GREYCOURT

White Paper No. 56:
Being Rich

February 2013

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It will come as no surprise to anyone who is a member of a wealthy family – or anyone who works with such families – that many of the rich have an uncomfortable relationship with their money. This is rarely a problem for G1 – the generation that made the money – but it crops up regularly as we go down through the generations. Worst of all, it tends to be a special issue for younger family members.

Scott Fitzgerald: "The rich are different from you and me."

Hemingway: "Yes, they have more money."

Young people – rich, poor or middle class – want to be like their friends. But if you're rich, you are by definition *not* like your friends. Having more money makes a person different, especially if that person is young and trying to make his or her way in the world. We work with a family whose son – we'll call him Sean – graduated from college and was looking for an apartment in Boston's Back Bay with three of his friends. Apartments in that part of town tend to be expensive, and so the friends came up with a terrific idea: Sean would pay for half the rent, while they would split the other half.

To the friends, this was simple fairness, since Sean was rich and they weren't. But Sean feared that it told him the one thing he didn't want to hear – that they only cared about him for his money. Maybe they did and maybe they didn't, but the episode fed into Sean's worst fears as a child of wealth.

The purpose of this paper is to examine the issue of wealth from a perspective outside of, but sympathetic to, the world of wealthy families. *Should* the rich feel guilty about their wealth, especially if they didn't earn the money themselves? And, more broadly, why should a democratic society tolerate a wealthy 1%? Our answers, we hope, may surprise you.

❖ Winning the "Wealth Lottery"

We frequently hear people who are struggling with their wealth saying something like, "I did nothing to earn my wealth. All I did was win the 'wealth lottery.' I was just born lucky. Why wouldn't I feel guilty about it?"

I did nothing to earn my wealth. Why *shouldn't* I feel guilty about it?

There's something to that, of course. Winning the Wealth Lottery was a nice bit of luck, to be sure. But it's worth keeping in mind that there are other "lotteries" people can win at birth, and many of them are more desirable than the Wealth Lottery.

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Gregory Curtis, Chairman
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Consider that you might have won the "IQ Lottery." People like Packard, Hewlett, Gates, Brin, Zuckerberg and others weren't born into wealth – they didn't win the Wealth Lottery at all. What they did win was the IQ Lottery, and that's what allowed them to become rich. (That and a lot of hard work and some good luck.) As between winning the Wealth Lottery or winning the IQ Lottery, the latter is a far more certain route to success, happiness, and even wealth. (Remember that most people who win the Wealth Lottery follow the "shirtsleeves-to-shirtsleeves-in-three-generations" model.)

Closely allied to winning the IQ Lottery is winning the "Talent Lottery." Michael Jordan, Luciano Pavarotti and Toni Morrison won the Talent Lottery and they rode it to both fame and wealth.

But if we think about it, even winning the IQ Lottery or the Talent Lottery, superior as they are to the Wealth Lottery, have their drawbacks. Far too many precocious children find themselves being pushed ahead by stage parents, living strange and lonely lives far removed from what we would normally think of as happy.

No, as parents and as a society what we most wish for our children is that they will win the "Loving Family Lottery." That's the surest route to happiness, good health, and a long, productive life.

So, sure, the Wealth Lottery is one of the good ones to win, but it's far from the best. Let's call it a fourth-place finish. Yet, we almost never hear winners of the top three lotteries feeling guilty about their lives. Why should winners of the Wealth Lottery feel guilty?

❖ Economic Anarchists

We often think of the wealthy as pillars of society, as conventional people who don't rock the boat and don't want others to rock it. But guess what? Wealthy families didn't start out that way. Doing the same thing as everyone else, following the rules, taking the traditional, expected path in life is, well, no way to get rich. The way to get rich is to do something – invent something, build something, create something – that seriously undercuts what the existing pillars of society did.

Grandpa was an *anarchist*?

From Mellon, Carnegie, Rockefeller and Ford earlier in the Industrial Revolution to Packard, Hewlett, Gates, Jobs and Zuckerberg more recently, wealth creators got rich by crushing the leading corporations and industries that had dominated the landscape before they came along. The creative destruction process by which capitalism works drives progress forward not just by creating something new, but by destroying something old.

Later generations of wealthy families might be conventional and they might not. But you can bet your iPad that G1 was about as unconventional as people can be: true economic anarchists. That spirit, that refusal to accept the status quo and just get by, is somewhere in your DNA. It can come out in good ways or bad ways, but it's there and it's something you can lean on to make the world a better place.

❖ But What About Equality?

As we all know, the Declaration of Independence – the document that started it all – opens with these stirring words: "We hold these truths to be self-evident, that all men are created equal…". There is no doubt that equality is a powerful idea and that there is a lot of inequality out there. But is full equality of *outcomes* really what we want? We could get that easily – by emigrating to North Korea or Cuba.

Like it or not, a certain amount of inequality is the price we pay to help the disadvantaged. Are you familiar with the "Gini coefficient?" It's a measure of statistical dispersion that is used to determine how equally income (or wealth) is distributed in a society. Among relatively developed countries, Denmark has the "best" Gini coefficient and Mexico the worst. Small, rich, homogeneous nations tend to have good Ginis and bigger, poorer, or more heterogeneous nations tend to have lower Ginis.

Wealth Ginis might surprise you: countries with lousy Ginis include Sweden, Israel and Switzerland. The so-called "Pareto principle" holds that changes in income or wealth are good if they make some people better off without making anyone else worse off. In other words, the Gini can get worse, but that's actually good. In the 1950s the US had a better Gini than it does today, but back then 20% of the population lived below the poverty line, while today that number is 13%. Which society would you rather live in?

Yearning for perfect equality? Consider moving to North Korea.

A young law school graduate recently wrote an amusing article making gentle fun of people who look only at Gini coefficients. He pointed out that, before they hired Michael Jordan, the Chicago Bulls had a great Gini. They also tended to finish 4th or 5th in their division and to miss the playoffs regularly. Then they hired Jordan and their Gini went to hell – Jordan alone made $33 million! But guess what? The Bulls built one of the greatest dynasties in sports history, winning six championships in eight years, including two three-peats. The average player's salary rose by a factor of seven. So who was unhappy about all this inequality? Not Jordan. Not the average Bulls player. Not the Chicago fans. The only unhappy folks were the teams with better Ginis.[1]

As no less an authority than Abraham Lincoln once put it:

> "The prudent, penniless beginner in the world labors for wages awhile, saves a surplus with which to buy tools or land for himself, then labors on his own account another while, and at length hires another new beginner to help him. This is the just and generous and prosperous system which opens the way to all, gives hope to all, and consequent energy and progress and improvement of condition to all."

Equality is important, of course, but it isn't everything. Instead of spending our time wringing our hands about inequality, that time might be better spent improving the lives of those at the bottom of the income and wealth pyramid. Wealthy people usually have both the time and the money to work on this crucial issue.

❖ What Makes America Great?

The obvious reason to encourage wealth in a free society – despite all the inequality associated with that – is that the lure of becoming rich is what motivates many talented people to put those talents to use in the service of human betterment. From Andrew Carnegie to Jonas Salk to Mark Zuckerberg, the world has been infinitely enriched by people who started out poor or middle class but who became rich by building something extraordinary.

What makes America great? Some of the answers might surprise you.

Ok, that covers G1, the one that made the money, but that generation is rarely troubled by guilt anyway – they know perfectly well how hard they had to work to get where they are. But what about G2 through, say, G7? (The oldest wealthy families in America are now into their seventh generation, with G8 just coming along.[2]) What role is played by capital that remains in the hands of generations subsequent to that of the founders?

We're going to make an assertion that might startle – or even annoy – you. But bear with us. The assertion is this: Of all the attributes that have led to American exceptionalism – that have made the country the most powerful, most dominant nation in the history of civilization, the most important may be our attitude toward private capital.

Since the days of Alexis de Tocqueville (1831), observers of America have tried to put their finger on what it is that makes America so different from other countries. Our candidate, as we just pointed out, is America's positive attitude toward private capital – toward wealth and what it can accomplish. Why would we say such a thing? Let's look at the evidence for it.

The first thing we might notice is that America (1788) and the Industrial Revolution (1800) were born at the same moment in human history. The Industrial Revolution was the most important historical event in the long course of human civilization because from that point in time human wealth and quality of life exploded. From Periclean Athens (about 450 BC) until 1800, human wealth grew hardly at all. From that point until 2000 – a mere 200 years – human wealth grew 4,000%.

The "separated at birth" relationship between the Industrial Revolution and the US is a crucial point: every other important country in the world had existed for centuries (or millennia) by the time the Industrial Revolution began and they therefore had developed robust cultures that were overwhelmingly hostile to the creation of private wealth.

Imagine that you were an aristocrat in Europe in 1800. Your family had been wealthy and powerful for untold generations. Now, suddenly, untitled upstarts were creating enormous wealth and power that rivaled, or in many cases exceeded, your own. Consider the case of Andrew Carnegie, an immigrant boy who arrived in America in 1848 too poor to afford schooling. By 1901, when he sold Carnegie Steel to a group of investors who formed the United States Steel Corporation, Carnegie was the wealthiest man in the world – king, prince, aristocrat or otherwise.[3]

But it wasn't just titled snobs who were scandalized by the sudden extension of wealth to former nobodies. At the other end of the spectrum, Karl Marx, Friedrich Engels and others simply couldn't stomach the idea of the new, wealthy middle class that had sprung up. In *The Communist Manifesto*, Marx confidently predicted that, come the revolution, this hated bourgeoisie would be destroyed.

But America had no such problems with the Industrial Revolution and its consequences. On the one hand we had no titled aristocrats, and on the other we had no rigid class structure. Marx advocated for the proletariat because the class system in Europe meant that once-a-prole, always-a-prole. But upward mobility was part of the American Dream from the beginning.

❖ What the Rich Do With Their Money

America welcomed wealth, and wealth made America great. Think we're exaggerating? A rich family, by definition, is one that can support itself in comfort and still have excess capital that needs to be deployed in some fashion. Consider just a few of the things these families do with their capital that has given America an enormous competitive advantage over other nations. And note that we're not talking about just G1, now, but about *every* generation of a wealthy family.

Supporting entrepreneurship. Not everyone – rich, poor or middle class – has what it takes to be an entrepreneur (whatever that is, no one seems to know). But families with excess capital can and do *support* entrepreneurship in numerous ways. Venture capital investing, as we understand it today, was invented by Andrew W. Mellon in the late Nineteenth century. While most of the early Industrial Barons made their money by creating one great company – Carnegie in steel, Ford in cars, Rockefeller in oil, Morgan in banking – Mellon was a very different kind of Industrial Baron. Mellon would sit in his office at the family bank, then known as T. Mellon & Sons (now Bank of New York Mellon), and loan money to businesses. When a particularly interesting new business came along, Mellon would not just make a loan, he would invest directly in the company, taking stock instead of a promissory note. Thus, while other barons built one great company, Mellon helped build many: Mellon Bank, Gulf Oil, ALCOA, Koppers, Carborundum and many others.

In the 1970s, when venture investing was "rediscovered," it was again private families who led the way. For nearly two decades the largest venture capital investor in the world was the Henry Hillman family. By the 1990s, institutional investors (led by Yale University) had begun to dominate the later stages of venture investing, but families continued – to this day – to dominate the early stages, including the all-important "friends & family" rounds, angel rounds, super angel rounds, and early stage investing.

The US has launched more Global Fortune 500 firms than all the rest of the world combined – by a huge margin.

Today, across the entire globe, the US dominates venture investing and it has developed an entrepreneurial culture more powerful than all the rest of the world combined. Over the past four decades, more Global Fortune 500 companies have been formed in the US than in all other countries put together – and that counts the many state-owned enterprises in the Global 500, firms that are the exact opposite of entrepreneurial firms.

Endowing higher education. No one needs to be reminded that higher education is crucially important to a nation's competitiveness. After all, this is where a society builds the intellectual capital that will power its progress. You might therefore expect that great universities would be evenly distributed around the world – but you would be wrong. Eight of the top ten universities in the world are in the US – add Oxford and Cambridge and you have the top ten. But it's better than that – roughly 80 of the top 100 universities in the world are in the US, a country with less than 5% of the world's population. How can this dominance possibly exist?

Here's the explanation. Let's rank the top 1,000 universities in the world by quality in one column. In the other column, let's rank the top 1,000 universities by *size of endowment*. What we'll find is that the correlation is extremely high. Endowment matters hugely to the quality, independence and stability of a university, and endowment comes from only one place: private capital.

Starting a foundation. Statistics are hard to come by, but of the roughly 90,000 charitable foundations in the world, 80,000 are in the US. How can that possibly be?

One explanation is that modern institutional philanthropy was invented in the US – by Andrew Carnegie – and over the subsequent century many, many wealthy American families have followed Carnegie's example of "giving back" to the society that nurtured their success.

But the larger explanation is this: foundation capital is best thought of as start-up capital for good ideas that can't easily be monetized. Just as wealthy families deploy venture capital to support good ideas that might make money, wealthy families deploy foundation capital to support ideas that can't.

Consider, just as an example, the Harlem Children's Zone, one of the most interesting and powerful anti-poverty programs in America since the demise of the Great Society. The Harlem Children's Zone is the brainchild of Geoffrey Canada, a brilliant and charismatic African-American; without Canada, no Harlem Children's Zone. But Canada's idea needed loads of money to get it launched and to keep it going, and Canada knew that government money, with all its restrictions, would be deadly. He sought out foundation capital and the rest was history. (As a matter of interest, the largest source of funding for Canada's brainchild has been the Druckenmiller Foundation, set up by hedge fund manager Stan Druckenmiller and his wife, Fiona. Stan chairs Canada's board)

Michael Dell once remarked that an idea that never got implemented was probably a hallucination.

The power of ideas. You've probably noticed one consistent theme here: wealthy families deploy their capital in support of *ideas*. Some of these are money-making ideas, some are not. I've mentioned foundation capital as a source of startup money for ideas like anti-poverty programs, but I could have mentioned programs in the arts, for senior citizens, for job creation, and so on. But private capital can be deployed to *generate* ideas, as well as to back them. Between 1960 and 1980, for example, a small group of funders backed a handful of brilliant young thinkers who gradually developed ideas that changed the course of history.[4]

Ideas power civilization forward, and private capital powers ideas. The less private capital a country has, the poorer will be the ideas it is able to execute. This is one reason that, of the roughly 300 Global Fortune 500 firms founded in the last 30 years, exactly one was founded in Europe. (About half were founded in the US.) It's also the reason that, of the 20 most important inventions to come along globally between 1970 and 2000, fully nineteen were invented in the US.

❖ With Great Good Fortune Comes Great Responsibility

Wealthy parents sometimes fear that inheriting a lot of money will destroy a child's initiative. Certainly there are lazy rich kids. There are also lots of lazy middle class and poor kids. If a wealthy family works to build a child's character, wealth won't destroy the child, but will simply leverage his or her capabilities. If the child's character is weak, withholding the inheritance will be the least of the child's problems.

At age 21 a fellow named John Keats was a hard-working medical student dissecting cadavers all day long. Then he received his inheritance and decided to devote himself to poetry, with results that proved to be immortal.

What you do with your life and your money is up to you, of course. But because you have excess capital, you have to do *something* with it. You have more opportunity than most to make the world a better place than it was before you arrived. How you do it is up to you. *That* you do it is what matters.

This paper was written by Gregory Curtis, Chairman, of Greycourt & Co, Inc. The author can be reached by phone at 412.361.0100 or by email at gcurtis@greycourt.com.

[1] Matthew Schoenfeld, "Air Jordan and the 1%," Wall Street Journal, July 10, 2012.

[2] This is actually an interesting point. Although America is a young country, America's wealthy families are the oldest in the world. Only the Rothschilds are more ancient. This is because before the Industrial Revolution began (circa 1800) there was no such thing as private wealth. Only kings and princes were wealthy.

[3] The sales price was paid to Carnegie in the form of gold bonds. There were so many bonds that when the final payment was delivered, the Hudson Trust Company (in Hoboken, NJ) had to construct a special vault to hold them all.

[4] The story is too involved to retell here, but you can read all about it in Gregory Curtis's blog at www.GregoryDCurtis.com/Blog (post dated 1/18/13).