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*The Theory of Entrepreneurship
in Austrian Economics*

In their writings on entrepreneurship, the Austrian economists were latecomers. Menger had little to say about the subject. Bohm Bawerk acknowledged it as one of the two important problems remaining to be dealt with following Menger's theory of prices but chose himself to tackle the second problem -- interest.[1] Schumpeter, in 1911, was the first Austrian to use the general equilibrium framework to define the entrepreneur. However, this had already been done by earlier American writers, particularly J. B. Clark (1899). Schumpeter did not add anything of methodological significance and perhaps took a step backward. Hayek wrote several papers about knowledge and competition but seems to have gone out his way to avoid using the term "entrepreneur." [2]

Truly original Austrian contributions to the theory of entrepreneurship began with Mises's 1940 *Nationaloekonomie* (Mises 1966). In that book, Mises put entrepreneurship at the center of the stage.[3] He regarded its elucidation (and the incentive to act entrepreneurially -- profit and loss) as the fundamental task faced by one who wants to describe and understand economic interaction. Mises defined entrepreneurship, in its functional sense, as the embodiment of all behavior in the market economy that is *distinctively human*. In other words, it encompasses all

behavior that cannot be expressed in a model of robots that operate according to maximizing algorithms.

Mises did not express his ideas in precisely these terms. Yet his meaning is clear. He entitled the English version of his magnum opus *Human Action*. And he pointed out that economics is the theory of human action (praxeology) under the conditions of the market economy.(Mises 1966: 232-4) Because readers may not be accustomed to using the term "human action" in Mises's sense, this paper uses the term *distinctly human action* to refer to Mises's conception. An advantage of this term is that the word "distinct" suggests that one must have in mind a procedure for distinguishing between action, which is human, and other behavior.[4] Mises called the procedure for doing this *the method of imaginary constructions*.

In recent years, Israel Kirzner, a student of Mises, has used the term "entrepreneur" to refer to the central idea in his "market process analysis." Partly as a result, Kirzner has been a major figure in the renewed professional interest in the entrepreneur. The publication of five books in the 1980s on the concept of the entrepreneur[5] are in no small measure due to his persistent argument that neoclassical economics put too little emphasis on entrepreneurship.[6] In spite of Kirzner's professional success as an Austrian economist, I believe that he has promoted a non-subjectivist conception of entrepreneurship and that he has neglected what is best in Mises's writing on entrepreneurship.

I believe that the best parts of the Austrian theory of entrepreneurship are two recognitions by Mises. The first is that the role of the entrepreneur encompasses all distinctly human action in the

market economy. The second is that in order to define and elucidate the role of the entrepreneur, one must use the imaginary construction of the static general equilibrium model, or evenly rotating economy (ERE), to make a contrast. The ERE is a comprehensive, yet action-less, image of the saving-factor supplying-producing-consuming nexus of a pure market economy. In the image, the savers, factor-suppliers, producers, and consumers are robots. To understand how distinctly human actors interact to cause saving, factor supplying, producing, and consuming actions, one must contrast the robot behavior with what one knows intuitively and through experience about how distinctly human actors will act under the conditions specified in the definition of the market economy. Thus, the ERE is an essential part of the procedure that enables economists to build an image of the market economy.

The basis for my beliefs is a continuing decade-long study of the economics of Mises. In that study, I had to sort through his profound yet prolix discussions. I had to clarify the link between praxeology and economics. I had to resolve apparent contradictions by identifying passages and even major ideas that went against the thrust of his revolutionary vision of economics and social science. And I had to try to resolve contradictions between these ideas and those of others who had written about Mises. The result is a complex tangle of insights and ideas that I am still struggling to fully and satisfactorily express. The tangible results have been two books on Mises and a few papers.[7] The first book (Gunning 1990) attempted to describe and extend Mises's work in a positive way and the second focussed on contradictions and errors in his work.

It is impossible in a short conference paper to present the fruits of all this labor except in summary form. I cannot expect to convince a skeptical reader of many of my conclusions. I can only refer such a reader to accessible works and hope that they will have the patience to follow them up. This, then, is the spirit of this paper. It is an expression of ideas that are not only far outside mainstream thinking but also far outside the thinking of those who regard themselves as mainstream Austrians. Perhaps its main value is as a stimulant to further reading and thought. It is by no means a logical, fully developed contribution to the theory of entrepreneurship.

This paper is divided into three sections and a conclusion. The first presents the new subjectivist theory of entrepreneurship in summary form. The second briefly discusses and assesses Schumpeter's theory. The longer third section presents and evaluates Kirzner's argument that we should define entrepreneurship as alertness. It strongly opposes that view and maintains that it threatens to undermine Mises's most important contribution to economic theory.

1. The New Subjectivist Elucidation of Entrepreneurship

The method economists must use to study the branch of human action that we call economic interaction is *subjectivism*. This does not say very much because this term has been used in a variety of ways. I am concerned here with what I called in my first book (Gunning 1990) the *new* subjectivism, which I believe can be derived from Mises's work. To understand my meaning, we

must begin with what I have called the old subjectivism, as proposed by Carl Menger. The typical reports on Menger's work in professional economics regard him mainly as one of several founders of a consumer-based marginal-utility theory of value. Although Menger's contribution to this theory was one of his greatest accomplishments, an equally important achievement was that he defined an economic good (and, therefore, all relevant economic phenomena) in terms of the viewpoints of subjects for whom the good is relevant in their choices, or actions. Especially significant is the assumption in Menger that for a thing to be a good, some person or set of persons must have knowledge of its causal connection to the satisfaction of wants.[8]

The subjectivism in Menger's work is thus twofold. First, he required the prices of all goods to be traced to valuations made by the *consumer role*. Second, he required descriptions of economic interaction to incorporate knowledge of causal connections among goods of different orders. From the standpoint of the history of the new subjectivism, the most important developments in the seventy years following Menger were the refinements that occurred in how economists came to represent these two aspects of Menger's work.

These developments were not made by Austrians but by other subjectivists, the most important of whom were J. B. Clark (1899), P. H. Wicksteed (1910), H. J. Davenport (1914), and F. Knight (1921). There is insufficient space here to describe this history. It is perhaps sufficient to say that, in one way or another, each of the authors helped to show that the concept of the entrepreneur, suitably defined in relation to the ERE, could be used to represent the two

aspects.[9] It was not until Mises's *Human Action* (Nationaloekonomie), however, that the *method* used by the authors was clearly identified.

The key to understanding Mises's contribution is to understand how he uses a combination of a priori assumptions and the evenly rotating economy to elucidate the relationship between the consumer and the entrepreneur roles. Consider first the a priori assumptions. We know a priori that regardless of any particular wants or technical (supply) conditions, human beings make choices among alternative means of satisfying their ends. Moreover, we know that these choices have a time dimension in the sense that choosers consider their anticipated future ends and their prospects for meeting them. Finally, for a variety of a priori reasons, individuals are uncertain about the outcomes of their choices.[10] In economic interaction, the significant type of uncertainty is intersubjective -- uncertainty about the wants, abilities and knowledge of other actors.[11] To elucidate the relationship between the consumer and entrepreneur roles, we introduce the concept of the entrepreneur "function."

The Entrepreneur "Function"

The "function" of entrepreneurship embodies all that can be deduced about how time and uncertainty are relevant to the choices to identify and use factors of production to satisfy consumers' wants.[12] There are three inseparable parts to acting entrepreneurially: appraisal, undertaking, and uncertainty-bearing.[13] *Appraisal* means identifying means (factors of production) and determining the profitability of using them to help satisfy consumers' wants.

Thus, appraisal captures the knowledge of the causal connections among goods that was stressed by Menger. It adds to this the assumption that entrepreneurs operate in the environment of a market economy, where calculations are made in terms of money by individuals who differ in their judgments.[14] *Undertaking* means performing the act of will that directs the factors to their specific employments.[15] This, of course, is necessary for any production (and ultimately for any satisfaction of consumer wants) to occur. Uncertainty-bearing refers to the prospect for loss that results when one provides funds or guarantees the funds provided by others that are necessary to cause the production to occur. Mises showed that uncertainty is a necessary characteristic of action[16] and that the uncertainty that is relevant in a market economy is intersubjective uncertainty.[17]

In other words, appraisal refers to the entrepreneur's use of his specialized knowledge of the causal connections among goods in order to attach prices to factors and decide whether the factors offered for sale by others are worthwhile buying and employing. A market economy would not be possible without this. Undertaking refers to the actual decision to hire and employ factors. Uncertainty-bearing refers to the assumption that every undertaking entails the prospect of loss because of the uncertainty inherent in trying to predict how other people will act. Since economics is the study of action in the market economy, uncertainty-bearing is a property of every relevant undertaking. And every relevant undertaking by distinctly human actors requires appraisal.

Although Mises did not neatly lay out these three inseparable characteristics, he clearly described the method one must use to do so. It consists of using the ERE to conceptually strip, or extract, the distinctly human action from economic behavior. Mises pointed out that such an imaginary construction is necessary in order to elucidate, by contrast, the role of the entrepreneur.[18] Perhaps because Mises did not clearly lay out the characteristics, his descriptions of entrepreneurship in the market economy seem not much different from, and in some ways inferior to, those of earlier writers on entrepreneurship. I believe that it is mainly for this reason that his contribution has gone unrecognized.

It is useful to have a precise definition of entrepreneurship. I have defined it in the following way: entrepreneurship refers to the willingness to bet one's time and/or money that one's appraisals of factors are superior to the appraisals of others. To fit this definition into the saving-production-consumption nexus, we must add that the bet contributes in some way to the production of goods to satisfy consumers' wants.

Entrepreneurship as the Distinctly Human Part of Human Action

I have argued that the highest point in our understanding of entrepreneurship was achieved when entrepreneurship came to be associated with the distinctly human part of human action in the market economy. And this association has, in turn, been attributed to Mises. Mises, himself, did not put the association in these terms however. The main burden of my 1990 book was to

demonstrate that his methodological apriorism, or new subjectivism, did precisely this. Although I obviously cannot repeat the logic of that book here, I will try to briefly summarize it.

First, Mises defined action as having the characteristics of ends and means, time and uncertainty. (Mises 1966: chapters 4, 5, and 6) These characteristics -- or properties of the category of action, as Mises called them -- comprise the distinctly human parts of human action. What makes them distinctly human? We can only determine this by using our intuition and experience to contrast our personal understanding of our own means and ends with what might otherwise be called the means and ends of robots or animals.

For a simple Crusonean consumption-production action I have shown that the distinctly human parts are:

- ◆ (1) the identification of factors
- ◆ (2) estimating net benefits of using a prospective factor according to a production plan
- ◆ (3) making the actual decision to use the prospective factors in the plan
- ◆ (4) bearing uncertainty.[19]

Constructing an Image of the Market Economy

The problem of economics is to incorporate these characteristics into an image of a market economy. Thus, the second step is to define these terms so that they refer to saving, factor-supplying, producing, and consuming under the conditions of private property rights, specialization, and the use of money. We can accomplish this by means of definition and separation. We

define saving as the *behavior* of setting aside goods or factors for the satisfaction of future wants. We define factor-supplying as the behavior of using one's factors to help produce a good. We define producing as the *behavior* of using items that are regarded as factors of production to satisfy wants. We define consuming as the *behavior* associated with using a first-order good (or goods, as opposed to factors) to meet the ends. We can imagine this behavior being performed by robots in a routine fashion or by animals according to imprinting and "learning." But we reserve the term "entrepreneurship" to refer to the distinctly human parts of using means to satisfy ends through time under the conditions of the market economy. Thus, we reserve the term "entrepreneurship" to refer to the four distinctly human parts of action referred to in the last paragraph, as they come to be expressed under the conditions that we assume to exist in the market economy.

The third step is to construct an image of the relationship between the prices of goods and the factors of production that includes the behavior of saving, supplying factors, producing, and consuming but no entrepreneurship. This is the ERE. It gives us the means of elucidating the distinctly human action in the market economy. We ask: what characteristics of human behavior related to saving, supplying factors, producing, and consuming cannot be represented in an image of robots? The answer: entrepreneur actions. Referring to the characteristics of entrepreneurship described earlier, robots do not appraise (identify factors and estimate net benefits), make decisions (as opposed to selections based on algorithms), or bear (intersubjective) uncertainty.[20]

The fourth step is to construct an image of pure entrepreneurial interaction. We do this by conceiving of the *pure entrepreneurial economy*. The pure entrepreneurial economy contains robot consumer-savers, factor suppliers, and producer-managers who carry out the directives of the pure entrepreneurs. However, these robots do not make judgments or act. They operate according to routines, or algorithms. All economic interaction occurs among pure entrepreneurs. Pure entrepreneurs use their own wealth to finance their bidding for factors and production. Each bears the uncertainty connected with his enterprise. We use this image to describe

- ◆ pricing
- ◆ competition, including copying and innovating
- ◆ the appraisal of appraisal ability in others
- ◆ how people select themselves, others, and objects to perform various functions in satisfying consumers' wants
- ◆ how people allocate the bearing of what they perceive to be uncertainty.[21]

This step enriches our definition of entrepreneurship in the market economy.

The fifth step is to use this enriched understanding of the entrepreneur function to refer to particular actions of real human actors who act in the role of savers, factor-suppliers, producers, and consumers under the conditions specified in the definition of the market economy. In other words, we use it to help us build an image of the pure market economy.[22]

A Note on Entrepreneurship in *Human Action*

After Mises described the functional concept of the entrepreneur in *Human Action*, he made what I believe was the serious mistake of discussing a "narrower" image of the entrepreneur concept that reflects how "[e]conomics...always did and still does use the term `entrepreneur.'"(Mises 1966: 254-255). This concept of the entrepreneur is based on the observable fact (datum) that individuals differ in the accuracy of their appraisals and in their willingness to bear uncertainty. Mises used the terms "promoter" and "promoting entrepreneur" to refer to this concept. It refers to

those who are especially eager to profit from adjusting production to the expected changes in conditions, those who have more initiative, more venturesomeness, and a quicker eye than the crowd, the pushing and promoting pioneers of economic development.(*ibid.*)^[23]

I cannot here summarize my argument that using this notion of the entrepreneur was not only a serious mistake in judgment but led Mises into error.^[24] However, it is necessary to mention this lest students of Mises mistakenly associate the functional concept with the promoting entrepreneur.

2. Schumpeter

J. A. Schumpeter was the first Austrian economist to explicitly develop what might be called a theory of entrepreneurship. In his 1911 book, he elucidated entrepreneurship by contrasting his image of a real market economy with the static general equilibrium. He defined the latter as

containing interaction but no invention and innovation ("the carrying out of new combinations").[25] He used the term entrepreneur to represent these activities. Although Schumpeter wrote extensively after his 1911 book, he did not develop the concept of entrepreneurship further. So far as I am aware, there were no other significant Austrian contributions until Mises.

Let us compare descriptions of economic interaction using Schumpeter's entrepreneur with descriptions using the "new subjectivist entrepreneur." Consider some examples. Suppose that a lender outbids his competitors by offering a prospective producer a lower cost loan. The new subjectivist represents this as a competition among entrepreneurs for the right to the profit from the producer's future activities. A producer who outbids his competitor for some factor of production and an employee who offers to do a particular job for a lower price than his competitors are also regarded as competing entrepreneurs. An employment compact is a competition among entrepreneurs (the buyer and the seller of work) for the right to the product of the employee's work. Finally a person who agrees to pay part of a future loss in exchange for part of what would otherwise be someone else's future business profit is really an entrepreneur who outbids his competitor for the right to part of the competitor's future profit. The "competitor" is not harmed, of course, but benefits from this competition because she happens to own the resources for which the bidding occurs. The unifying feature of all of these examples is that they can be expressed in terms of competition among individuals in their capacity as entrepreneurs. The subjectivist can form an understanding of these kinds of phenomena theoretically simply by using his image of the pure entrepreneurial economy.

Schumpeter's descriptions are more cumbersome. For example, to describe phenomena like judgments of future wants, uncertainty-bearing, credit, underwriting, and even competition; he must refer to producers, capitalists, businessmen, and workers. By adopting this mode of description, one runs the risk of confusing the distinctly human category of entrepreneurship with various behaviors that are not entrepreneurship. Because Schumpeter did not identify the entrepreneur function, he could not reason as abstractly as the new subjectivist and, consequently, could not easily shift back and forth between abstract theoretical reasoning and concrete description (or theory and history, in Mises's terms).

Schumpeter's limited conception of entrepreneurship stems directly from the problem with which he was concerned. He wanted to write about economic development, which he associated with new combinations. So he defined the entrepreneur as the discoverer and actuator of those combinations. Having appropriated the term entrepreneur to refer to this phenomenon, he had no other term to describe economic interaction in the abstract.

Correctly understood, economic development is a special application of the theory of economic interaction generally. One asks: "What would be the effect of changing a particular set of laws so that the real society conforms more (or less) closely to the imaginary construction of the pure market economy? One outcome of changing from a socialist economy toward a pure market economy would apparently be the greater amount of discoveries of what historians would call new products and methods of production, the opening of new markets, etc. But the motiva-

tion for this and the sequence of events that has this result are no different from those involved in the satisfaction of wants generally (with the use of "old" combinations, for example).

In fact, Schumpeter's entrepreneur is not a subjectivist concept. In the market economy, what constitutes a new combination is a subjective judgment. No one knows all of the combinations and thus no one can be certain whether a combination is new or old. And, of course, no one cares. No one will finance or undertake what he thinks is a new combination (or, for that matter, an "old" combination) unless he judges that he can earn a profit. It is this judgment and the decision to act on it that constitute the important phenomenon to the economist, not whether the combination is regarded as old or new.

The difference between the concept of the static equilibrium used by Schumpeter and the evenly rotating economy of the new subjectivism parallels this. Schumpeter uses the static equilibrium to define old combinations. The new subjectivism uses the ERE not as a model of human beings who only produce and consume the fruits of old combinations but as a model of robots who do not and cannot perform distinctly human action. The absence of distinctly human action, not the absence of new combinations, is the distinguishing feature of the ERE.

3. Kirzner's Entrepreneur

Kirzner's treatment of "entrepreneurship" is extensive. Some of it uses a concept of the entrepreneur that is not too different from that used by Schumpeter and which is familiar to most professional economists. By this, I mean that he defines entrepreneurship in terms of an equilibrium on the basis of the particular phenomenon which he implicitly aims to elucidate. However, the distinguishing feature of his work concerns what he calls "the entrepreneurial element in human decision-making, or alertness." In any case, This section will focus mainly on the Kirzner's idea of entrepreneurship as alertness. Toward the end of the section, I discuss his departures from this usage.

Alertness as Entrepreneurship

The fundamental concept in Israel Kirzner's definition of entrepreneurship is alertness. Alertness leads individuals to make discoveries of information that is valuable in the satisfaction of wants. It is subconscious, unplanned, and completely unexpected. Because discoveries are unexpected, the discoverer is not able to prepare for them or to promote them. In Kirzner's terms, a discovery is like realizing that a free ten-dollar bill which already has been discovered is resting in one's hand.(Kirzner 1973: 47).

The discoveries due to alertness can be contrasted with another type of discovery. Like the captains of the first European ships that sailed out to the "new world," an individual can make a

discovery which, while not planned for precisely, would nevertheless be expected in some measure at the outset of a particular plan of action. Using Kirzner's analogy, one can go searching for money and, with luck, find a ten dollar bill in his hand. Kirzner is not talking about this kind of discovery. Discoveries due to "alert entrepreneurship" are totally unexpected. The alertness of which he speaks is either totally unrecognized by the individual or, if it is recognized, he can do nothing to promote it.

The Relevance of Alertness

There can be no doubt that discoveries of the type that Kirzner describes occur. We know this from inspecting our own actions. The issue I wish to raise is why such discoveries are relevant to economics. Given that they are totally unknown and unknowable to the actor, their relevance can only be derived from the action that occurs *after* the discovery. Suppose that someone discovers that an item that was previously not a factor of production can be profitably used as such. If neither she nor someone else acts on this knowledge, it is irrelevant. So let us consider the case where the knowledge is accompanied by an incentive to act. Following the discovery, suppose that the discoverer comes to appraise the item and other factors of production differently than previously. She then proceeds to change her plans by buying factors and producing a saleable good. In this case, the discovery is relevant. We conclude that in the relevant case, the discoverer of a factor must bet that her discovery can earn a profit. She must be willing to bet that her appraisals of factors are superior to those of other appraisers. In terms of this paper, alertness is

relevant if it leads to discoveries that *entrepreneurship* regards as relevant to its choice. But, of course, Kirzner uses the term "entrepreneur" to describe alertness. Although he surely would agree with the ideas expressed in this paragraph, he could not use these words to express them.

Alertness, Entrepreneurship, and Maximizing

If we use the term "entrepreneurship" to refer to alertness, what term should we use to describe the action of betting that one's discovered knowledge is correct by using one's wealth or factors of production to produce a saleable good? In his initial work, Kirzner contrasted the alert discoverer of knowledge with a Robbinsian maximizer. To date, however, he has said nothing about the Mises's entrepreneur function, which Mises contrasted with the maximizing robots of the ERE.

Mises would have regarded the discoveries that result from alertness data.[26] In a proper subjectivist analysis, data enter through the choosing minds of the subjects studied. To be relevant to economics, they must be accounted for by appraising and uncertainty-bearing entrepreneurship. The economist may refer to data by telling how they are perceived by entrepreneurship. For example, if lenders incorporate a belief that business borrowers will have subconscious, unplanned, and unexpected windfalls, they will act differently than if they do not have such a belief. Speculators may even buy and sell stock on the basis of their respective beliefs about the probable windfalls that will occur in the various businesses. However, if the prospect

for windfalls is not taken into account by anyone, it does not belong in economics. To call the alertness that results in windfalls "entrepreneurship" is tantamount to calling attention "choice."

Alertness as a Real Phenomenon

It is so unusual for a student of Mises to appropriate the term entrepreneurship in this way that one is naturally led to ask why. Kirzner provides answers of sorts in two of his books (Kirzner 1979; 1992). In his 1979 book, he seems to give two answers. The first is that alertness is a real phenomenon.

The truth surely is that, of the mass of knowledge, beliefs, opinions, expectations, and guesses that one holds at a given moment and that inspire and shape action, only a fraction can be described as being the result of deliberate search or learning activity. Surely a very great volume of one's awareness of one's environment, and of one's expectations concerning the future, is the result of learning experiences that *occurred entirely without having been planned*. (Kirzner 1979: 142)

One can hardly deny that much of our expectations of the future have resulted from experiences that were not planned by us. Even if we exclude experiences planned by others, such as schooling and "socialization," there still appears to be quite a range of experiences that were not planned and which yielded knowledge that we regard as useful in predicting the future. Moreover, we have quite a bit of knowledge of which we are normally unaware but only call upon when we encounter an unfamiliar situation. Notwithstanding these facts, the important question is how we should include the unplanned knowledge or discoveries in our images of economic interaction. The sun rises every day but this does not mean we should regard it as an important economic phenomenon and call it "entrepreneurship."

Desirability of Institutions to Generate Unplanned Learning

Kirzner's second answer of sorts is that institutions differ in the extent to which they generate subconscious discoveries. Thus, alertness has policy relevance. He says

I contend that the market performs a crucial function in discovering knowledge nobody knows exists; that an understanding of the true character of the market process depends, indeed, on recognizing this crucial function; and, finally, that contemporary economists' unawareness of these insights appears to be the result of otherwise wholly laudable attempts to treat knowledge objectively...(Kirzner 1979:139)

...it must appear highly desirable to choose among alternative social institutional arrangements those modes of organization that minimize this kind of ignorance -- that is, those modes of organization that generate the greatest volume of spontaneous undeliberate learning. (*ibid.*: 147)

The Market Process

It is important to realize that the "market process" as Kirzner uses the term in the quote from p. 139, does not refer to individuals deliberately positioning themselves or making contractual arrangements so that they can benefit from the actions or behavior of others. It means "a process of *spontaneous* discovery of the plans of other market participants."(*ibid.*: 148, italics added)

"Spontaneous" means subconscious and unplanned.[27] He assumes that the soon-to-be discoverers of plans are completely unaware of their prospect for gain. It follows that part of the statement under consideration can be rewritten as: "I contend that the market performs the important function of inducing subconscious learning about others' plans." The "market" in this statement presumably refers to the conditions of private property rights and freedom of contract.

Alertness and Instincts

At first glance, this is a remarkable claim. Since spontaneous, undeliberate learning is not a conscious process, it apparently falls into the category of an instinct. Instincts are either the consequence of a genetic accident or natural selection. (Mises 1966: 27) Let us suppose that the relevant instincts are due to natural selection. Then they would have developed and have been selected for during times of species or group stress. And they would be suitable mainly for enabling the species or group to survive similar stressful situations. If we accept this, then instinctual curiosity and imitation would have arisen during periods of survival stress to pre-human and early human groups.

Such instincts may be more of a liability in the market economy than an asset. Human actors who studied such instincts in others could potentially prompt behavior that is contrary to the others' interests. For example, a stock promoter who knows that a new stock is worthless might expect some people to buy out of instinctual curiosity. As a result, he could gain at their expense. Similarly, recognizing an instinct for copying, a wise stock market speculator may sell his stock when he thinks that instinctual imitators have bid the price to an artificially high level. In these cases, the wise speculator gains at the expense of the instinctive behavior.

Institutions and Alertness

Can institutions effect alertness? The converse of Kirzner's argument is that socialism would stifle alertness. Is this true? It would surely stifle the betting that people do on their knowledge,

subconscious or otherwise. But if people had an instinct for discovering wants and means of satisfying them, how could socialism stifle it? Kirzner provides no help on this of which I am aware. One could make the argument that parents in the market economy deliberately promote alertness in their children in order to prepare them for success. But Kirzner does not speak about alertness that can be promoted through "socialization." And for good reason. A parent who can stimulate the alertness in her child could presumably also stimulate alertness in herself.

This is not to deny, of course, that the institutions of the market economy give individuals an incentive to utilize all knowledge, regardless of source, for the purpose of satisfying others' wants. My argument is that if there is a relationship between market institutions and subconscious discoveries, it is not direct and in any case is not relevant to action, and therefore economics, defined as a branch of praxeological theory. Alertness is relevant only to history or applied economics; since those disciplines require one to construct images based on realistic assumptions about all relevant facts.[28]

Kirzner's 1992 Paper

In the more recent paper, Kirzner deals among other things with what he calls the radical subjectivist critique of his claim that economists should study how the "entrepreneurial process" leads to equilibrium.(Kirzner 1992: 12-14) The concept of alertness plays a role in his argument.

He says:

...The writer's attempt to develop a theory of systematic entrepreneurial equilibrating tendencies that is rooted in creative entrepreneurial alertness is pronounced to fail because the 'subliminal teleology' implicit in notions of equilibration is thoroughly inconsistent with creativity. (*ibid.*: 17-18)

Kirzner defends his attempt by pointing out that by equilibrating tendencies, he means tendencies toward coordination; and the tendencies he has in mind are those envisioned and re-envisioned by individual actors as time passes. The wording of his defense is critical and quotations are necessary to avoid misunderstanding. He says:

...Once we acknowledge the meaningfulness of endeavouring to imagine the future more correctly, we can hardly refuse to recognize the quality of 'alertness' (or more correctly fertile imaginary, or of greater prescience - call it what one will) in human beings. We must, that is, recognize something like 'entrepreneurial ability,' understood as the capacity independently to size up a situation and more correctly reach an imagined picture of the relevant (as yet indeterminate) future...(ibid.: 26)

...what the alertness of the entrepreneur strives to notice and correctly to imagine are (what will turn out to be) future realities, and it is the *prospective gain offered by these realities* which 'switches on' entrepreneurial alertness...(ibid.: 27)

...The entrepreneur is not so much choosing a course of action that shall be appropriate to the 'realities' as he is choosing among alternative imaginable realities that his prospective action may be initiating...(ibid.)

...it is the imagined *reality*...which inspires and shapes the entrepreneur's decision...(ibid.: 32)

...different imaginable realities may simultaneously exercise their influence on the entrepreneurial nose for profit...(ibid.: 33)

To the reader who is interested in whether Kirzner's reference to the entrepreneur is to conscious action or to subconscious processes, these statements seem equivocal. The imagined reality to which Kirzner refers must be part of consciousness. The individual constructs an image of a future reality and chooses what he regards as the best course of action. Thus, the "entrepreneurial ability" to which he refers on p. 26 would seem to be part of a conscious choice. On p. 27, however, he does not say that an individual strives to notice prospective gain; he says that *the alertness of the entrepreneur* strives to notice this gain. Since he has consistently used the concept of alertness in previous work to refer to a subconscious process, he is presumably

referring to that subconscious process here. This appears to be confirmed by the next quote to the effect that entrepreneurial alertness is *switched on* (notwithstanding that in the same sentence he says that the entrepreneur strives to notice and correctly imagine future realities).

In the next statement, again on p. 27, he speaks of the entrepreneur choosing among imaginable realities. Choosing is presumably a conscious process. (It is noteworthy, however, that he uses the term "imaginable" and not "imagined" suggesting that perhaps he is not referring to what the entrepreneur imagines. There seems to be a certain slipperiness here, although one cannot be sure.) Next, on p. 32, he says that the imagined reality "shapes" the entrepreneur's decision. On p. 33, the imaginable realities exercise their influence on the entrepreneurial "nose for profit." Is he speaking here of instincts?

Admittedly, such a deep scrutiny of anyone's work might lead us to conclude that his ideas are consistent. However, the point I want to make is that if we assume that Kirzner is talking about conscious action, his argument is consistent with the new subjectivism. In this case, his is talking about the method of imaginary constructions used by the appraising, undertaking, and uncertainty-bearing entrepreneur. However, the failure to use the term entrepreneur in the functional sense results in metaphors that are best avoided. On the other hand, if he is referring to subconscious processes, his argument fails. Subconscious behavior cannot be driven by realities that are imagined by the behavior. And it cannot be driven by the individual's prospect for profit.

Recognition of Conscious, Planned Action

It would be incorrect to say that Kirzner ignores the characteristic feature of the new subjectivist entrepreneur, namely, betting on one's judgments, Quite the contrary. He reminds us in his 1982 paper that he dealt specifically with this issue in his original work on the subject.[29] He points out to critics who had objected to his stress on alertness as opposed to uncertainty and speculation that his emphasis was deliberate and intended to help illustrate the "market process":

All human action is speculative; my emphasis on the element of alertness in action has been intended to point out that, far from being numbed by the inescapable uncertainty of our world, men *act upon their judgments* of what opportunities have been left unexploited by others."(Kirzner 1973: 86-87; 1982: 141, emphasis in original)

In a related statement earlier in the same paragraph, he says that he has "of course recognized that in a world of uncertainty every entrepreneur decision, no matter how much alertness it reflects, must to some extent constitute a gamble."(Kirzner 1973: p. 86)

On the basis of these statements one can hardly maintain that Kirzner ignored appraisal and uncertainty-bearing. My argument is first that his emphasis on alertness distracts attention from intersubjective uncertainty, as other writers have pointed out.[30] Second, and more important, his effort to appropriate the term "entrepreneur" obscures what I believe is the most important contribution to economics made by an Austrian economist during this century. There is no hint in Kirzner that a new subjectivist revolution could have occurred.

IV. Conclusion

To my mind the theory of entrepreneurship is the single most important contribution to economic theory during this century. The Austrians were really latecomers, although a case can be made that non-Austrian contributions can at least partly be traced to Menger's subjectivist theory of prices. Mises's contribution superceded those of the non-Austrians. Yet, to date, the Mises story is a tragic one.

He was the first to recognize the true significance of entrepreneur function. Moreover, he provided the epistemological underpinnings necessary to defend his view of that significance. He did this in steps in *Human Action*. First, he identified economics as a type of knowledge that differs from logic, mathematics, psychology, physics, or biology.(Mises 1966: 1) Then he showed that economics is really just a branch of a broader type of knowledge which also differs from logic, etc. The broader type is praxeology -- the theory of distinctly human action.(*ibid.*: 3) Next he told us that the starting point of economics is to construct an image of the pure market economy (*ibid.*: 238), that the method of praxeology and economics is the method of imaginary constructions (*ibid.*: 236), that the entrepreneur means acting man in regard to changes in market data (*ibid.*: 254), and that to comprehend the entrepreneur function it is essential to use the imaginary construction of the evenly rotating economy.(*ibid.*: 248)

In my previous work I have tried to elaborate and expand these ideas in an effort to construct an image of entrepreneurship that we can trace directly to distinctly human action. I wanted a

concept of entrepreneurship that embodies all of the distinctly human action in the market economy. This is the kind of concept that I believe Mises had in mind when he wrote about the function of the entrepreneur. I have called this the new subjectivist concept of the entrepreneur.

In this paper, I outlined the procedure that one must follow to develop this concept, although space considerations limited the exposition. Then I went on to show that two other notable Austrian writers who used the term "entrepreneur" proceeded in different directions. On the one hand, Schumpeter associated entrepreneurship with assumed new combinations and disregarded subjectivism entirely. On the other hand, Kirzner has associated it with the unplanned, subconscious discoveries that he calls "alertness." In so doing (and to the extent that he has not in recent years revised his definition), he has not only tried to elevate a non-subjectivist idea to the status of a critical concept for our understanding of the market economy, he has distracted those who might otherwise be interested in exploring the true meaning of the entrepreneur in *Human Action*. The tragedy, of course, is that the Austrian contribution to the most important idea of the century is in danger of being missed.

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THE THEORY OF ENTREPRENEURSHIP
IN AUSTRIAN ECONOMICS

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Notes

1. See the introduction to Bohm Bawerk (1959: vol. 1: p. 6-7).
2. See especially his 1937 and 1945 papers.
3. Lachmann (1951) seems to have recognized this clearly.
4. The term "human," as used by Mises in his title, is redundant. In his book, he defines action as the conscious use of means to accomplish ends (Mises 1966: 92), which rules out other behavior. I have retained the redundancy in this paper for the sake of continuity.
5. See Barreto 1989; Casson 1982; Hebert 1982; Reekie 1984; and Wu 1989.
6. See particularly Kirzner 1973; 1979.
7. Gunning 1988a; 1988b; 1990; 1991; 1992a; 1992b; 1994; 1997.
8. The role of knowledge in Menger's system was explored by Kirzner and by Lachmann in a symposium on Menger which was published in 1978. Streissler has especially emphasized it. See Kirzner 1978; Lachmann 1978; Streissler 1990.
9. The history of the entrepreneur concept as it pertains to the new subjectivism is discussed in Gunning 1992a.
10. See Mises 1966, chapters 4, 5, and 6, respectively.
11. Strictly speaking, intersubjective uncertainty cannot be derived a priori in the same way as uncertainty in general (see Gunning 1990: 42-4).
12. Mises did not define the term entrepreneur so clearly. He said:

...When economics employs the [following] terms it speaks of catallactic categories. The entrepreneurs, capitalists, landowners, workers, and consumers of economic theory are not living men as one meets them in the reality of life and history. They are the embodiment of distinct functions in the market operations...(Mises 1966: 251-2)

Economics, in speaking of entrepreneurs, has in view not men, but a definite function. This function is not the particular feature of a special group or class of men; it is inherent in every action and burdens every actor. In embodying this function in an imaginary figure, we resort to a methodological makeshift. The term entrepreneur as used by catallactic theory means: acting man exclusively seen from the aspect of the uncertainty inherent in every action. In using this term we must never forget that every action is embedded in the flux of time and

therefore involves a speculation. The capitalists, landowners, and the laborers are by necessity speculators. So is the consumer in providing for anticipated future needs...(*ibid.*: 252-3)

In the context of economic theory... (e)ntrepreneur means : acting man exclusively seen from the aspect of [intersubjective] uncertainty inherent in every action...In the context of economic theory the meaning of the terms concerned is this: Entrepreneur means acting man in regard to the changes occurring in the data of the market. (*Ibid.*: 254)

13. Gunning 1990: chapter 6. Appendix 5 of that book supports my argument that these parts were identified by Mises.

14. Mises says:

Appraisal must be clearly distinguished from valuation. Appraisal in no way depends upon the subjective valuation of the man who appraises. He is not intent upon establishing the subjective use-value of the good concerned, but upon anticipating the prices which the market will determine. Valuation is a value judgment expressive of a difference in value. Appraisal is the anticipation of an expected fact. (Mises 1966: 332)

It would appear from this statement that Mises is making a distinction between the consumer role, which evaluates, and the entrepreneurial role, which appraises. But he does not actually say this. In fact, there is not a distinct and direct link in Mises between appraisal and the function of the entrepreneur. The link is indirect. To appreciate it, one must sort through Mises's prolix discussions, after coming to appreciate his unique contribution to methodology.

15. Regarding undertaking, Mises says: "The specific entrepreneurial function consists in determining the employment of factors of production." (Mises 1966: 290-1) Also, he says: The function of the entrepreneur cannot be separated from the direction of the employment of factors of production for the accomplishment of definite tasks. The entrepreneur controls the factors of production...(*ibid.*: 306) Finally, he says:

The entrepreneur determines alone, without any managerial interference, in what lines of business to employ capital and how much capital to employ. He determines the expansion and contraction of the size of the total business and its main sections. He determines the enterprise's financial structure. (*ibid.*: 307)

16. Mises 1966: 105-6.

17. Mises does not refer specifically to intersubjective uncertainty. The validity of this point must be inferred from his discussion of how dealing with uncertainty involves *understanding*: "...understanding is the only appropriate method of dealing with the uncertainty of future conditions." (Mises 1966: 118) And "...A prospective entrepreneur does not consult the calculus of probability which is of no avail in the field of understanding. He trusts his own ability to understand future market conditions better than his less gifted fellow men. (*ibid.*: 299)

The scope of understanding is the mental grasp of phenomena which cannot be totally elucidated by logic, mathematics, praxeology and the natural sciences...

The *understanding* establishes the fact that an individual or a group of individuals have engaged in a definite action emanating from definite value judgments and choices and aiming at definite ends, and that they have applied for the attainment of these ends definite means suggested by definite technological, therapeutical, and praxeological doctrines. It furthermore tries to appreciate the effects and the intensity of the effects brought about by an action; it tries to assign to every action its relevance, i.e., its bearing upon the course of events.(*ibid.*: 50, emphasis added)

18. Mises 1966: 248.

19. See Gunning 1990: chapter 5.

20. See Gunning 1990: chapter 6.

21. Mises (1966: 256) constructed such an image for the purpose of defining the pure entrepreneur but did not take the next step of describing abstract entrepreneurial interaction.

22. I used this procedure in Gunning (1990) and laid it out in summary form in chapter 1 of Gunning (1994).

23. These two definitions are explored in greater detail in Gunning 1994.

24. See Gunning 1994: chapters 4 and 5.

25. Schumpeter (1934: 66) presents a five-item list of characteristics.

26. "For praxeology data are the bodily and psychological features of the acting men, their desires and value judgments, and the theories, doctrines, and ideologies they develop in order to adjust themselves purposively to the conditions of their environment and thus to attain the ends they are aiming at. These data, although permanent in their structure and strictly determined by the laws controlling the order of the universe, are perpetually fluctuating and varying; they change from instant to instant."(Mises 1966: 646)

27. Note the difference between this meaning of spontaneous and the meaning attached by Hayek. For Hayek spontaneous meant not planned by a central authority. See Hayek 1967.

28. See Gunning (1991) for the relevance of different kinds of assumptions to economic theory.

29. According to the title, this paper is about Misesian entrepreneurship. But it is really about Kirznerian entrepreneurship. There are only a few references to Mises and no serious contextual interpretation. Nevertheless, Kirzner argues that his work provides a deeper understanding of the

Misesian entrepreneur. In some passages, he attributes his idea of alertness to Mises (see, for example, Kirzner 1979: 158). I could find no evidence that Mises used the term entrepreneurship in this way. Entrepreneurship to Mises always exists in a market context and always involves intersubjective uncertainty. I can only guess that he was misled by Mises's unfortunate decision to write extensively about the entrepreneur as "promoter."(see above)

30. See Kirzner 1982: 140-142. The most authoritative criticism is that of Rothbard (1985) who apparently understood the importance of uncertainty to Mises. However, Rothbard did not quote Mises and I could find no hint in Rothbard's other words that he envisioned what I have called the new subjective revolution. The closest comment on entrepreneurship to the new subjectivist concept of entrepreneurship is in a paper on Marxism by Grinder and Hegel (1977). They identified the second two characteristics -- undertaking and uncertainty-bearing -- clearly enough. However, instead of appraisal, they referred to "alertness to price discrepancies," a very Kirznerian term. Their paper was not about entrepreneurship so they did not try to defend their definition. Also given Kirzner's definition of alertness, it is far from clear that they had the new subjectivist notion of appraisal in mind.

The Theory of Entrepreneurship in Austrian Economics

Abstract

This paper describes the writings of Austrian economists on entrepreneurship from the standpoint of the new subjectivism. The main focus is on Ludwig von Mises, who was the first economist to identify the distinct method used by economists to understand the distinct phenomenon of economic interaction under the conditions of the market economy. Mises showed that knowledge of the market economy is a special kind of knowledge that is different from logic, mathematics, and the sciences. He maintained that the knowledge acquired through economic reasoning is a branch of a broader category of knowledge -- praxeology. Mises regarded entrepreneurship as crucial to the understanding of economic interaction. The author has shown in previous work that Mises's idea of the "functional entrepreneur" can be extended so that it embodies all action that is distinctly human and which occurs under the conditions of the market economy.

The paper begins by outlining Mises's position and the extension of that position carried out by the author in earlier works. It then discusses two other Austrians who have written about entrepreneurship: J. A. Schumpeter and Israel Kirzner. It argues that while Schumpeter was the first Austrian to explicitly be concerned with the subject, he contributed little. Kirzner, it is claimed, took a step backward. About a third of the paper is concerned specifically with Kirzner's ideas, since they are today widely regarded as representing Austrian economics.