit not only ousts the small or medium-sized firms and expropriates the bourgeoisie as a class which in the process stands to lose not only its income but also what is infinitely more important, its function.

As the large firm replaces the small and medium sized enterprise, economic concentration starts to have a negative feedback effect on entrepreneurial values, innovation and technological change. Technology, one of the means by which new markets are created, the source of that perennial gale of creative destruction that fills the sails of the capitalist armada, may die out, leading to a stationary state. This view of the future of capitalist society was held by both John Maynard Keynes (1963) and Schumpeter (1942 (1950)) and by much of the left in the 1960s (Heilbroner, 1985).⁵

Schumpeter was wrong about the future of capitalist society in the United States. He erred by underestimating the deep-rooted nature of the entrepreneurial spirit buried within American civilization (Acs, 1984, p. 172):

While for Marx and Heilbroner the principle struggle is between privileged and underprivileged, for Schumpeter, as in the transition from feudalism to capitalism, the quintessential struggle is between elites and elites: that is merchants and aristocrats, entrepreneurs and bureaucrats. Schumpeter did not see – partly because of his aristocratic European background – that the entrepreneurial spirit would emerge from the nation's past and rise to challenge, engage and extinguish the embers of bureaucratic hegemony, bringing to an end the era of monopoly capitalism, heralding a new dawn.

In fact, in Sweden, according to a recent study Schumpeter was nearly right (Henrekson and Jakobsson, 2000). While the Schumpeterian prognoses about the economic consequences of firm-size appear to have been wide of the mark for the United States, in the former socialist countries they appear to ring true where industrial concentration has left its mark (Stiglitz, 1994).

When the Berlin Wall fell in 1989 the focus of the international order shifted from issues of East vs. West (Capitalism vs Socialism) conflict to questions of global competition (Acs and Audretsch, 2001). The perceived wisdom at the time was that the United States might not be able to compete in the new global economy. Jeffrey E. Garten, Under Secretary of Commerce, summed up this view at the beginning of the first Clinton administration (Garten, 1992, p. 15).⁶

Relative to Japan and Germany, our economic prospects are poor and our political influence is waning. Their economic underpinnings – trends in investment, productivity, market share in high technology, education and training – are stronger. Their banks and industry are in better shape; their social problems are far less severe than ours.

However, after a quarter century of painful ups and downs since 1976, the U.S. economy appears to be doing extraordinarily well. According to Lawrence H. Summers, former deputy Treasury Secretary: "The economy seems better balanced than at any time in my professional lifetime" (*Washington Post*, December 2, 1996, p. 1). Unemployment in 1999 was just under five percent, the economy was growing at four percent a year, inflation was at bay, manufacturing productivity was rising, the dollar was strong, and the stock market was breaking records as a matter of course. It appears that the U.S. economy has restructured, moving from an industrial economy to a knowledge economy, and made the transition to the twenty-first century (Acs et al., 2002).

Entrepreneurs – *individuals who take risk and start something new* – are indispensable to economic growth and prosperity. Entrepreneurship – *the process of creating a new venture and assuming the risks and rewards* – has been essential in the renewal of prosperity in the U.S. in the past two decades, just as it was at the turn of the twentieth century. There is little doubt that the dramatic increase in the number of entrepreneurial

business (and business failures) in the United States in the late 1970s and early 1980s, then maintained at a high level in the 1990s, has contributed significantly to the relatively vigorous U.S. economy in recent years.⁷ And it is important to connect entrepreneurship to innovation as suggested in the following succinct quote (U.K. Secretary of State for Trade and Industry, 1998):

Entrepreneurship and innovation are central to the creative process in the economy and to promoting growth, increasing productivity and creating jobs. Entrepreneurs sense opportunities and take risks in the face of uncertainty to open new markets, design products and develop innovative processes.

The direction of technological development is important because it is into these industries that resources had to be channeled. Each of the last three industrial revolutions was characterized by a revolution that made possible the transportation both of raw materials and finished commodities to market. During the first industrial revolution (1780–1830), a system of canals in England made possible the transportation of goods at a fraction of the previous cost. During the second industrial revolution (1830–1850), the railways provided cheap continental-wide transportation in England, Germany, and the United States. During the third industrial revolution (1920–1940), the automobile, truck, and airplane made the transportation of goods and people inexpensive. The fourth industrial revolution now under way (1984–?) also has as one of its integral parts a transportation revolution. However, it is a revolution not in the transportation of goods but of information. Like the technologies of the past – the steam engine and the internal combustion engine – the micro-processor does not operate within the confines of existing structures but makes possible a new one: the Information Age (Jorgenson, 2001).

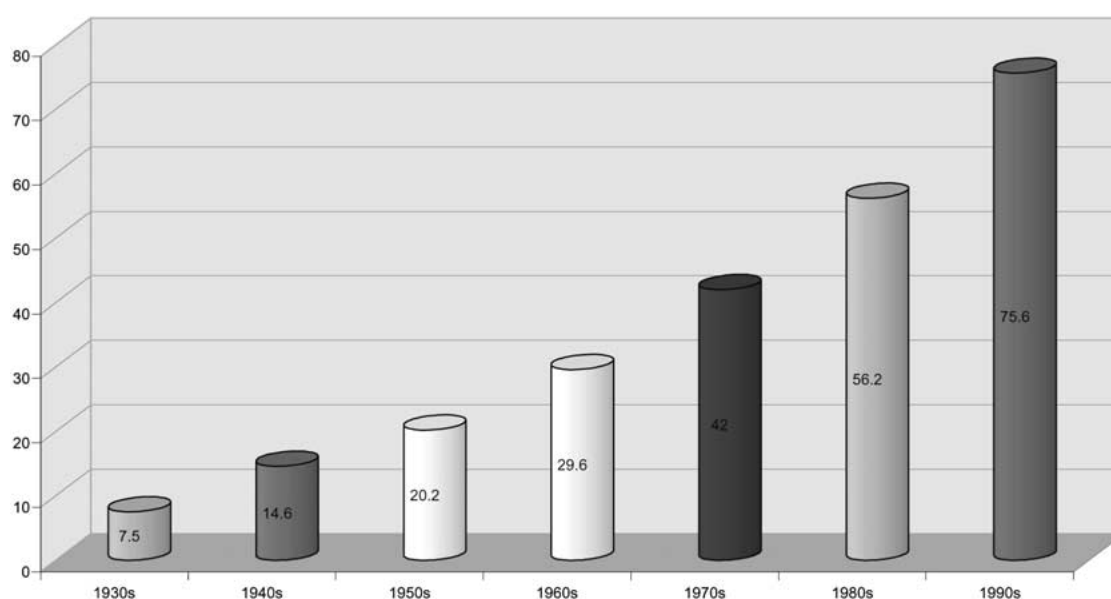
Much of the entrepreneurial investment to finance America's information infrastructure was made during the 1980s. According to the *Wall Street Journal* (March 2, 1993) Michael Milken raised \$21 billion for the information industry. His largest commitments were to MCI, Tele-communications Inc, McGraw Cellular Communications Inc, Turner Broadcasting, Time Warner Inc, and Metromedia Broadcasting. Virtually devoid of conventional collateral, none of these companies could have raised comparable

sums from other sources. The original investment of \$10 billion in the above companies had a market value of \$62 billion in 1993. This web of glass and light is today an essential resource of America's information economy. A second wave of entrepreneurial start up companies, financed in part by venture capital, is today completing the infrastructure for the information age: America on Line, Cisco Systems, Amazon.Com, Oracle, Sun Microsystems, Netscape, and Yahoo.

The impressive performance of the U.S. in the last few years may be contrasted with the rather lackluster performance in both Europe and Japan, where GDP has grown at less than 1.5% per annum in the last five years. In the European Union (EU) the unemployment rate has remained stubbornly in double digits, and in Japan the stock market has been stagnant since the early 1992 at half its previous level (Audretsch and Thurik, 1998; Wennekers and Thurik, 1999; Acs et al., 1999; Acs and Armington, 2001; Carree et al., 2001).

The re-emergence of entrepreneurship in the United States during the 1980s, and the positive channeling of it, must be seen as a triumph of American capitalism. A clear manifestation of this entrepreneurial success is the increase in job wealth creation in the United States. An enormous amount of wealth has been created in the U.S. since the Great Depression of the 1930s. Between 1950 and 2000 household net worth in the United States increased from \$130,000 to \$400,000 in 2001 inflation adjusted dollars. The growth of this wealth can be seen in Figure 1 below which represents additions to real wealth by decade measured as contributions to Gross Domestic Product. The addition to real measured by additions to gross domestic product by decade increased by \$56.2 billion in the 1980s and by \$75.6 billion in the 1990s. In 1950 eighty percent of wealth on the Forbes list of the richest people in America was inherited by 1990 it has fallen too only 20 percent.⁸ Between 1998 and 2001, four trillion dollars of new wealth was created in the stock market (some of it recently lost). The number of billionaires had increased from 13 in 1982 to 170 today; the number of deca-millionaires stands at 250,000 and millionaires at 4.8 million (*Economist*, May 30, 1998, p. 19).

The accumulation of wealth in private hands is



Source: Bureau of Economic Analysis, National Income and Product Account, Real Gross Domestic Product, various years.

Figure 1. Additions to real wealth measured by additions to gross domestic product by decade in constant 1996 chained dollars, 1930–1990s (in billions of dollars).

a function of the freedom that we allow individuals in an entrepreneurial society. If that wealth is taxed away wealth creation will cease. However, with that right goes responsibility. Private wealth that was created in a community needs to be reconstituted in the future growth of society.

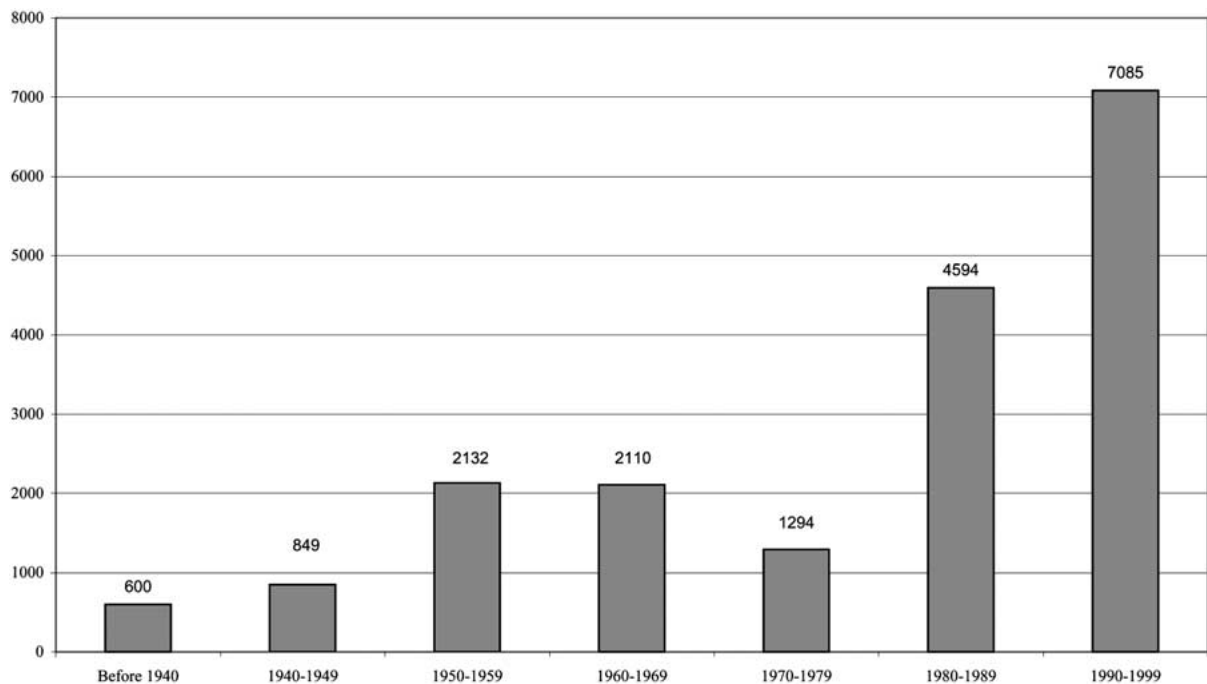
At the same time that enormous new wealth has been created, the role of philanthropy has also increased. The contribution to philanthropy in the United States rose to around two percent of GDP. The number of active private and community foundations has more than doubled since 1980. About three-fifths of the largest foundations have been created since 1980 as seen in Figure 2.

It has only been in the last two decades, since 1982, that a combination of political changes (The Reagan Revolution), together with massive technological changes, and the collapse of communism have once again enabled America to return to its historic roots of individualism, entrepreneurship and philanthropy. However, while entrepreneurship is a *necessary* condition to the shift from industrial capitalism to an entrepreneurial society it is not *sufficient* for economic prosperity, opportunity and social progress (Dewey, 1963).

V. Philanthropy in the “New Gilded Age”

In the introduction of this paper, we had suggested that American philanthropists created foundations that in turn contributed to greater and more widespread economic prosperity by investing in the future of America. However, such views are not really fashionable among scholars of philanthropy and more than a few of the professionals who staff foundations. For example, a book recently published by MIT Press on American foundations argues that they mostly serve as vehicles for advancing the economic and social interests of their benefactors (Dowie, 2001). At an American Assembly meeting a few years ago, the participants (most of whom were professionals who worked for foundations and other non-profit groups) produced a statement calling on philanthropists to do more to redistribute their wealth from the “haves” to the “have nots.” Carnegie would have been appalled since he thought that by fostering greater economic opportunities, philanthropists could prevent such redistributive schemes.

It is important to state the argument. The point



Source: Adapted from Foundation Growth and Giving Estimates, 2001, http://fdncenter.org/research/trends_analysis/pdf/fgge01.pdf.

Figure 2. Close to three-fifths of larger population were established since 1980.

is that we need to distinguish between redistribution and the creation of opportunity. This distinction is similar to the distinction between small business and entrepreneurship that readers of this journal are familiar with. Small business is about life style while entrepreneurship is about wealth creation. In the same sense, charity is about redistribution, while, philanthropy in the American tradition is about investing wealth to create opportunity. The first question is, "How do we evaluate what should be done and what has gone before?" What is needed is a benchmark against which to evaluate the role of philanthropy today. This clearly does not exist. However, recently Jeffrey Sachs has articulated a position by which to judge our philanthropic activities based on past accomplishments. According to Jeffrey Sachs, writing in the economist, creating opportunity for future generations is about creating knowledge today, and the model to study is the Rockefeller Foundation (*The Economist*, June 24th 2000, p. 83):⁹

The model to emulate is the Rockefeller Foundation, the pre-eminent development institution of the 20th century, which showed what grant aid targeted on knowledge could

accomplish. Rockefeller funds supported the eradication of hookworm in the American South; the discovery of the Yellow Fever vaccine; the development of penicillin; the establishment of public-health schools (today's undisputed leaders in their fields) all over the world; the establishment of medical facilities in all parts of the world; the creation and funding of great research centers such as the University of Chicago, the Brookings Institution, Rockefeller university, and the National Bureau of Economic Research; the control of malaria in Brazil; the founding of the research centers that accomplished the green revolution in Asia; and more.

While it is beyond the scope of this paper to identify all wealthy entrepreneurs and to study the extent to which they engage in philanthropy we would like to focus on three that set the standard – George Soros, Ted Turner and Bill Gates. Soros, the financier, through the Soros Foundations has pledged \$2 billion dollars to a network of foundations throughout the world to promote an open society.¹⁰ The foundation supports education, children's programs, public health programs, contemporary artistic and cultural programs and small-enterprise development. He has given a fortune in creative and unusual ways, taking great

care over how the money is spent in transforming the former socialist countries. He donated \$500 million to Russia to fund health and civic programs (*The Washington Post*, October 21, 1997, p. A3.). Recently Soros gave \$25 million to Baltimore to fund after school programs. He described Baltimore as a miniature version of the world with much of the world's bounty, problems and promise (*The Baltimore Sun*, December 16, 1998, p. C1).

Yet another large gift was the donation of \$1 billion to the United Nations by Ted Turner from the income created by the rising price of his shares in the Time Warner media empire. With that gift, Turner challenged the super rich to give away more of their money. The Turner Foundation, based in Atlanta, is dedicated to making the earth more environment-friendly – protecting clean water and air quality, alternative forms of transportation and fuels, strategies for infill development rather than continuing the pattern of sprawl and loss of habitat. Goals of the foundation also include slowing down population growth and preserving wildlife. The foundation has an endowment of about \$350 million, but its annual giving (\$50 million) is more in line with a \$1 billion foundation. (Maria Saporta *The Atlanta Journal and Constitution* October 8, 2001.) Ted Turner was recently awarded the 2001 Albert Schweitzer Gold Medal for Humanitarianism given by The Johns Hopkins University.

Bill Gates, who had previously announced \$100 million to fight childhood disease in developing countries, and \$200 million for computers for libraries, has now created the largest philanthropic foundation in the United States: the Bill and Melinda Gates Foundation endowed with \$22 billion.¹¹ To put this into perspective, the contribution is about four times as large as that created by Carnegie or Rockefeller in constant dollars. The focus of the foundation which will give away one billion dollars each year has focused on third world health issues. In evaluating these social experiments the question is, "To what extent are the investments of these philanthropist creating knowledge that will in turn contributed to greater and more widespread economic prosperity in the future?"

These views of giving back are not universally shared even in the United States, and the rest of

the rich have retreated from facing up to the challenge of how to reconstitute their wealth (*Fortune*, February 2nd 1998, p. 88). Recent articles in the popular press have attempted to evaluate the philanthropic activities of the new rich.¹² Such articles that provide comparative figures on wealth accumulated and philanthropic activities provide subtle social pressure to give back to society. *Slate Magazine* has begun publishing an annual list of the 60 largest philanthropic donations by the rich. The creation of this list has also prompted criticism that assumes that every philanthropic dollar is equally valuable to society. Arianna Huffington proposed an adjustment factor that broadly sought to distinguish self-interested behavior from altruistic behavior. Thus for example, altruistic behavior might be exhibited if the giver donates his/her time along with his/her money (a 15 percent bonus in the Huffington scale). Bonuses were also given for philanthropic contributions that create a scholarship fund for disadvantaged kids who otherwise couldn't afford to attend the well-endowed college, giving that focuses on poverty, giving to preschool and K-12 education, giving that immediately alleviates suffering: food assistance, shelter, child care, health care, and safer neighborhoods, and giving to grass-roots, community-based projects that turn lives around and operate on a hand-to-mouth budget. The contributions were reduced for "self-referential giving" directly connected to the giver's business interests, for investing in buildings not people, if the gift goes to a building named after you or a loved one, or for gifts that win the donor huge tax write-offs, especially donations of stock or expensive paintings to museums (Huffington, 2000).

Those whose contributions were judged to have a positive adjustment factor (more altruistic and more society oriented) and those who received a negative adjustment factor (more self-interested and less society oriented) are listed on Table II. One of the most striking things from this table is that giving to private universities that were endowed in the nineteenth-century or earlier is no longer viewed as a particularly productive use of philanthropic dollars. Those activities that are directed at community development are the most productive use. Though we are hesitant to draw conclusions about the contributions of the new

TABLE II
Largest philanthropic contributions in 1999

Craig and Susan McCaw	\$15,000,000	25.00%	Nelson Mandela Foundation; Foundation for Community Development
Ron Burkle, Ted Fortsmann, and John Walton	\$30,000,000	13.00%	Children's Scholarship Fund
Alice and Leonard Samuel Skaggs Jr.	\$42,000,000	10.00%	Catholic Archdiocese of Salt Lake City
Kirk Kerkorian	\$15,000,000	10.00%	American Red Cross
James H. Clark	\$150,000,000	-40.00%	Stanford University for Biomedical-Engineering Center
Carl Icahn	\$20,000,000	-40.00%	Princeton University
Gregory C. Carr	\$18,000,000	-40.00%	Harvard University
William A. and Joan Porter	\$25,000,000	-55.00%	MIT
Steven Ferencz Udvar-Hazy	\$60,000,000	-70.00%	Smithsonian Institute

Source: *Slate Magazine*, "The Slate 60 Huffington Virtue Remix", March 2000.

philanthropists, the results of the Huffington adjustment is perhaps more encouraging than discouraging. Indeed, the publication of such lists may provide an impetus for increased philanthropic contributions that are more altruistic and societal development oriented.

The next question has to do with how well is the philanthropic sector meeting its obligations. The philanthropy sector as we have argued above has lost its historic focus. Among others, it needs new leadership from the new rich. In an editorial in the *Wall Street Journal*, Michael Milken challenged the new rich to use their wealth to "find permanent solutions to what seem like intractable problems" (Milken, 1999). John Doerr, who leads the \$20 million dollar New Schools Ventures Fund, argues that one of the major problems with the nonprofit sector is that there is not a mechanism to weed out inefficient organizations (*Time*, 2000, p. 55). What he and others are now saying is that it is time for mechanisms of the marketplace to be applied to the philanthropic sector. In an important article in the *Harvard Business Review*, the traditional operations of philanthropic foundations were challenged. The authors stated (Letts et al., 1997, p. 1):¹³

Foundations should consider expanding their mission from investing only in program innovation to investing in the organizational needs of nonprofit organizations as well. Their overemphasis on program design has meant deteriorating organizational capacity at many nonprofits.

The authors suggest that foundation officers

familiarize themselves with practices found among venture capital firms. The challenge according to a recent study (Morino Institute, 2000; W. K. Kellogg Foundation (Reis, 1999), is not just to create solutions. The challenge is to figure out how to make those solutions affordable, sustainable, and replicable and figure out how to get them to a scale that fulfills their organization's mission. Specifically, they suggest the following practices for adoption:

- 1) Compensations and career prospects of the foundation officers should be tied to the performance of grantees.
- 2) Foundations should evaluate not just short term goals of the grant, but the longer term objectives, such as reducing poverty.
- 3) There should be a closer working relationship between the foundations and the nonprofit sector.
- 4) Foundations should increase funding to a smaller number of recipients in order to increase their impact.
- 5) Foundations should offer grantees support over a longer period of time.
- 6) Foundations should have an exit strategy.

This is not the first time in history that businessmen have bought new tools to create more responsive organizations in the nonprofit sector. Venture philanthropy holds the promise of ushering in a new era in American philanthropy by infusing foundations with new tools. It

combines two crucial elements that have made America great: entrepreneurship and philanthropy. As such, it may be as significant a development as the great gifts from the industrialists and philanthropists of the Gilded Age. However, it is too early to tell if these changes will make foundations missions more effective.

VI. The future of global capitalism

There are two realities that stand out in the global economy. First, the world is getting wealthier. Second – and perhaps the greatest criticism of market economies – the unequal distribution of wealth is becoming more unequal. We have suggested in this essay that the American model of entrepreneurial capitalism may be the only sustainable model for global development. In this essay we argue that what differentiates entrepreneurial capitalism from all other forms of capitalism is its historical focus on both the creation of wealth (entrepreneurship) and reconstitution of wealth (philanthropy). Both of these stem from American views of individualism, agency and human nature.

In industrial capitalism wealth creation, wealth ownership and wealth distribution was in part left up to the state. However, in an entrepreneurial society it is individual initiative that plays a vital role in propelling the system forward. Entrepreneurial leadership is the mechanism by which new combinations are created, new markets are opened up and new technologies are commercialized that are the basis for prosperity. In an entrepreneurial society, entrepreneurship plays a vital role in the process of wealth creation and philanthropy plays a crucial role in the reconstitution of wealth. The execution of this as we have argued earlier in this paper was based on the development of a new character type possessing unprecedented new powers of discretion and yet bound to collective ends.

American philanthropists – especially those who have made their own fortunes – create foundations that, in turn, contribute to greater and more widespread economic prosperity. This was Andrew Carnegie's hope when he wrote about "the responsibility of wealth" over a century ago that still inspires entrepreneurs today, though they usually express it in terms of a duty to "give

something back" to the society that helped make their own success possible. This model of entrepreneurial capitalism, despite the unequal distribution of wealth, with its sharp focus on entrepreneurship and philanthropy should be encouraged. Much of the new wealth created historically has been given back to the community to build up the great institutions that have a positive feedback on future economic growth. Rather than constraining the rich through taxes, we should allow the rich to successfully campaign for social change through the creation of opportunity. For example, in the past the fight against slavery had some very wealthy backers. If we shut off the opportunities for wealthy individuals to give back their wealth we will also shut off the creation of wealth which has far greater consequences for an entrepreneurial society.

VII. Conclusions

Self-interest and altruism, though very different motives for human activity, are in fact fundamental traits of human nature that are especially crucial in maintaining the strength and vitality of a capitalism economy. Generation of economist has cited the Adam Smith of the *Wealth of Nations* in support of the preeminent role of the self-interest motivation in human activity. But even Smith recognized that society does not progress on the basis of self-interest alone.

In order to understand the relationship between economic development and economic dominance, we need to answer two questions. First, do the wealthy entrepreneurs engage in philanthropy on a purely self-interested motivation or is it altruism? If the answer is the latter, then economic theory should alter its underlying premise of a self-interest motivation for human activity. If there is not only self-interest, then the question that arises is, "Whether the returns to society are greater when the philanthropic behavior requires no *quid pro quo*?"

The Entrepreneurship-Philanthropy nexus is an emerging area of research (Acs and Phillips, 2000). There are six research agendas that are relevant to understanding this nexus. First, Identifying wealthy entrepreneurs and measuring their philanthropic contributions. Second, identifying the extent to which wealthy entrepreneurs

engages in philanthropic activities. Third, Are the philanthropic activities of today's wealthy entrepreneurs, when measured by size and societal impact, greater than with those in the late 19th and early 20th century? Fourth, Do the wealthy entrepreneurs engage in philanthropy on a purely self-interest motivation or is it altruism? Fifth, Should economic theory alter its underlying premise of a self-interest motivation for human activity? Sixth, How do these activities vary across countries?

What is required to sustain American and global capitalism into the next century is a renewed spirit of philanthropy among the new rich. Through philanthropy the maldistribution of wealth can be channeled into creating opportunities for future generation through creating knowledge today. Sustaining global capitalism will require vision and investment from Americans and a spread of the ideas that indeed make American capitalism successful. The projects for philanthropy are as broad today as they were one hundred years ago: health, education infrastructure, and social values. If the new rich rise to the occasion, then prosperity will continue well into the next century as the coming "Golden Age of Philanthropy" creates the investments that will have a positive feedback on entrepreneurship and future prosperity.

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Notes

¹ For a statement on the nature and logic of capitalism see Robert L. Heilbroner (1985). Of course it is precisely the institutional framework that differs from country to country and not necessarily the logic of the system. For a discussion of the different institutional frameworks see Michael Porter (2000) on Japan, Wolfgang Streech and Kozo Yamamura (2002), on France see Honah D. Levy (1999) and on Sweden see Karlsson and Acs (2002, special issue on Institutions, Entrepreneurship and Firm Growth).

² One could argue that the recent antitrust case against Microsoft was as much about anticompetitive behavior as about violating this social contract.

³ Also see Coase (1976).

⁴ See Salamon and Ahheier (1999).

⁵ For an alternative view see Ayn Rand (1999).

⁶ Also see Tyson (1992) and Thurow (1992).

⁷ While Americans allow entrepreneurs continually to change the economic system, the French, for example, "are fighting to preserve what is to them one of the most successful societies and most agreeable ways of life in the world – one that other Europeans esteem and Americans still flock to, admire and even envy." *The Washington Post*, April 14, 1997, A1.

⁸ This is important, because recent evidence suggests that the share of inherited wealth is *negatively* related to economic growth, while entrepreneurial wealth is *positively* related to economic growth at similar levels of development (Morck et al., 1998).

⁹ For a theory of knowledge in economic growth, see Arrow (1962) and Romer (1990). For an application to the regional and global economy see Acs (2000).

¹⁰ For treatment of the Soros perception of the global problem, see Soros (1998).

¹¹ *New York Times*, December 2, 1998: A10 and *Newsweek*, August 30, 1999, p. 50.

¹² "The New Philanthropists", *Time*, July 24, 2000.

¹³ Also see Porter and Kramer, 1999.

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