THE BROOKINGS INSTITUTION

CAN AMERICA GETS ITS ENTREPRENEURIAL GROOVE BACK?

A DISCUSSION ABOUT PRIVATE CAPITAL'S ROLE IN THE ECONOMY

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Morning Keynote: Can America Get Its Entrepreneurial Groove Back?

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P R O C E E D I N G S

MR. RICE: This morning we're going to talk about capitalism, free markets and entrepreneurship. The Private Capital Research Institute is pleased to co-sponsor this event with the Brookings. We've been working together for some period of time now on this particular project. And I must say it really is very gratifying to see this turnout this morning. You know, you hold one of these and you wonder whether anybody's going to show up or not.

So -- thank you very much. We appreciate it.

I want to say a couple of words by way of introduction to the Private Capital Research Institute. PCRI was formed to sponsor academic research on private capital. It's the successor to an effort that began in conjunction with the World Economic Forum to study the impact of private equity in a variety of different areas such as employment, capital investment, and creativity. That particular effort was led by Josh Lerner, who will lead the discussion on research this morning.

Josh is, in my opinion, the foremost academic working in this field. And he has felt for some period of time that the databases available for research in this area are inadequate, confused, and confusing. It's almost impossible for policy-makers, legislators, chief executives, or academics to truly analyze the impact of any particular private equity transaction because the gaps in the data are so great. And so the PCRI has undertaken to develop an extensive database, which will be accurate, complete, and unimpeachable.

The work of gathering this data is hard work, because the data is owned by a series of organizations who regard it as very valuable and highly proprietary. But thanks to Josh's efforts and the efforts of the research director, Leslie Jeng, we're making progress. And at some point in time, PCRI is going to have constructed a database, which will permit new insights into the role that private capital plays in our economy.

I think we're all conscious of the fact that we need new insights. Whenever we talk about growth, and debate the questions of growth, the conversation always goes -- almost like a knee jerk -- to public capital, to government intervention. And yet we know that private capital is infinitely more flexible and more creative than public capital is. And so the knee-jerk reaction is one that we simply have to get by.

We are hopeful that the work that's done by the PCRI will introduce a whole series of new thoughts, and may suggest some solutions to the problems that we face today.

Let me close with a note of thanks to Martin and the Brookings. Martin's been an active and good partner in this effort. And the Brookings, of course, is the Brookings -- the finest institution of its kind in the country. And we're very grateful for their support.

Let me now introduce out keynote speaker, the noted columnist David Brooks.

David?

Morning Keynote: Can America Get Its Entrepreneurial Groove Back?

MR. BROOKS: I guess lacking as much expertise as anybody else in this room, I thought I would give sort of a background on the values, the environment, and the historical forces that I think shape private capital markets and entrepreneurialism in America.

And the story begins about four or five hundred years ago. The first European settles come to this shore, and see -- they see forest stretching off into infinity, flocks of geese so big it takes them 45 minutes to take off. And they're just stunned by the material abundance of the country.

And they have two simultaneous thoughts. The one is that God's plan for humanity can be completed here. And the second is, they're going to get really rich in the process.

And so this is the essence of American capitalism, the idea that we have a moral materialism. We are materialists working on matter. As the Puritans said, "We have two callings: a rowing for heaven, and a rowing for wealth." And these two things in American culture are intertwined and hard to pull apart.

And this driving moral materialism has given us what America has always been known for, which is energy. We move more often than people in any other country. We switch jobs more often. The job tenure in the U.S., on average, is about seven years, whereas it's 10 years in France, 11 years in Germany and Japan.

We switch religions more often. I recall covering a Democratic presidential field where very single candidate in the primary presidential field had switched religions, switched denominations. Howard Dean switched from, I think, Episcopal to Baptist because he didn't like the Episcopal policy on a bike path in Burlington, Vermont. (Laughter.)

We volunteer more often. Eighty percent of Americans belong to a voluntary organization, compared to 36 percent of Italians and Japanese.

We dine out more often. Fifty-seven percent of Americans eat out in a given week, compared to about 12 percent of the French.

And so we have 5 percent of the world population, roughly 20 to 25 percent of world GDP, three-quarters of the Nobel laureates. Some of the best schools in the world, some of the worst schools in the world. And as Seymour Martin Lipset wrote, “We are an outlier nation because we are driven by a spiritual wind.”

And this creates a climate of entrepreneurialism which I think is different -- others have different -- everybody has a spirit of entrepreneurialism in their country. I think you have fewer entrepreneurs in other countries than in this country, where the people think they are creating new futures, when they think their mission -- it’s not only to make money, though that’s part of it, it’s to change the world.

And so this is a cultural underlie that underlies American entrepreneurialism and the capitalists who fund it.

The second thing we have is we have a political system that grew out of this culture, designed to nurture capital formation and capital movement. This political system was pioneered by Alexander Hamilton.

And Hamilton, too, has his own value system. When Hamilton was 10, his father abandoned him. When he was 12, his mother died, in the bed next to him. He was adopted by a cousin, who committed suicide within a year. He was then adopted by his aunt and uncle, who died within a year and a grandmother, who also died within that year.

So between the ages of 10 and 14, Hamilton had lost every single person he loved, except for his brother. And a court actually took away all of his property.

By 17, he was managing a trading firm. By 24, he was George Washington’s chief of staff. By 34, he had written the Federalist Papers and was New York’s most successful lawyer. By 40, he was stepping down as the most successful Treasury Secretary in American history.

And so he created, and helped create, a system of capitalism, which was designed for poor boys like himself -- people who came from nothing and wanted to succeed. And this involved creating the credit markets, as we know them today. It involved sometimes using government money to fund manufacturing. It involved using government to break up the oligarchs, like Thomas Jefferson, to create fluid and open capitalism, and fluid and open credit markets.

And so this was the political tradition. We have sort of two parties in this country, but we have three traditions. We have a liberal tradition that believes in using government to enhance equality. We have a conservative tradition that believes in limited government to enhance freedom. But this Hamiltonian tradition is sort of in the middle, and sort of spans both parties -- more or less -- at a given historical moment, that believes in using government in limited, energetic ways, to enhance capitalism and to enhance social mobility.

And this tradition created the early industrial era of Hamilton's day, and then it sort of was embodied by the Whig party, then it was embodied by the early Republican Party with the Homestead Act, or Land Grant legislation, and the Railroad Act, and other pieces of legislation -- which involved using government to enhance the atmosphere for dynamic capital.

And this led to an entirely different political-economic culture than in other countries. In the 19^{th} century, the Europeans spent heavily on their welfare states. We spent heavily on our education systems. And over and over again, we've had the choice between achievement and equality, and Americans have tended to favor achievement. We've had the choice between security and dynamism; we've tended to favor dynamism -- with real human costs.

But the key was -- the key to the value system underlying American capitalism is the balance between moral and the materialism. The key to the Hamiltonian system was the balance between government and private markets, private capital markets. And it was always achieving that balance, and maintaining that balance, that was the key to the prosperity through the 19th century.

Now I would say over the last few years -- especially in the last three or four years -- we've a bit lost that balance, which explains sort of the crisis of confidence the country is in now. Sixty percent -- or 60 or 70 percent Americans think America is in decline. A tremendous loss of faith in institutions, and especially in the financial markets.

Now, I'd say that loss of faith, and the crisis we now find ourselves in, has a series of deep causes. One of them is a shift in values. From a sense of balance of what to achieve and what not to achieve, I'd say that balance got out of whack over the last 30 years. One of my favorite polling statistics over the last generation or so is this one: Gallup asked high-school seniors in 1950, "Are you a very important person?" And in 1950, 12 percent of high-school seniors said, "Yes, I'm a very important person." They asked that same question in 2005, and it wasn't 12 percent, it was 80 percent who said, "I'm a very important person."

And that's one thing -- I could go on for hours about this, but that was a cultural shift. A cultural shift from a culture of self-effacement that says, "I'm no better than anybody else, but nobody's better than me," of sense of limitation of what you should do, to a culture of self-enhancement, that says, "I am pretty special." We spent a generation telling people, "You're incredibly special," and they believed us. (Laughter.)

And so this shift produced some real-world changes. One, if you think you're pretty special, you're going to spend on yourself as befits your station. And so personal consumption, which is about 60 percent of GDP throughout the 20th century, shoots up to 70 percent starting in 1970. Personal debt, which is about 43 percent of GDP over the course of the 20th century shoots up to 133 percent starting in the 1970s.

Attitudes toward risk -- if you think you're pretty special, you're going to be willing to tolerate huge amounts of risk. And we're seen in the capital markets and in entrepreneurialism, and especially on Wall Street, an incredible risk tolerance over the past 20 or 30 years, which has led to this boom-and-bust psychology, which has a tremendously corrosive effect on the general public.

Another factor that's changed is compensation patterns. Throughout the 20th century there were many companies making a lot of money. Their CEOs could have asked for huge compensation packages. There are many reasons they didn't but one of them was social norms. You just didn't ask for a $20 million a year compensation package, because that would have been shameful. But starting in 1970, compensation packages begin to shoot up because it seems fine, and those norms are eroded.

And then finally: polarization. If you have a modest sense of yourself, you feel, well, I need people to disagree with me, because I need the debate. I rely on the debate, and I rely on the other side. If you think you're pretty special, and you have 100 percent of the truth, than the people who disagree with you are just in the way.

And so I think this shift in culture has contributed to a lot of social problems, including the debt, the boom-and-bust cycle, and the polarization.

The second challenge is what Mancur Olson called "demosclerosis," the rise of institutions which burden, especially, the political system -- the tax code, the regulatory code, the special interest groups like Grover Norquist, which rule out any tax increases for anybody on the Republican side. We've had an agglomeration of these interest groups, which serve as carbuncles on the body politic. And they've just built up slowly over time, but they now impinge anybody in power.

The third challenge is what I think -- and I'm persuaded by this -- the great technological stagnation. Tyler Cowen has written has about this. A number of people have written about this, the idea that technology, which was improving so quickly during the 20^{th} century, has hit a phase of stagnation -- not forever, but a phase of stagnation. And I highly recommend Cowen's book on this subject. He points out that if you were born in 1900, you were born into horse-and-carriage world. But if you died in 1969, you died in a moonwalking world. That's a huge technological advance over 70 years.

We've now entered a phase where technological advance has slowed down in many fields, with the exception, you would say, of IT and probably robotics. But our kitchens look pretty much the way kitchens looking when we were born. Our energy sources look pretty much the way our energy sources looked when we were born. Our airplanes are pretty much the same as the airplanes we used when we were born. Pharmaceuticals have seen this slow growth of stagnation.

Cowen's argument is we've seized the low hanging fruit, and now we face much tougher challenges. And I observe this myself when I go to NIH and take to the geneticists. You talk to the geneticists and they'll say, "Ten years ago, I really thought we were going to understand these problems in my lifetime. Now we realize they're much more complicated than I thought, and we will not solve them in my lifetime." So there's sort of a double-hump of the learning curve. We climbed to the top, thought it was going to be straight up, but then complexity came in and we were all the way down here again.

And so that's the third challenge. And so it's led to this long economic slowdown.

So I've tried to describe, first, the historical values underlying American capitalism. Second: the political system. And third, the challenge we find ourselves under.

And so the question becomes, is this indeed -- these challenges, is this long-term decline, which will drag American capitalism to a state of stagnation, or is it a recuperation of -- a winter of recuperation? We're just in a down phase, and we're going to come back stronger than ever?

I happen to think we're in a -- well, the majority of Americans clearly think this is the beginning of long, slow decline. That our capitalism is becoming ossified.

I think that's wrong. The America that the founds, our ancestors, came to, the America that Alexis de Tocqueville came to, is still basically the America that we live in today. The values and the culture are the same.

Second, we're in a period of incredible social repair. Government is terrible. But American society is actually in pretty good shape. Crime is down 70 percent. Domestic violence is down 50 percent. Teenage pregnancy is down 30 percent. Teenage suicide is down. Divorce rates are coming down.

And so people -- the younger generation in particular -- has done an incredible job of re-weaving the social fabric. They're an incredibly hardworking, responsible generation -- or we're going to have the biggest mid-life crisis in human history in about 10 years. (Laughter.) But up until then, we're in a period of incredible social repair.

Third -- demographics. I'm going to get the numbers slightly wrong, but by 2050, the average age in China will be about 52, in Japan 52, in the U.S. it will be 38. And so that's the sign of a hopeful country.

We still are a low corruption country. We still are a hardworking country. We still have competitive industries.

But the most vital thing is, is that we still have the ingredients for creativity here. We have the fundamental ingredients for creativity.

And what are those ingredients? Well, it's in the social networks. What is creativity? There's a whole vast body of research on what creativity is. And basically, creativity is not starting and creating something new out of whole cloth. Creativity is taking two discordant idea networks and smashing them together.

So, for example, Picasso took Western art and African masks, and he smashed them together and came out with his art. Steve Jobs took computer geekdom and LSD-India-New Age hippiedom and he smashed them together, and created his creativity.

And so we still have a dynamic culture, which encourages that kind of smashing of idea networks. And that's because, second, what do you need idea networks smashed together? You need what the historians call "verges." Verges are a place where discordant cultures come together. And we still remain a crossroad nation, where people from all over the world come together and share ideas. We have a tremendous tolerance for outsiders. And so we have a tremendous talent for creating hubs. Creativity depends on hubs and social networks.

The most important ingredient to entrepreneurial activity is creating places where people can go, leave, go to again. Howard Gardner of Harvard has a quintessential create person, and the life span of a creative person. And he says this person, she comes from the periphery. She lives off on the edge of society somewhere. She feels alone when she's in her hometown. And she feels herself outgrowing her small circle. So she goes to the big city and finds a lot of people like herself, and forms a group of people with people like herself. She gets involved in a team and they work on a problem.

But then after working the problem with a team for a little while, she has her own independent interests, and she goes off on her own. And she works on this interest on her own, leaving the team. Then she emerges with some new thing. Then she brings it back to the team. They test it, they work on it, it fails, and they build it.

So it's this process of going to the hub, leaving the hub, going to the hub, leaving the hub. This idea of creative networks -- flexible and rich networks.

These flexible and rich networks don't just happen out of nowhere. You can't just build them with a government program. They depend on incredibly high degrees of social trust. "Spontaneous sociability" is what the sociologists call it. You could be off in Dubai somewhere, and you can build a lot of buildings together, but if you don't have that spontaneous sociability, you're not going to get the networks, you're not going to get the creativity. And this is something we do phenomenally well here naturally.

By contrast, look at Edward Banfield's work on southern Italy. People had tremendous trust for people within their own families. They did not trust people outside the families. So the firms could grow as long as they could employ only family members. They had trouble growing when they stepped outside the family bonds.

But we have that spontaneous sociability. We're incredibly good at creating clusters deep in American culture. We're incredibly good at creating new cities -- a new Mesa, Arizona, a new Silicon Valley. Cities work because they are hubs. They magnify talent. Urban incomes rise faster because productivity of urban workers rises faster than the productivity of rural workers.

People are smarter because they work better in teams. And they work better when those teams are face-to-face. The University of Michigan did these studies where they gave people tests, math tests. Some groups met face-to-face and they were given 10 minutes to do the test. And they could solve the math, no problem. Some groups were given 30 minutes to solve the test, but they had to communicate electronically. They could not solve the problem. Because so much of our communication is by intonation of voice, by gesture, you need to be there together in the hub. And so you need that physical hub-ness.

And so we have, even despite the crisis, we still have the culture that we inherited from our ancestors, that culture of social trust, spontaneous sociability, of creating hubs. And out of that culture emerges the private capital industry, the venture capital industry, and others like it, which are really good at creating temporary communities.

The most accurate movie about American history is a John Ford movie called *My Darling Clementine*. Most of the westerns -- I think Henry Fonda was in this movie as Wyatt Earp -- most of the westerns are about shootouts, and the lone cowboy off on the range. *My Darling Clementine* is about people coming together out of nowhere and building a community. They put up a church. A barber moves to town. A newspaper is formed. The sheriff comes in and establishes law and order. And so it's not about the lone guy out on the range, it's about community-building -- achieving a purpose and then leaving to build another community. It's that community, leave, build another community.

And that's what the capital industries do. They gather people together and build those communities.

And so to take advantage of the underlying culture, we've obviously got to do two things. We've got to have government policies that will be in accordance with our underlying culture. And now there's a big debate -- which I'm sure others will talk about, with more information than I -- which is how deeply should government get involved?

Now, I have to say, when I interview politicians on this subject, I ask them a trick question. I ask them, "What industries do you think are the real industries of the future? What's going to really create a lot of jobs in the future?" Now the correct answer, when I ask a politician that question is, "How the hell should I know? I'm a politician?" (Laughter.) And I sometimes get that answer. In this administration some senior people give me a different answer. They name a series of industries they think are going to be the keys to the future. Other people in this industry give me what I think is the right answer, in this administration, give me the right answer. So I think there's a split.

And so the question is, how deeply involved is government going to be in this field? If the zero-yard-line is government should just provide police forces, and the 100-yard-line is government should be picking winners and losers and all that stuff, then me, I'm on our own 40-yard-line. Some people are on the 60-yard-line. Some people are stuck on the 40.

But that seems to me the debate. And it seems to me the lessons of the last few years have underlined the case that all of us who believe in staying on our side of the 50-yard-line has always made -- that government has essential problems in getting too involved in funding private business. There's the epistemological problem -- government just doesn't know enough. None of us know enough. There's a related problem -- the inability to fail productively. Private capital firms can fail productively, learn from that failure, and the market can move forward. Government is terrible at learning from failure.

There's the corruption problem and the regulatory capture problem. There's the politicization of goals. Government necessarily wants to expand the labor force. Most firms are trying to reduce their labor costs.

And so, to me, these are all endemic, and they haven't been solved. And even though we're in a moment when a lot of people are arguing for a more aggressive industrial policy, I think the fundamental truths still apply. They're embodied not only in Solyndra -- Steve Mufson had an article on a whole series of failures.

But even if you're like me and you think government should only be on the 40-yard-line and below, there's still a ton of stuff to do. Or -- Josh Lerner is here, who calls it "table-setting activity." And there's stuff to do like the Simpson-Bowles, to ensure fiscal future. Stuff to do like tax reform, corporate tax reform. A second generation of human capital policies.

We've done a great job of getting people into college. We've done a terrible job of getting them through college, providing them with the human capital they need to actually get a degree. Basic research. Creating technical universities, like Robert Steel and Mayor Bloomberg are doing up in New York. Fixing patent law. Fixing regulatory processes. Doing infrastructure. Fixing export controls. Creating clustering with zoning and other metropolitan policies. Creating one-stop career centers. You can go to the Kauffman Foundation, or Mackenzie, or Milken, AEI, Manhattan Institute -- there are good ideas, what Lerner would call table-setting ideas, which are just bubbling forth. There's plenty of good stuff to do without having to interfere too severely, crossing the 40-yard-line.

And then the final thing -- I'll just end on this -- is what private capital can do itself. Now, the industry is about to become a pariah. When Mitt Romney's running for president, his time at Bain is about to become a major issue in the campaign. And there's just going to be a wall of crap -- garbage (laughter) -- thrown at the industry.

And, you know, the smart thing probably would be to do a little preemptive publicity to get the news out there of what actually private capital does. The second thing to do is just keep your head down and do your job. But that's just going to be what's coming.

But keeping your head down and doing one's job is probably the right thing, and harkens back to the theme I started with -- the theme of balance.

I do think there's a sense -- one of the reasons the animal spirits are low is because there's a sense we've had this boom-and-bust cycle, and nothing is real. Effort is divorced from award. And to me, doing one's job, and picking entrepreneurs correctly, picking teams correctly, picking companies correctly, is a question of balance.

I'm a huge believer in Jim Collins' finding that the people most likely to succeed, either as entrepreneurs or in any other field of business endeavor, are those who combine these two balanced traits. Collins says they are extreme professional humility combined with intense personal will. And these two things are in tension with each other, but they're both the necessary traits for success in business.

I'm also a big believer in what Sarasvathy found, which is the distinction between people whose minds necessarily flow in corporate direction, and people whose minds necessarily flow in entrepreneurial directions. Sarasvathy says that corporate people do causal reasoning. They define a big goal, and then they march steadily toward that goal entrepreneurs possess what she calls "effectual reasoning." They define very vague goals. And their progress is a series of unpredictable improvisation toward that vague goal.

And finding people of that skill, it's people who have certain mental virtues. The virtues are what the scientists call "meta-cognition," the ability to see what you don't know. So they combine this intense personal drive with modesty bootstraps -- the ability to correct for their own overconfidence. We tend to be incredibly overconfident people. *Time* magazine recently asked Americans, "Are you in the top 1 percent of earners," and 19 percent of Americans are in the top 1 percent of earners. (Laughter.)

And so they correct for things like -- they correct with things like modesty bootstraps. The best one I read was recently, it's called the pre-mortem. Before you make a decision, write a short story about what would happen if that decision went horribly wrong -- which is the thing we tend not to think about before the decision.

They'll be aware of things like the focusing illusion. Nothing is as important as we think it is at the moment we're thinking of it. And so, for example, we think that education is really powerful in shaping inequality in this country. And that's true. Education is the most powerful thing in shaping inequality.

But if we equalized education in this country, we would reduce inequality by less than 15 percent. So there's a zillion other factors, and we should focus on some -- things like path-dependence. We should be aware that every circumstance we're in the middle of existed for some historical reason, but which may not exist for a good reason now.

The Pareto principle -- we tend to be under the illusion that all curves are bell-curves that most people are in the middle. But the Pareto principle holds that 20 percent of the employees do 80 percent of the productivity. That 5 percent of the Twitter users produce like 90 percent of the tweets.

And so we have this illusion that things are always bell-curves. Things are not always bell-curves.

So what these successful entrepreneurs have is this balance, this balance between extreme personal daring, and extreme modesty about what they know -- this epistemological modesty.

And so I've tried to describe very quickly, to lay an underground for all the more substantive discussion to follow, the historical forces facing American entrepreneurialism and American capital markets, the historical structure that Alexander Hamilton and others have created to give us a superstructure for capital markets. And then the current crisis that we find ourselves in the middle of, which I think has value, values and philosophical basis. And then, finally, just to remind us that we have these underlying strengths -- dynamism, the flexibility, our ability to create spontaneous sociability and networks.

And then, finally, the tasks ahead which, to me, are about government setting the table, staying on this side of the 40-yard-line -- and entrepreneurs creating a more balanced and sustainable system for funding entrepreneurs.

And my basic belief is that we're going to have a very bad 10 years in this city. We're going to have a fiscal crackup at some point. I once asked somebody in this administration, "Do you think we'll avoid a fiscal crisis in the next 10 years?" And he said, "Nah, I don't really see that." And so I said, "Well, how bad will it be? Will it be like Greece? Or will it be like the decline and fall of the Roman Empire?" And he said, "Well, probably a little worse than Greece, not as bad as Rome -- sort of in the middle there." (Laughter.) And I basically agree with that.

But the good news is that we have tremendously strong values, tremendously strong institutions. And we have this ethos of daring, and we have people willing to fund that daring and create the communities that build companies. So we'll be okay after a bad 10 years.

Thank you very much. (Applause.)

SPEAKER: (Inaudible) -- questions?

MR. BROOKS: Okay. Sure.

MR. HEDERMAN: Thank you. Bill Hederman, from Deloitte.

I want to thank you for solving one of the big mysteries I've had for a long time, which was -- as someone who grew up in Brooklyn, how come I can't get a good pizza outside of New York? Now, I know it's just Italians only trust their family -- (laughter) -- and non-Italians building pizza franchises.

But my question was related to the point you made about shame and corporate executive compensation. That made sense when you said it, but as you went on, I'm going, gee, the entrepreneurs have gone far beyond that compensation.

And I just was wondering if you could speak to that difference?

MR. BROOKS: First, they're probably going to -- well, I won't -- there are probably Chinese firms in China that are making fabulous pizza that are going to take over. (Laughter.) And I should also mention -- you mentioned Brooklyn. There are various strains -- and I'm fascinated by these strains that run through families. If you look at *Who's Who in the 20th Century*, that book in 1950, the number of people who had parents who were missionaries in China is phenomenal. Way disproportionate. You get incredibly driven.

And similarly, if you look at entrepreneurs today, the number of people who could trace their ancestry back to the textile business in Brooklyn, either by one or two generations, is phenomenal -- including Steve Jobs, by the way. The number of entrepreneurs, really big entrepreneurs who had people working in the "schmatta business," as we say in my faith, tradition.

Now, the point about the shame, and why entrepreneurs can earn more -- there is a certain -- I wrote a column about this last week -- certain social status which is peculiar by industry. So if you make a product that's used by yuppies, like the iPhone, you can make a zillion dollars and nobody things the worse of you. If you make a product not used by yuppies, like a turbine, you better not earn too much. And so there's that difference.

But the more serious thing is -- and I think this undergirds a lot of our politics -- there is an equation people have in their head between effort and reward. People think if you took your average Tea Party person, he went to high school; he worked hard when nobody else was. He went to college, maybe he wanted to major in history, but he knew he needed a job so he became an accountant. He bought a house he could afford when people around him were not buying a house they could afford.

All along the road he played by the rules. And he things his effort should be rewarded. And he looks around the society and, because of the bailouts, because of the compensation packages -- especially in finance -- he says, "Those people are not playing by the rules. They're getting bailed out. And I'm paying the bill. There's been a severance of the link between effort and reward. And I want that put back."

And so if you make a zillion dollars, like a Steve Jobs or Bill Gates, but I can see how your compensation is related to effort, then people don't have a problem with that. If you're part of a group of young people on Wall Street who, the compensation happens to reward you for minimal effort, or for average effort, and I don't see the link, then I do have a problem with that.

So it's really establishing that values link, rather than the overall number of your salary. That's the key.

SPEAKER: Well, let me ask you a question.

You mentioned teamwork. Do you think our education system teaches people how to do teamwork?

MR. BROOKS: Ahh -- no. (Laughs.) You know, what teaches people how to do teamwork, it's mom. And this is actually a problem. Scientists can predict at 18 months who's going to graduate from high school. Because what they do is they take a look at infants in a room, they give them what they call the "strange situation test." An infant goes in a room with mom. Mom leaves the room, stranger comes in, mom comes back into the room. They watch the infant at each of these transition moments.

And about 55 percent of the infants in this country have what they call "secure attachment." And those kids cry a little when mom leaves, but then they settle themselves and they run to greet her when she comes back.

Those kids have in their head a model -- a model for how to build a relationship with mom. And then when they get to school they use that model, how to build a relationship with teacher, how to build a relationship with peers. And they are generally, on average, reasonably good team-builders and members of a group.

Twenty percent of the kids in this country are what they call "avoidingly attached." And those kids, they sent signals to mom but nothing's come back. And so those kids, when they go to teacher -- a teacher described it in one thing I read -- like a sailboat tacking into the wind. Wanting to get close to the teacher, not knowing how. And those kids do much less well in school because they don't know how to build relationships. And even in adulthood, they tend to be more aloof. They have, according to one study, two-thirds fewer friends at age 70.

And then another 20 percent are what they call "have disorganized attachment." Home has been completely chaotic. They're terrible at forming teams.

And so it's not really school's job to make people good at team-building, it's family structure that does it. It's the models laid down in people's head at phenomenally early ages. And I should say nobody's life is determined by 18 months, but these early experiences open up pathways, which can be confirmed or de-confirmed by later experience.

And so one of the problems we face in the country is that 40 percent of kids are born out of wedlock -- 70 percent of African Americans, 65 of Hispanics, about 55 percent of Whites whose parents have high school degrees. And so those people, on average -- again, on average -- are going to be less able team-builders. And that's one of the reasons, by the way, we see the huge social inequality between college-educated and less-college-educated people.

So to me, you know, schools can compensate if they're KIPP Academies. But the underlying social fabric is being eaten away a bit by that problem, which is going to make it hard to build communal teams.

SPEAKER: Do we have time for one more question?

MR. BROOKS: Over there.

SPEAKER: I agree with you that it's difficult for anybody, including government, to pick winners. But how would you assess DARPA, which seems to have been able to pick winners and further certain industries. How would you analyze DARPA?

MR. BROOKS: Well, again, I would go back to my football, which is staying on the 40-yard-line, or the table-setting analogy. And there are many other people in this room -- you should ask this later in the day -- but my impression from the research is that you can create the original idea. You can go up to NIH and show the basic research. But actually bringing that idea to market is probably best done by somebody else because it involves a lot of failures.

Government just doesn't fail well. When things fail they don't die off. And we don't -- the people who tend to go into government are not the people who have that kind of mind-set that I described.

And so DARPA, I think, is an example of a group of people who, A, were outliers within government -- because it's sort of a unique entity -- who experimented and created this thing which was then brought to market by other people. So they set the table, but I would not say they actually created the companies. And so, in some sense, that's a reasonably good example. NIH is another reasonably good example. Creating a technical university in New York, funding great colleges and great universities, doing the basic research -- those are all fine examples of setting the table.

And you can point to examples where government actually brought something closer to market. And other people in this room have done a lot of work on this. I would say that's by far the exception, and by far overshadowed by the syn-fuels, by the fusion, by all the experiments that government has done that didn't work out.

Anyway, thank you very much.

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CERTIFICATE OF NOTARY PUBLIC

I, Carleton J. Anderson, III do hereby certify that the forgoing electronic file when originally transmitted was reduced to text at my direction; that said transcript is a true record of the proceedings therein referenced; that I am neither counsel for, related to, nor employed by any of the parties to the action in which these proceedings were taken; and, furthermore, that I am neither a relative or employee of any attorney or counsel employed by the parties hereto, nor financially or otherwise interested in the outcome of this action.

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