

# An Entrepreneurial Theory of Social and Cultural Change\*

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**Abstract:** This paper contends that the entrepreneur is the agent of social and cultural change. We consider the entrepreneur in three settings: market, non-market and political. Our purpose is to understand how entrepreneurs create anew or shift existing focal points and how they make these changes salient. We also seek to understand the transferability of the desirable consequences of entrepreneurship in the market setting to activities in the non-market and political settings. It is our contention that the desirable aspects of entrepreneurship in economic settings are transferable to non-market and political settings to the extent that there are proxies for prices and profit/loss. We argue that while reputation serves as a soft constraint in non-market settings, there is a complete absence of a disciplinary device in political settings. Several applications are provided to illustrate the wide-ranging applicability of the framework.

Keywords: common knowledge, cultural change, entrepreneurship, social change, social entrepreneurship

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## 1. Introduction

On a daily basis, each and every individual faces a multitude of scenarios with coordination aspects. Etiquette, marriage, fashion, eating and drinking habits are but a few examples of the situations that possess coordination characteristics. To illustrate this, consider Schelling's famous example of picking a meeting place in New York City (1960: 54-58). If the individuals in this situation can coordinate their activities and meet at the same location at the same time, both will be better off. However, if they fail to coordinate on the same location or the same time, both fail to gain some positive payoff. Schelling asked, in the absence of full information as to a specific meeting time and place, how will individuals choose to act?

Schelling introduced the notion of focal points to explain how individuals coordinate with one another in the absence of full information. They do so by relying on information that is salient to them. Knowing how others will act helps people coordinate on a superior focal equilibrium by forming a cooperation-inducing set of expectations. In Schelling's example, the participants chose the clock at Grand Central Station at 12pm as the meeting location.

There are two central questions driving our endeavor. First, how did meeting at the clock at Grand Central Station at 12pm become focal? As Schelling notes:

Where there is no apparent focal point for agreement, he can create one by his power to make dramatic suggestion...coordination requires the common acceptance of some source of suggestion (1960: 144).

More generally, we seek to understand the agent (Schelling's "he") who creates new focal points or shifts existing focal points and makes these changes salient. It is our contention that the activities of these change agents are the essence of social and cultural

change. Our notion of social and cultural change involves shifting the formal and informal institutions which are currently focal. We contend that social change involves both an act of creation and one of convergence. In other words, the process of change entails not just creating a new focal point but also developing common knowledge to make it focal on a larger scale. As such, we argue that the notion of focal points is critical to any discussion of social and cultural transformation.

While others have focused on learning and the emergence of conventions and norms within games (see, Sugden 1998; Young 1998), we focus on understanding the agents of change. Stated differently, instead of focusing on how players passively learn about the various strategies available to them and others, we focus on how new conjectures are actively created and how common knowledge is created around those conjectures.

We place the entrepreneur at the center of our analysis as the agent of change.<sup>1</sup> The notion of entrepreneurship underlying our analysis entails alertness to previously unrecognized opportunities for mutually beneficial exchange. Entrepreneurship involves a wishful conjecture; these conjectures represent “bets” that individuals place on the potential of the underlying conjecture. The entrepreneur sees things differently and acts upon that vision to affect change. This alertness transcends any one specific contextual setting and therefore requires a detailed consideration across various settings.

We initially consider the entrepreneur in the market setting. Given that he acts in the context of property, prices and profit/loss, he is able to engage in economic calculation. We then seek to extend the notion of entrepreneurship to non-market and

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<sup>1</sup> The entrepreneur as the agent of change in market settings has received attention in the economic literature see, Baumol (1990), Boettke and Coyne (2003), Kirzner (1973), Leff (1979). We seek to extend and explore this realization in the context of non-market settings.

political settings. Clearly, social and cultural change can take place via interaction in the market setting as well as in non-market settings characterized by the absence of a price structure and the profit and loss mechanism.

In extending the application of entrepreneurship to non-market settings, the second issue that we seek to understand is the transferability of the desirable consequences of entrepreneurship in market settings to these non-market and political settings. In other words, how much confidence can we have that wishful conjectures of entrepreneurs will be sorted in a manner which matches them to the demands and desires of others as well as the underlying technological possibilities and resource availability while acting outside the context of a price and profit/loss system? To answer this, we need to understand how entrepreneurs in various settings deal with the issue of economic calculation.

Our core thesis is that in addition to being the catalyst of economic change, the entrepreneur is also the driver of social and cultural change. It is our contention that the desirable aspects of entrepreneurship in economic settings are transferable to non-market and political settings only to the extent that there are proxies for prices and profit/loss. We argue that while reputation serves as a soft constraint in non-market settings, there is a complete absence of a disciplinary device in political settings. The existence of disciplinary devices is critical to guide actors in their allocation of resources. While the reputation mechanism is clearly imperfect, in the absence of any mechanism, actors will have no way of knowing if they are engaged in activities that allocate resources to their most highly valued uses. Therefore, an imperfect mechanism is preferable to no mechanism.

## **2. Entrepreneurs as the Agents of Social and Cultural Change**

### **2.1 The market setting**

In economic life, the entrepreneur is the agent of change. In this role, the entrepreneur serves a dual purpose. Via the recognition and exploitation of previously unexploited profit opportunities, the entrepreneur pushes the economy from an economically and technologically inefficient point inside the production possibility frontier toward the economically and technologically efficient point on the frontier. Moreover, in discovering and innovating new technology and new production methods which use resources in a more efficient manner, the entrepreneurial process shifts the entire production possibility frontier outward.

According to Kirzner, we can conceive of the market process as follows (1992, 38-56). There are two sets of variables in economic life - underlying variables of tastes, technology and endowment of natural resources, and induced variables of prices and profit and loss. In the context of imperfect information and knowledge, a lagged relationship exists between the two sets of variables.<sup>2</sup> To the extent that the induced variables of the market do not reflect the underlying variables, there will exist opportunities for pure profit for those that move in that direction (see Kirzner 1973). The entrepreneur is the economic agent who is alert to these opportunities and exploits them. However, acting in a world of uncertainty and imperfect information, it is also possible

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<sup>2</sup> This is in contrast to competitive equilibrium where the induced variables of the market correspond perfectly to the underlying variables such that all resources are utilized in their highest valued use and all least cost technologies are employed. When the market is in competitive equilibrium production efficiency, exchange efficiency and product-mix efficiency are simultaneously realized. In short, given the conditions of the world, affairs could not be arranged any better even if an omnipotent being wanted to do so.

for the entrepreneur to make errors. The question then becomes how the entrepreneur knows if he is allocating resources correctly or making an error.

In the market setting, entrepreneurs are guided and disciplined by three key institutions. A well-defined set of property rights provides the incentive for entrepreneurs to allocate resources to their most highly valued use. A subsequent effect of private property is the evolution of markets and prices. Prices serve to convey knowledge and information to market participants. Current inefficiencies in economic relations are quickly translated through the informational mechanisms of the price system into profit opportunities for those entrepreneurs who can eliminate those inefficiencies and realize the gains from exchange that were previously unexploited. In short, the price system allows the entrepreneur to engage in economic calculation. Interconnected with the price system is the profit and loss mechanism.

In the market setting, the entrepreneur faces a hard constraint of real resources. Entrepreneurial efforts that serve to align the underlying and induced variables yield a profit. Likewise activities that divorce the two sets of variables yield a loss. The market disciplines the entrepreneur who engages in erroneous activities in that he incurs a real loss. The market adjusts to ensure over time that prices and profit/loss statements accurately reflect these underlying variables. The disciplinary devices inherent in the market system serve as a learning tool not only to the acting entrepreneur but also other agents in the economic setting as well. An activity that earns a loss signals the undesirability of that activity to both the entrepreneur who undertakes it and society at large.

Clearly, entrepreneurs in the economic setting contribute to social and cultural change. By introducing new goods and services, these entrepreneurs impact and shape the social setting and provide the tools for others to effect change as well. Consider for instance that almost all countries now have access to personal computers and Internet connections. While the introduction of the personal computer and Internet can themselves be seen as a type of social and cultural change (see Putnam 2000: 169-180), they have also presented new opportunities for further social and cultural change through their use by those in non-market settings. As a result of the Internet, one can access images of artwork from museums around the world from the comfort of his/her own home. Likewise, one can participate in online discussion groups with others from around the world focusing on topics ranging from specific ethnic groups to politics and sports to art and entertainment. In short, the Internet has lowered the cost of experiencing culture from around the world.<sup>3</sup>

This does not mean that every activity undertaken by an entrepreneur is an act of creating or shifting focal points. One can envision a distinction between activities taken within a set of focal institutions and activities causing a shift in the underlying focal points. The car market is an example of this point. Within the car market, producers have established a specific well-known brand but are constantly seeking to shift their product line within their focal brand. The recent introduction of hybrid cars by several dealers (including Honda, Toyota and Ford) serves to illustrate this point. While each car maker continues to produce their “best sellers,” they also introduce new products to market – i.e., hybrid cars.

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<sup>3</sup> The spread of the Internet has potentially interesting implications for civic society and social capital. On the one hand, an increasing number of individuals are connected. However, this could potentially lead to a decrease in face-to-face interaction and participation in civic society.

This example illustrates the state of most markets – some entrepreneurs are engaged in activities within the existing market structure while others are alert to potential means of shifting the overall makeup of the market. In other words, one can envision some activities which strengthen certain aspects of existing focal points and other simultaneous activities which shift or create anew certain aspects of those same points of saliency.

In an attempt to make their products focal, entrepreneurs create convergence around them in a number of ways. Advertising is perhaps the most common form of developing common knowledge.<sup>4</sup> Closely related, reputation and branding efforts both serve to establish common knowledge around a set of products. These various efforts serve to lower information costs and create common knowledge around the good or service provided.

## **2.2 Non-market settings**

We limit the non-market setting to private agents (i.e., outside the political setting) whose activities take place in civic society. This means that they act outside of the context of economic calculation grounded in prices and the profit/loss mechanism. In non-market settings, it has become fashionable to refer to entrepreneurship as “social entrepreneurship.” The idea of social entrepreneurship has become an increasingly popular topic in the last decade, as the subject of the non-market component of civil society has become increasingly discussed.<sup>5</sup> How can civic enterprises succeed in such

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<sup>4</sup> On the economics of advertising see Ekelund and Saurman (1988).

<sup>5</sup> As Bornstein indicates, “between 1995 and 1999, 100,000 citizen groups opened shop in the former communist countries of Central Europe. In France, during the 1990s, an average of 70,000 new citizen groups were established each year, quadruple the figure for the 1960s. In Canada, the number of registered

things as helping the needy or increasing human welfare when the state bureaucracy and the vagaries of the market have failed? New initiative is required and these new ideas of community activism are termed social entrepreneurship. Analogous to entrepreneurship in market settings, social entrepreneurship entails alertness to an opportunity for change and betting on a wishful conjecture.

Acting within the market setting of prices and profit and loss, the entrepreneur is desirable because, engaged in economic calculation, he constantly reallocates resources to their most highly valued uses. The central question is: how transferable are the desirable consequences of entrepreneurship to settings outside the market context? While economic calculation cannot exist in the absence of monetary prices, we need to ask if any alternative disciplinary mechanisms are present to guide entrepreneurs. It is our contention that the transferability of the desirable consequences of entrepreneurship in market settings to non-market settings is directly contingent on the existence of proxies for prices and profit and loss in alternative settings.

We wish to postulate that face-to-face civic interaction and the related reputation market serve as a disciplinary mechanism for entrepreneurial activities in non-market settings. Admittedly, this mechanism is not nearly as effective as the price and profit/loss system for allowing entrepreneurs to engage in economic calculation. Reputation is a soft constraint as compared to the hard constraint of real resources faces by entrepreneurs in the market setting. However imperfect, we contend that it is preferable to the complete absence of a disciplinary device in guiding activities.

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citizen groups has grown by more than 50 percent since 1987, reaching close to 200,000...In the United States, between 1989 and 1998, the number of public service groups registered with the Internal Revenue Service jumped from 164,000 to 734,000..." (2004: 4).

To understand our reasoning, it is important to note that the key aspect of civic interactions is that they are voluntary.<sup>6</sup> Those that support the activities of the entrepreneur – either monetarily, as in the case of privately funded non-profits, or through approbation – can voluntarily choose to sever the relationship at any point in time. When one undertakes an activity in a non-market setting, whether it is starting a political movement or wearing a new style of clothing, the outcome will impact how others view him. If others approve of the activities they will voluntarily maintain the current level of support, and hence reputation, or increase their support of the entrepreneur. If they are unhappy with the course of action, they will likely curtail their support for the entrepreneur undertaking the activity. In other words, entrepreneurs in a non-market setting who satisfy the wants of consumers gain a “profit” via increased reputation capital and those that fail to meet consumer needs incur a “loss” via decreased reputation capital.

For the reputation market to serve as an effective disciplinary mechanism, it requires intricate knowledge of the trustworthiness of the acting entrepreneur.<sup>7</sup> The issue is one of the “span of control.” Only those that have strong ties with the entrepreneur will be in the best position to have intricate knowledge of the entrepreneur's stock of reputation capital. To the extent that the reputation market relies on direct interaction, it will necessarily be limited to small social networks. In other words, entrepreneurship in non-market settings is, at least in its earliest stages, a local phenomenon. Beyond these

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<sup>6</sup> As Hayek writes, “In actual life the fact that our inadequate knowledge of the available commodities or services is made up by our experience with the persons or firms supplying them—that competition is in large measure competition for reputation or good will – is one of the most important facts which enables us to solve our daily problems” (1948: 97).

<sup>7</sup> One can see a connection here with the work of Fukuyama in the area of social capital and specifically his notion of the “radius of trust” (1999: 52, 88-91). Our claim is that the intricate knowledge of the acting entrepreneur is initially only available to a small social network or within a small trust radius.

small social networks the span of control breaks down as it becomes increasingly difficult to have intricate knowledge of the reputation of others. The effectiveness of the reputation mechanism is directly dependent on the span of control.<sup>8</sup>

Consider for instance the case of micro-finance. In the standard case, members of a society who are denied access to normal financial markets can be aided through a micro-lending program to start small businesses that improve their situations. Since the individuals seeking loans do not have access to traditional forms of collateral, a substitute must be found. In many cases, in order to secure a loan, an individual must put up their reputation capital as collateral. For example, a specific number of non-family members from the community must vouch for them and be willing to shoulder their debt if they default. The transaction is based on a small social network and is grounded in the existence of reputation capital.

The importance of a close social network in non-market settings is supported by work in cognitive psychology and anthropology. The anthropologist, Robin Dunbar, has argued that through evolution, the brains of humans have gotten larger to deal with the complexities brought about by larger social groups. Dunbar has developed a neocortex ratio which compares the size of the neocortex to the size of the brain for a particular species. The ratio is meant to provide the maximum expected group size for the species under consideration. For humans, Dunbar has found the number to be 147.8 or approximately 150. In other words, 150 represents the maximum number of people that humans can have a close relationship with or their span of control. Dunbar has applied

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<sup>8</sup> As Adam Smith wrote: “In civilized society he stands at all times in need of the cooperation and assistance of great multitudes, while his whole life is scarce sufficient to gain the friendship of a few persons” (1776: 18).

this theory to a range of historical groups from hunter/gather societies to the military and has found that the number 150 holds in these various settings (Dunbar 1992).

This realization of the importance of one's close social network also finds collaboration in diffusion theory developed by sociologists. This theory considers how an idea, innovation or product moves through a society. Many of the studies that employ diffusion theory have found that it only takes a small number of individuals to start an idea, innovation or product that is eventually accepted by a larger number of people.<sup>9</sup> In the framework developed here, the idea, innovation or product is first put to use by a few focal individuals whose reputation is established and well known. As those with established reputation capital adopt the idea, innovation or product, others within his social network observe his actions. Risk and uncertainty begin to diminish and the number of willing participants increases. It is critical to note that although many diffusion studies are focused on products, innovations or ideas that linked to the market this need not be the case. Many activities undertaken by social entrepreneurs are entirely outside the market context. What we wish to establish is that outside the market setting, reputation capital works as a soft constraint providing the entrepreneur with some guidance in their actions. By the very nature of reputation capital – namely the need for face-to-face interaction – social entrepreneurship is a local phenomenon. As the idea or activity is rewarded in that local context it is then possible for it to graduate to a broader context although it need not do so.

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<sup>9</sup> Perhaps the most well known study in this area is Ryan and Gross' study of the diffusion of hybrid corn in Iowa (1943). Other notable diffusion studies include Hagerstrand's study of the diffusion of TB tests in Sweden (1967) and Coleman et al.'s study of the diffusion of tetracycline among midwestern doctors (1966).

Much of the diffusion literature makes reference to “opinion leaders” and “agents of agents.” One finds similar reasoning in communication theory and, more specifically, the two-step flow of communication hypothesis. In its simplest form, this theory states that public news or information is not simply accepted by the masses. Rather, it is filtered through established “opinion leaders” who then pass the filtered information on to the public.<sup>10</sup> In other words, information is filtered through an individual’s social relationships and hence, is influenced by his stock of reputation capital.

These opinion leaders and change agents in sociology and communication theory possess many of the same attributes as the entrepreneur in the economic and philanthropic literature – namely, their role as catalysts of change. These individuals create new focal points or shift existing ones. Further, they create convergence around the change because their social network looks to see what actions they are undertaking. These individuals are focal in their role as opinion leaders; the actions they take are focal as well. In short, in non-market settings, the stock of reputation capital not only serves as a soft constraint on entrepreneurs but also as a convergence mechanism. Others will converge around the activities of those that have a well-established stock of reputation capital.

What is missing in the sociology and communication literature is how these agents of change, to the extent they act outside the market setting, are disciplined if they are not allocating resources to their proper uses. We have offered a potential solution here with the reputation market as a proxy for the discipline mechanisms found in market contexts. The key aspects of the non-market disciplinary mechanism are the face-to-face

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<sup>10</sup> For more on the two-step flow of communication hypothesis, see Lazarsfeld et al (1948) and Weiss (1969).

nature of relationships and the fact that relationships are voluntary and can be ended if one of the parties is unhappy with the activities undertaken by the other.

Given that the reputation capital of the entrepreneur serves as collateral, he has a strong incentive to accomplish the task for which he has received support. Indeed, it is our contention that the necessity of reputation as the main self-governing mechanism makes social entrepreneurship a function of betting on people, not on projects. Projects can be attractive, but unless the disciplinary feedback loops are well established, even the most promising project can be poorly executed.

### **2.3 The political setting**

In order to gain tractability in our analysis, we limit the political setting to democracies where political agents are elected via majority voting. We adopt the standard Ferejohn political marketplace model where voters are “owners” and politicians are the “agents.” Political agents are self-interested vote maximizers and the owners hire or fire the agent based on economic performance (Ferejohn 1986). Again, we focus on the same questions as in the prior subsections. We seek to understand how agents in political settings create or shift focal points and how, if at all, they are guided and disciplined.

Clearly, political agents create and shift focal points in a number of ways. To the extent that the populace accepts and coordinates around a set of political institutions, the institutions themselves are focal. Acting within these institutions, political agents create and influence existing focal points. Political agents can encourage or prohibit certain types of activities through the creation of laws, rules and regulations. If, for instance, political agents want to encourage a certain line of activity, they will subsidize it. If they

want to discourage the activity, they will tax it. It is common for political agents to attempt to create convergence around a certain issue by investing resources in raising awareness of the issue. Given the clear influence of political agents in social and cultural change, the question then turns to the existence of suitable disciplinary devices for activities in political settings.

We saw that in the market setting, entrepreneurs are disciplined by the profit/loss mechanism. Entrepreneurs acting in the market context face the hard constraint of real resources. In non-market settings, face-to-face interaction and the market for reputation serves as a soft constraint. On the surface, it may seem that the vote mechanism is a suitable disciplinary device in political settings. It is our contention that this is not the case. We argue that there is no direct proxy in political settings to discipline activities.

The voting mechanism is governed by the logic of concentrated benefits and dispersed costs. The interaction in democratic politics is one characterized by rationally ignorant voters, specially interested voters and vote-seeking politicians. Given this, the bias is for politicians to concentrate benefits on the well-organized, well-informed special interest voters and to disperse the costs on the unorganized and ill-informed mass of voters. It is this basic examination of the logic of democratic discipline that underlies the argument for government failure theory, which is juxtaposed with market failure theory in modern political economy. In short, it is our contention that the voting booth is not an effective disciplinary mechanism.<sup>11</sup>

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<sup>11</sup>In contrast to this claim, Stigler (1982) and Wittman (1995) argue that inefficient policies are an illusion. Their argument is that rational individuals are no more likely to leave potential gains unexploited in political markets than in economic markets. Therefore, democratic markets must be efficient. For criticisms of Wittman see Boudreaux (1996) and Rowley (1997). Caplan (2001) provides a defense of Wittman's logic and offers his own answer as to why political markets are inefficient. Specifically, he argues that political markets are inefficient because individuals don't pay individually for their beliefs.

Moreover, while the key characteristic of civic relations in non-market settings is the voluntary nature of the interaction, interactions in the political setting are characterized by an enforced order grounded in coercion. While individuals in non-market settings voluntarily choose to interact and can sever that interaction if they are dissatisfied, individuals in political settings are forced to accept the terms dictated by political agents. This is not to say that reputation is absent in democratic settings, but rather to indicate that it is not nearly as effective as in non-market settings where private agents interact. The face-to-face interaction necessary to build the appropriate reputation capital is lacking. Further, where reputation capital does exist, there is no effective means of communicating satisfaction or a lack thereof to the agent.

It is not our claim that government activities fail to influence existing focal points or create new focal points. In contrast, our claim is that the desirable effects of entrepreneurship in the market and non-market settings are not transferable to the political setting. This is due primarily to the absence of a disciplinary mechanism to guide activities. Stated differently, there is no way for political agents to gauge if they should adjust their activities to realize mutually beneficial exchanges which have been previously unexploited.

## **2.4 Overlap between settings and the implications for entrepreneurs**

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Given that they don't incur the cost of their beliefs, it is more likely that individuals will hold irrational beliefs.

Another argument against the view that political markets are efficient is that political agents lack perfect information and therefore are subject to errors just like participants in the market setting (Boettke and Lopez 2002: 114-116; 117 fn6; Holcombe 2002: 143-159; Sutter 2002: 199-209). Government actions, based on coercion, force people to participate in activities where they lack information, and the incentive to gather the relevant information, and hence where they are unable to effectively determine costs and benefits. Given this, those who are informed can take advantage of the uninformed the result being an inefficient outcome (Holcombe 2002: 156).

In the previous sub-sections, we considered the entrepreneur in various settings in isolation. In reality, agents in different settings often interact in undertaking a certain activity. Moreover, we often observe one entrepreneur undertaking activities which overlap more than one setting. For instance, we often observe individuals in a market setting developing a unique image or reputation in order to differentiate themselves from others and make themselves focal. They are subject to the profit/loss mechanism in market settings, but the realized profit/loss is directly linked to their reputation capital. In connection with the profit/loss mechanism, it serves to inform entrepreneurs that their efforts have been misallocated.<sup>12</sup>

We often observe entrepreneurs in market settings employing others who have established reputation capital to endorse their product or service and make it focal. In other words, these entrepreneurs are purchasing the use of the reputation capital of others to certify their product or service. Linking the product or service to a focal individual greatly eases the process of convergence around the good. Some have developed reputation capital in one setting and carried that capital over to another setting market. For instance, politicians often author books after their political career and are paid well to appear at speaking engagements.<sup>13</sup> In the framework developed here, they are able to carry over the reputation capital developed during their time in political settings to capitalize on their stock of capital in the market setting.

We also observe direct interaction between agents in political settings and those in market and non-market settings. As already indicated, the activities of political agents in

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<sup>12</sup> Cowen discusses the “snowball effect” in which fame is achieved or lost very quickly as fans accept or reject a star as long as others are willing to as well (2000: 14-16). The snowball effect itself requires the existence of common knowledge. .

<sup>13</sup> Examples include Bill Clinton, who received a \$10 million advance for his autobiography, *My Life*.

terms of legislation and regulation directly influence, and in some cases limit, the type and extent of activities that entrepreneurs in market and non-market settings can undertake. This interaction between entrepreneurs in the political and non-political settings creates an interesting dynamic in terms of the disciplinary mechanisms which should be addressed. We know that there is an inherent disciplinary device for entrepreneurs in market and non-market settings. We also know that a disciplinary device is lacking for entrepreneurs in political settings. What does this mean when agents in the various settings interact?

When entrepreneurs in market settings or non-market settings interact with political agents, the same disciplinary devices that guide them in the absence of the interaction with political agents are still present. For instance, if political agents subsidize the start-up costs of a business, that business will still be subject to market forces absent additional subsidies to keep it in business. Likewise, if political agents fund an entrepreneur in a non-market setting, that entrepreneur is still subject to voluntary face-to-face interactions with his social network. There is no guarantee that his activities will be accepted by society at large.

This does not overcome the fundamental issue – political agents have no way of determining if they are, from an economic standpoint, effectively allocating resources. It does mean, however, that when agents from different settings interact, the disciplinary mechanisms that are present in isolation are still present. It is possible that the activities of agents in political settings can distort these disciplinary devices. For example, a firm that received continued subsidies would not respond to the profit/loss mechanism as it would in the absence of the subsidy.

This also raises an important issue for political agents who wish to undertake activities aimed at creating social change which require acceptance by groups within society at large. As diffusion theory in sociology and the two-step flow of communication hypothesis in communications theory indicate, it is critical for indigenous “opinion leaders” and “agents of change” to support the endeavor. These individuals have well-established credibility and legitimize the information they transfer. This will be illustrated when we consider the post-World War II reconstruction of Germany below.

### **3. Applications**

We find historical support for the general categories outlined above across a wide range of applications. Let us first consider the case of nonprofits and, more specifically, apply the framework developed above to the case of Ashoka: Innovators for the Public.<sup>14</sup> This case illustrates entrepreneurship in a non-market setting relying on face-to-face interactions as outlined in subsection 2.2. We will then consider, the post-World War II reconstruction of Germany. Focus is on the role of cinema in crafting new focal social and cultural institutions in the wake of World War II. Finally, we consider the role of media in economic transition and development.<sup>15</sup> These cases illustrate the interaction of entrepreneurs across the various settings discussed in Section 2.

#### **3.1 Ashoka: Innovators for the Public**

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<sup>14</sup> For an economic analysis of non-profits and a criticism of the work of Lester Salamon, see Boettke and Prychitko (2004).

<sup>15</sup> Although we focus on cinema and media as mediums for generating convergence around new or shifting focal points, one can also see a connection with the social capital literature. For instance, Putnam (2000: 96-7, 195-6; 218-220) considers cinema and newspaper readerships as two social connectors allowing individuals to be civically engaged with others building and/or strengthening social capital.

Ashoka: Innovators for the Public is a nonprofit organization whose mission is to “develop the profession of social entrepreneurship.”<sup>16</sup> Founded in 1982 by Bill Drayton, the current CEO, Ashoka provides funding for social entrepreneurs in forty-eight countries across Africa, Asia, Central Europe, Latin America and North America. The organization’s history illustrates many of the main points discussed above regarding entrepreneurs in non-market settings. Although it is sizeable now, Ashoka began as a small operation based on the reputation capital of Drayton.

Bill Drayton attended Harvard College, Oxford University and Yale Law School before working at the consulting firm, McKinsey & Company, and the Environmental Protection Agency (EPA). To begin Ashoka, Drayton turned to his network from his various schools as well as his close contacts from McKinsey and the EPA. With three former classmates and two former colleagues, Drayton traveled to India, Indonesia and Venezuela in 1978 and 1979. Their goal was to design a program which effectively identified and funded social entrepreneurs. India was selected as the first location for Ashoka, mainly for political reasons. Operations began in 1982 with a staff of local volunteers and \$50,000, donated by three friends and Drayton himself.

The founding of Ashoka, illustrates our framework of entrepreneurship in the non-market setting discussed above in subsection 2.2. The organization began in the context of a small social network in which the reputation capital of each member was well known via face-to-face interactions. That network provided not only the original members of the organization but also the necessary operating funds. As Drayton’s organization has continued to grow, he has continually accumulated reputation capital. Ashoka now has approximately 1,400 “fellows” (i.e., funded social entrepreneurs) in

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<sup>16</sup> Ashoka’s official website is: <http://www.ashoka.org/home/index.cfm>

forty-eight countries and has provided them with over \$40 million in funding. Its operations are entirely funded by private means – it receives donations from individuals, corporations, foundations and other business entrepreneurs.<sup>17</sup>

Ashoka provides an interesting case study because it originated in a non-market setting and its main purpose is to fund other social entrepreneurs. As such, it faces the difficulties of attracting funds for its own operations and also identifying worthwhile projects. While Ashoka accepts applications from any potential “fellow,” most applicants come from a network of “Nominators” who recommend potential social entrepreneurs for funding. These Nominators are located throughout the countries of operation and have an “on-the-ground” perspective and knowledge of the potential social entrepreneur and his area of operation. They serve as middlemen in that they have a stock of reputation capital established with Ashoka and can also identify social entrepreneurs in their various countries because they have intricate knowledge of the potential entrepreneur’s stock of reputation capital. In other words, face-to-face interactions take place on two levels – between the Nominator and the potential social entrepreneur and between the Nominator and Ashoka.

A multi-step, detailed selection process is undertaken to select fellows. After receiving an application, a “Country Representative” reviews the application and engages in a detailed background check including personal references and a site visit. The Country Representative presents the information to a “Second Opinion Reviewer” and the “Selection Panel” along with a recommendation as to the viability of the project. The Second Opinion Reviewer is from outside the country where the potential fellow is

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<sup>17</sup> A listing of Ashoka’s endowments is available at: [http://www.ashoka.org/what\\_is/endowment.cfm](http://www.ashoka.org/what_is/endowment.cfm)

located and serves as an external check. The final step is a series of face-to-face interviews with the Selection Panel before a final decision is made.<sup>18</sup>

The implications of this case study are critical to our thesis. The problem of attempting to determine and assess proxies for prices and profit/loss is that social entrepreneurs face the challenge of acquiring capital through reputation collateral. This requires face-to-face knowledge of the donors and of the needs and desires of the communities the social entrepreneur strives to help. The problem of dispersed knowledge necessarily makes social entrepreneurship a local phenomenon both in terms of convergence and efficiency. To accurately assess the needs of the community and have knowledge of the reputation market, the donor must be connected at the local level. The case of Ashoka illustrates the local, face-to-face nature of social entrepreneurship and the importance of reputation collateral in allowing activity in the non-market setting to be allocated to its most highly valued use.

### **3.2 Cinema and the post-WWII reconstruction of Germany**

Postwar reconstruction is one of the most difficult policy achievements. On the one hand, it involves the restoration of physical infrastructure and facilities, minimal social services, and structural reform in the political, economic, social and security sectors. On the other hand, it involves a shift in the social and cultural makeup of the country. Focal points need to be created around a new social and political order and the populace needs to be coordinated on the conjectures underlying those focal points. Given this, a complete understanding of the reconstruction process requires an understanding of these agents of social and cultural change who create the “dramatic suggestion” of a new set of

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<sup>18</sup> For more details on this process, see [http://www.ashoka.org/fellows/search\\_procedure.cfm](http://www.ashoka.org/fellows/search_procedure.cfm)

conjecture. Hence, the framework developed here is applicable. Here we focus specifically on the role that cinema played in the reconstruction of Germany for reasons addressed below.

In general, while films provide entertainment and are linked to prices and profit/loss, they can also provide a social message (i.e., “dramatic suggestion”) and hence contribute to social and cultural change. For instance, Mel Gibson’s recent independent film, *The Passion of the Christ*, led to public debate over religious issues from both supporters and critics alike.<sup>19</sup> In the cinema industry, reputation capital often plays a significant role. In many cases, those involved in the industry develop reputation capital that is directly linked to the profitability of their films. Steven Spielberg for instance, is a famous director whose work is known in many countries and is arguably the most financially successful film director of all time. Similar reasoning applies to actors and actresses as well.

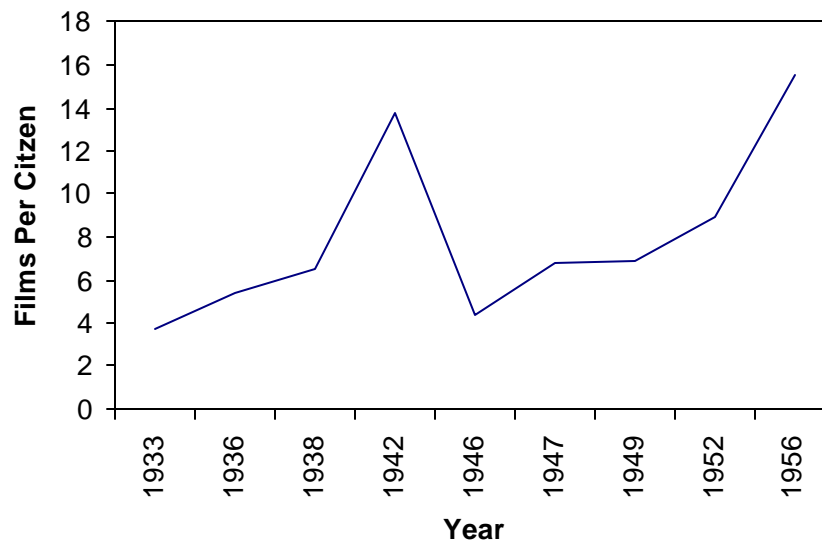
Cinema played a critical role in the cultural and social reconstruction of Germany. As the film historian, Sabine Hake, writes, “In the Western zone, the cinema after 1945 emerged as the driving force behind the ongoing self-transformation of postwar culture and society” (Hake 2002: 104). Moreover, cinema involved change agents in all three settings discussed in Section 2. From its earliest beginnings in the early 1900s through 1942, when the Nazi regime nationalized the industry, the cinema industry was operated on a profit/loss basis. As a result, entrepreneurs in the cinema industry were guided by prices and the profit/loss mechanism.

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<sup>19</sup> As of June 13, 2004, the total worldwide box office for *The Passion of the Christ* was over \$600 million. The top grossing countries were: \$370mm in the U.S., \$26.7m in Italy, \$22mm in the UK, \$18mm in Mexico, \$15mm in Brazil, \$13mm in Spain, \$12.8mm in South Korea and \$11mm in Poland. Source: <http://www.boxofficemojo.com/movies/?page=intl&id=passionofthechrist.htm>

The claim that cinema played an important role in the reconstruction of Germany is supported by three facts. The first is the cinema was a well-established medium of entertainment and information dissemination. The second factor is the consumer demand for film measured through film attendance. The third and final factor is the amount of resources invested by political leaders to control and influence the cinema industry.

A brief look at the history of the cinema industry in Germany indicates that it was a well-established medium. Introduced in the early 1900s, film was a well-known source of information and entertainment among the German populace in both the pre- and postwar periods.<sup>20</sup> The second indicator is attendance trends which generally increased over time, as illustrated in Figure 1. This supports the fact that the populace viewed cinema as a source of entertainment and information.



*Figure 1: German Cinema Attendance: 1933-1956<sup>21</sup>*

<sup>20</sup> Although we focus on cinema here, media was also a well-established medium which played a significant role in the reconstruction process, see Gienow-Hecht (1999) and Humphreys (1990).

<sup>21</sup> Attendance numbers from: Hake (2001: 72, 2002: 64-5); Fehrenback (1995: 43); Welch (1983: 12-12); Wollenberg (1972: 36-8) and SPIO. Population figures used to calculate films per citizen are available at: <http://www.library.uu.nl/wesp/populstat/Europe/germanyc.htm>

We observe a steep increase in the early 1930s primarily due to heavy subsidization from the Nazi government. Cinema and media were at the center of Hitler's propaganda program and the sharp increase in attendance illustrates this (Hake 2002: 59). The decrease between 1942 and 1946 was due largely to physical destruction related to the war and also the end of Nazi subsidies and occupation laws related to the cinema, slowing production. However, cinema attendance steadily increased as the film industry began to grow in the postwar period, with an attendance record reached in 1956.

Finally, political agents expended a great amount of resources in the pre and postwar periods to control and influence the cinema. Assuming that political agents aim to maximize revenues, we would only expect them to expend resources if there was some return to be had. In this case, the return was the ability to control and influence a key medium for developing and disseminating common knowledge.

Political agents and cultural elites were involved in cinema in its earliest stages, mainly attempting to influence content along moral lines. With the beginning of World War I, censorship laws manipulated the cinema content to increase nationalism among the populace. The Weimar Republic (1918-1933) removed many of the censorship laws, allowing the cinema industry to develop in a largely unhampered environment. With the rise of Hitler in 1933, the cinema industry came under increasing state control until it was ultimately nationalized in 1942.

The United States studied the German cinema industry prior to the end of World War II. Realizing the popularity of cinema and its importance in disseminating information and influencing culture, a well-developed plan for German cinema in the postwar period was critical. The U.S. realized that cinema could coordinate the populace

around the aims of the reconstruction. Moreover, it would enable the establishment of a national identity that would carry over into the post-occupation period.

In the immediate postwar period, the film industry was shut down. Soon thereafter, in November of 1945, production of films was allowed under a set of strict guidelines. Domestic producers were required to be licensed by the U.S. Information Control Division (ICD). All personnel involved in the film and the content of films were screened. In order to receive a license, films were required to communicate a message consistent with the end goals of reconstruction. Films were reviewed throughout their production and a final review was undertaken before they were released.

The critical element of the occupation film laws is that they allowed indigenous agents to participate in the film industry. These individuals had intricate knowledge of German culture and way of life, and were able to effectively make “dramatic suggestions” to the populace. For instance, Wolfgang Staudte, Helmut Käutner and Kurt Hoffman were all directors in the prewar period that continued their work in the postwar period as well.

Another link between the public and those in the film industry was the German film clubs. In general, film critics play an important role in the reputation market linking participants in the film industry and the populace.<sup>22</sup> Film clubs were groups of ten to twenty moviegoers – artists, journalists, writers, directors, movie-going intellectuals, etc. – who met once a week to screen a movie and discuss its artistic and cultural aspects.<sup>23</sup> The first film clubs were founded and subsidized by the French in their zone of occupation. The first film clubs in the U.S. zone were completely private. The first club

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<sup>22</sup> For more on the role of critics, see Cowen (2000: 72-3) and Cowen and Tabarrok (2000).

<sup>23</sup> For a more detailed history of the film clubs, see Fehrenbach (1995: 169 – 210).

in the U.S. zone began in Frankfurt in the summer of 1945 without the knowledge of the U.S. occupying forces. This initial club was followed by the creation of subsequent clubs throughout the U.S. zone in various towns and universities (Fehrenbach 1995: 178-180).

These clubs were not profit driven and their main purpose was a “cultural exchange,” involving critical viewings and discussions of the latest releases.<sup>24</sup> In the early occupation period, the opinions of the clubs were spread to the local populace largely through word of mouth. The influence of these clubs on public opinion was directly dependent on their reputation capital. Although beginning as a local phenomenon, the clubs quickly grew in number. In 1949, the various independent clubs joined together to form the Association of German Film Clubs and thereafter had a more widespread public voice, holding annual meetings and contributing to various publications.

In general, postwar films in Germany provided widespread legitimacy for the new political and social order and also helped define the break from Germany’s past. Films dealt with a wide range of topics, from anti-Semitism – *Affäre Blum* (*The Blum Affair*, 1948), *Morituri* (1948) and *Der Ruf* (*The Appointment*, 1949) – to pacifism – *Die Brücke* (*The Bridge*, 1959) – to military life – *Hunde, wollt ihr ewig leben* (*Dogs, Do you Want to Live Forever*, 1959) – to the role of women in society – *Die Sünderin* (*The Sinner*, 1951), *Mädchen hinter Gittern* (*Girl Behind Bars*, 1949), *Liebe kann wie Giftsein* (*Love*

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<sup>24</sup> It should be noted that some clubs did lobby the government for subsidies and some of the club leaders had relationships with members of the government. For example, in 1950, the Federal Interior Ministry placed Johannes Eckardt, who was a founder and leader of one of the clubs, on the selection committee in charge of awarding the Federal Film Prize.

*Can Be Like Poison*, 1958) and *Anders als du und ich (Different From You and Me*, 1957).<sup>25</sup>

Cinema clearly played a role in shaping the social order and culture of postwar Germany. Indigenous agents with local knowledge of the prewar German culture were effectively able to disseminate information and ideas through their films. The agents of change consisted not only of movie personnel (writers, directors, actors, etc.), but also the members of the film clubs who influenced public opinion toward the film industry. The films themselves were subject to the profit/loss mechanism and those who participated in the film industry were able to shape the cultural identity of Germany through the messages communicated in their films. Many who participated in the film industry had some stock of reputation capital from their previous films in the prewar period. The films produced contributed to convergence around the reconstructed social order.

The members of the film clubs served as informal middlemen between the film industry and the Germany populace. Of course, these indigenous agents were acting within a set of constraints set forth by the occupying forces but nonetheless were able to contribute to crafting German culture. Clearly many other forces were at work in the reconstruction of Germany but entrepreneurs, through the cinema industry, played an important role in shifting and creating convergence around the focal points underlying the reconstructed society. Working within the context of prices, profit/loss and reputation markets, these entrepreneurs were guided in their activities. To the extent that the Allies contributed finances to the rebuilding of the industry, it weakened the ability of these mechanisms to discipline entrepreneurs, but they were still present nonetheless. One

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<sup>25</sup> For more on social relationships, national identity and specific films in the postwar period, see Fehrenbach 1995: 93-101.

critical implication from this case study is that attempts at social change must involve at a minimum an understanding of the already established opinion leaders. These opinion leaders should be included in the process to the greatest extent possible for they are well-established and relatively low costs means of coordinating individuals around a specific set of conjectures.

### **3.3 The role of media in economic transition and development**

While the reconstruction process involves rebuilding social, political and economic institutions, often from scratch, the transition process involves working within a given set of institutions to bring about change. In short, the process involves transitioning to a liberal economic order. The importance of a well-functioning media in maintaining a liberal order can be traced back to Alexis de Tocqueville. In *Democracy in America*, Tocqueville emphasized how newspapers “maintain civilization” (1835-1840: 517).<sup>26</sup> Although the role of media has been largely overlooked in the economic development community, lately one observes a shift in that trend.<sup>27</sup>

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<sup>26</sup> A free media can be seen as a necessary condition for economic development. All of the members G-7 (Canada, France, Germany, Italy, Japan, the United Kingdom and the United States), which account for approximately two-thirds of the world’s economic output, have a free media (as determined by the Freedom House “Freedom of the Press Survey” 2003). Moreover, those countries that are considered transition “successes” – Estonia, Hungary, Botswana and the Czech Republic – all have a relatively free media. However, it is critical to note that while a free media is a necessary condition for economic development, it is not a sufficient condition. One observes many countries that have a free media but remain relatively poor – Costa Rica, Benin, Bolivia, Fiji, Ghana, the Philippines, etc. This indicates that there are other key factors in addition to a free media that are requisites for development. Among these other factors are political stability, a stable economic environment outside of the media industry, quality of the media, education, ideology and interest in political, social and economic issues.

<sup>27</sup> The role of media has recently been studied in terms of its impact on government transparency, accountability (Stiglitz 2002), solving the principal (citizens)-agent (government) problem (Besley and Burgess 2001; Besley et al. 2002), public policy (Spitzer 1993) and corporate governance (Dyck et al. 2002). Djankov et al (2003) discuss how theories of media have historically fallen into one of two opposing camps: public interest theory and public choice theory. A small but growing literature theoretically addresses how state owned media prevents the adoption of growth enhancing policy reforms (Besley and Burgess 2002; Besley and Prat 2002; Coyne and Leeson 2004; Sen 1984, 1999;). Additionally,

The media is critical for economic transition because it is in the business of making “dramatic suggestions.” To the extent that these suggestions deal with transition efforts, they serve to coordinate the populace around. A free media is important for two reasons. First it can be seen as a signal that certain institutions have been adopted allowing the media industry to operate effectively. Second, the media serves to reinforce institutions already established as well as creating convergence around other institutions necessary for a successful transition. In other words, the arrow of causation points in both directions. In equilibrium, the basic institutions are strong enough to support a free media and, at the same time, the media plays a role in shaping existing focal points and creating new ones.

A similar situation exists with consumer demand. In equilibrium, consumer demand influences what media outlets cover while the specific content of the media outlets influence consumer taste and preferences (Tullock 1968: 1265). The media profits from reporting but part of what makes a certain media outlet attractive to consumers is the ability to provide a unique viewpoint that creates a “dramatic suggestion.” As such, media can be seen as a key aspect of social and cultural change in terms of shifting focal points and creating convergence. Tocqueville recognized the role of media in this context when he wrote, “Only a newspaper can put the same thought at the same time before a thousand readers...A newspaper is not only able to suggest a common plan to many men; it provides them with the means of carrying out in common the plans that they have thought of for themselves” (1835-1840: 517-518).

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many case studies address the state of the media industry in specific countries (for example, see Gross 1996, O’Neil 1997, McAnany 1980, Paletz et al. 1995, Lent 1980).

To the extent that media is autonomous, entrepreneurs will operate in the context of the market setting as they will be subject to prices and the profit and loss mechanism.<sup>28</sup> The image of the media outlet itself as well as those that work for it will also be tied into the reputation market. For instance, media outlets and journalists will develop a reputation over time which is directly tied to the economic performance of the outlet. For instance, *The New York Times*, *The Wall Street Journal* and the *Financial Times* all have well-established, worldwide reputations as reliable news sources which benefit their overall sales and profitability. Moreover, the media does not just report on the news but influences public opinion and hence plays a role in social change. In other words, while acting within the general market context, media outlets provide employees the opportunity to be entrepreneurial and provide “dramatic suggestion” through their work.<sup>29</sup> The key point is that in an environment characterized by media autonomy, entrepreneurs will have guideposts – an interconnection of the profit/loss mechanism and the reputation market – to direct their activities. In the case of a state run or influenced media, political actors will have no way to know if they are directing resources toward the “right” ends from an economic standpoint.

Understanding media as a coordination-enhancing device, one key issue is how to address those countries characterized by a lack of media or by a low quality media. Many countries do not have the basic infrastructure necessary for a media industry to develop. In other cases, it is often difficult to find well-trained employees to staff media

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<sup>28</sup> Coyne and Leeson (2004) consider the factors necessary for media to serve as an effective coordination-enhancing mechanism. One of these factors is media autonomy. Also see Djankov et al (2003) have found that state ownership of the media is higher in countries that are relatively poor, have more autocratic regimes and have higher levels of state ownership in other areas in the economy.

<sup>29</sup> It should be noted that the claim is not that each and every media report is an instance of dramatic suggestion. Rather, those in the media industry have the opportunity to make dramatic suggestion through their reporting.

outlets. This difficulty impacts the full range of media related roles from management to editors, analysts and journalists. In these cases, there is potential for misreporting of information and coordinating the populace on set of conjectures not aligned with the transition. One solution to this is opening the borders to foreign investment. Doing so not only allows for foreign monetary investment but also allows the transitioning country to learn from the experiences of foreigners.

As the case of TV-2 in Russia illustrates, indigenous employees can also learn “on the job.” Those running TV-2 in the 1990s had little knowledge or experience running a TV station, but through trial and error as well as assistance from foreign consultants, were able to sustain and develop the station (Muchnik and Muchnik 2002: 304-5). This trial and error process took place in the context of prices, the profit and loss mechanism and the reputation markets guiding the activities of the entrepreneurs involved.

There are further affects of opening the media industry. External media sources create an instant environment of competition and also serve as a model for local media outlets. These external media outlets, which often have an established stock of reputation capital, also serve as a check on misreporting. For instance, in Korea and Russia, *The Financial Times* is considered more credible than many of the local news sources (Dyck and Zingales 2002: 120). This forces local media outlets not only to recognize the stories receiving coverage from these major outlets, but also to cover them accurately.

Consider, for instance, the case of Poland. In 1989, Poland became the first of the Eastern European countries to overthrow its Communist regime. Although it still has problems – high unemployment, low incomes and some government corruption – Poland

is considered a success relative to other Eastern European transition countries.<sup>30</sup> Prior to 1989, the media industry – radio, television, newspapers and magazines – in Poland was owned and operated by the state. However, Poland has since developed a strong media industry with relatively favorable privatization, legal structures and journalistic practices (Carrington and Nelson 2002: 232). Today there are about 5,500 newspapers and periodicals on the Polish market, many of which are local or regional.<sup>31</sup> Moreover, a wide variety of topics are covered including general news (*Gazeta Wyborcza* and *Rzeczpospolita*), “light papers” providing entertainment news (*Detektyw*, *Skandale*, *Sensacje*, *Kobra*, etc.), magazines aimed at shoppers (*Top*, *Kontakt*, etc.) and music papers (*Magazyn Muzyczny*, *Rock ‘n Roll*, etc.). The major independent media sources are the daily papers, the *Gazeta Wyborcza* and *Rzeczpospolita*, which have established reputations as being credible and have maintained demand for their product. *Gazeta Wyborcza* has an average daily circulation of 536,000 copies while *Rzeczpospolita* has a circulation of 306,742.<sup>32</sup> Both publications have overcome the barriers of the economic environment and lack of training through foreign investment (Goban-Klas 1997: 25-6, Carrington and Nelson 2002: 232-5).

The success of these papers indicates that Poland has adopted the basic institutions necessary for a free media. But these papers have also established reputation capital as credible news sources and have played a key role as coordination-enhancing mechanisms reinforcing these institutions as well as other transition efforts. For example,

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<sup>30</sup> For instance, during the first decade of transition from communism to democracy, Poland’s economy had the quickest turnaround, experiencing economic growth in 1992.

<sup>31</sup> The number of periodicals is from Osrodek Badan Prasoznawczych Uniwersytetu Jagiellonskiego w Krakowie - Press Research Centre at Jagiellonian University in Krakow, which keeps the electronic database available at the following address: [www.media.onet.pl](http://www.media.onet.pl).

<sup>32</sup> Source of *Gazeta Wyborcza* circulation: [http://www.agora.pl/gw\\_advertising2/1,44368,1268408.html](http://www.agora.pl/gw_advertising2/1,44368,1268408.html); Source of *Rzeczpospolita* circulation: <http://www.mercury-publicity.com/germany.html>

the *Rzeczpospolita* expanded its economic and political coverage and created the “green pages,” which focus specifically on Poland’s economic development in terms of the policies adopted as well as their progress. The paper serves as an information source on the mass privatization, allowing readers to realize the benefits and track the progress of political efforts (Carrington and Nelson 2002: 235). In short, the media in Poland assisted in the generation of common knowledge, allowing the government and populace to coordinate on a set of conjectures aligning with the aims of transition. The populace was (and continues to be) better able to understand the benefits of privatization. Further, decision-makers are aware that their progress toward privatization is being monitored.<sup>33</sup> This is a perfect example where the media is able to operate because of the adoption of some foundational institutions and also where it assists in strengthening existing convergence and creating convergence around other institutions.

Ukraine serves as a stark contrast to the case of Poland. The country is characterized by widespread corruption, a weak rule of law and excessive regulations, so it is not surprising that the media in the Ukraine is not free.<sup>34</sup> While many media outlets are privately owned, there is indirect government influence through subscription subsidies, printing privileges and distribution through the state-run postal service to state-run media sources. The administration regularly engages in censorship, issuing instructions (“*temniks*”) to media regarding coverage or noncoverage of events. The state also controls newspaper distribution and broadcasting transmitters. Additionally,

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<sup>33</sup> It should be noted that there is still some state pressure on the media in Poland. For instance, there are still state-owned television (Telewizja Polska, which operates two stations, TVP1 and TVP2; and TV Polonia) and radio (Channels 1 & 2) stations. Moreover, the state still exerts pressure on those media sources which are critical of the government, as evidenced by the increased number of defamation lawsuits brought by political agents (Freedom House 2003: 126).

<sup>34</sup> The status of the Ukraine media as “not free” was determined by Freedom House (2003: 150).

being a journalist in the Ukraine is not a safe profession. According to one poll, 78.7% of the people in the Ukraine consider journalism to be a “dangerous profession” (International Research & Exchange Board 2002: 144). Ukraine has failed to adopt the institutional environment conducive to a free media and therefore has prevented the media from acting as a coordination-enhancing device. Given the state involvement in the media industry, effective disciplinary devices to guide the actions of agents in the industry are absent.

In the absence of media autonomy, we have no reason to expect that the media will be effectively used to generate common knowledge around the aims of the transition. In fact, given public choice insights, we would expect those in political positions to utilize the media to maintain their entrenched positions. This is illustrated by the case of the Ukraine where political agents abuse the media for their own ends. As a result, convergence is created around perverse conjectures that hamper the transition and development process.

From a purely economic standpoint, in the absence of media autonomy, there is no way to ensure that resources are being allocated to their most highly valued use. If media autonomy does exist, entrepreneurs in the media industry will be guided by a combination of prices, profit/loss and the reputation market, all of which are driven by consumer demand.<sup>35</sup> Given a stable institutional environment, resources will be allocated to their most highly valued use over time. These mechanisms are absent or greatly hampered in the cases of state run or influenced media.

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<sup>35</sup> Of course, an autonomous media does not guarantee that information supporting transition efforts will be provided. Consumers must have an interest in these issues and demand coverage of certain topics from the media outlets (see Coyne and Leeson 2004: 32-34).

## 4. Conclusion

Two central issues motivated this paper. The first was understanding how new focal points are created and existing focal points are shifted. We postulated that the entrepreneur, who is the driver of economic change, is also the catalyst of social and cultural change. By being alert to and betting on wishful conjectures across various settings, the entrepreneur creates new focal points.

The second and related issue that we addressed was the transferability of the desirable consequences of entrepreneurship in market settings to non-market and political settings. We contended that entrepreneurship in non-market settings is initially a local phenomenon guided by reputation capital. We developed a framework for framing entrepreneurial activities in non-market settings.

Our argument is that, from an economic standpoint, non-market activity is most effective when initially limited to local actions where the reputation collateral of the entrepreneur is on the line. If we want for resources to be effectively allocated to their most highly valued use, large-scale efforts at social and cultural change must be coordinated through various impersonal forces that serve as an imperfect proxy of monetary prices in the market setting. Granted, the reputation mechanism is not nearly as effective as monetary calculation but it does provide some check on entrepreneurs in non-market settings. Small-scale efforts can be coordinated through face-to-face forces of reputation, either directly with the entrepreneur or through middlemen who possess the necessary local knowledge.<sup>36</sup>

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<sup>36</sup> For examples of local solutions to local problems, see Ostrom 1992.

Finally, in political settings, we concluded that there is no disciplinary device to guide the actions of political agents. In other words, there is no way for these agents to know if they are allocating resources toward the “right” ends. Political interference can create social and cultural change, but will be coupled with waste and ineffectiveness because of the lack of a viable disciplinary mechanism to bring to identify errors. The main policy implication is that entrepreneurial efforts outside the market context should be undertaken at the local level where the disciplinary devices of face-to-face interaction and the reputation market can be most effective. This is especially true in underdeveloped and war-torn countries lacking well-developed social networks. Moreover, our case studies indicate the importance of identifying and involving opinion leaders in the change process given that these individuals have an established stock of reputation capital.

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