ECONOMIC GROWTH AND ITS CAUSES: COMMENT ON HOLCOMBE

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In his article "Entrepreneurship and Economic Growth," Professor Holcombe (1998) argues that Kirznerian entrepreneurial alertness enables market actors to spot previously unnoticed profit opportunities. Entrepreneurs then act upon these opportunities. As a result, the economy becomes more productive because now more consumer satisfaction can be produced at a lower cost. This is a creative application of the Kirznerian theory, but one that nonetheless suffers from the weaknesses of the theoretical foundation on which it is based.

According to Kirzner, for analytical purposes human action can be divided into a mechanical aspect and a purely entrepreneurial aspect. Once we have adopted this view, Kirzner rightly maintains, "we have automatically excluded the asset owner from an entrepreneurial role. Purely entrepreneurial decisions are by definition reserved for decisionmakers who own nothing at all" (Kirzner 1973, p. 47). The function of the entrepreneur in this framework is to be alert; that is, "simply to know where these unexploited opportunities exist. All he (the entrepreneur) needs is to discover where buyers have been paying too much and where sellers have been receiving too little and to bridge the gap by offering to buy for a little more and to sell for a little less" (ibid., p. 41).

Entrepreneurial profit, then, is not a yield on exchange or production but simply the difference between the two sets of prices. For that reason, "the discovery of a profit opportunity *means the discovery of something obtainable for nothing at all.* No investment at all is required; the free ten-dollar bill is discovered to be already within one's grasp" (Kirzner, p. 48; emphasis in original).

This view of entrepreneurship can be distinguished from that advanced by Murray Rothbard, who argued that for profit to emerge, one needs to employ assets.

> Profits, after all, are simply the other side of the coin of an increase in the value of one's capital, losses are the reflection of a loss in capital assets. The speculator who expects a stock to rise uses money to purchase that stock; a rise or fall in the price of stock will

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> raise or lower the value of the stock assets. If the prices rise, the profits are one and the same thing as the increase in capital assets. (Rothbard 1997b, p. 247)

While stating that the pure entrepreneur cannot have assets, Kirzner, however, argues that we must view the pure entrepreneur "as *hiring* all the talent needed to organize factors of production into a smoothly working team and as *buying* all the resources needed to effectively complete the transactions which his entrepreneurship suggests he enter into" (Kirzner 1973, p. 45; italics in original). But how is all this possible if the Kirznerian entrepreneur does not have assets? According to Rothbard (1997b, p. 247), ideas alone are not enough to exploit profit opportunities. "I might be keenly alert to a profit opportunity virtually lying at my feet. I may have a sure tip on the stock market. But if I haven't got any money to invest, the profits, perceived opportunity or not, will simply not be made."

One might respond to this problem by arguing that the "pure entrepreneur" is merely an analytical device to help us isolate what distinguishes his contribution from other market actors; in the real world, of course, the entrepreneur does own assets. Kirzner has in mind the desire to distinguish the entrepreneurship from the purely passive economizer; "it is analytically expedient to treat [the entrepreneur] as if he represented two entirely separate decisionmakers, one a passive economizer, the other a pure entrepreneur" (1973, p. 43).

However, the purpose of abstraction is to help to grasp the facts of reality and not to obscure them. By viewing human action as comprised of two separate parts—the mechanical and the conscious—we are no longer dealing with human beings but with pure thought experiments. The mechanical aspect of the entrepreneur, although it is part of the real world, is unconscious and automatic, while the other part is pure consciousness disembodied from real objects. Because the two parts are separate and not integrated, neither part can secure actual entrepreneurial profits: unconscious beings cannot know how to earn profits, while conscious but assetless beings can observe profit opportunities but not realize them. The Kirznerian entrepreneur, then, is not a human being but an abstraction. This entrepreneur can observe, but he does not confront risk and does not suffer losses.

It is for this reason that Rothbard (1997a, p. 128) asks, "if superior alertness accounts for entrepreneurial profits, what in the Kirznerian world can account for entrepreneurial losses?" As an alternative, Rothbard points to the Misesian idea of the entrepreneur. He "*takes risks* that he can make profits by risking resources and through superior forecasting of the future, while suffering losses from inferior forecasting." The Kirznerian entrepreneur confronts neither risk nor uncertainty (ibid.; emphasis in original).

How, then, can it be that Kirzner's disembodied phantom is a promoter of economic growth? Professor Holcombe suggests that the Kirznerian entrepreneur promotes economic growth by creating an environment that is suitable for growth. In this environment, innovations are built on themselves, leading to continually increasing productivity. Thus Holcombe (p. 51) writes, "When entrepreneurs take advantage of profit opportunities they create new entrepreneurial opportunities that others can act upon. Entrepreneurship creates an environment that makes more entrepreneurship possible."

To illustrate the point, Holcombe suggests that entrepreneurial opportunities come from the actions of other entrepreneurs. By way of example, "Bill Gates could not have made his fortune had not Steve Jobs seen the opportunity to build and sell personal computers, and Steve Jobs could not have built a personal computer had not Gordon Moore invented the microprocessor" (pp. 50–51). There is no particular reason not to regress further in time with this analysis. If not for all past inventors, Bill Gates also would not be able to make his fortune; one might even suggest that if not for the Greek philosophers, Bill Gates could not have succeeded. This scenario is indisputable because it simply depicts the evolution of human ideas.

But this is not actually how it came to be that Bill Gates made his fortune. It was not mere knowledge of the technological capacities or marketing success of the microprocessor that made him rich. It is because he raised and risked his own capital when other people were unwilling to do so. He certainly utilized the existing capital structure, which also included personal computers introduced by Steve Jobs. However, the crux here is that Bill Gates bore the risk and he might have wrongly judged the needs of consumers. Mises argues that this capacity for sound judgment, this entrepreneurial talent,

> cannot be bought on the market. The entrepreneurial idea that carries on and brings profit is precisely that idea which did not occur to the majority . . . the prize goes only to the dissenters, who do not let themselves be misled by the errors accepted by the multitude. What makes profits emerge is the provision for future needs for which others have neglected to make adequate provision. (Mises 1966, p. 898)

Adam Smith also saw entrepreneurship as the engine of growth, while David Ricardo held that the main driving forces are land, labor, and capital. According to Professor Holcombe (1998), the Smithian has a greater claim to validity than the Ricardian view. But from the Misesian–Rothbardian perspective, both theories are flawed. Economic growth cannot be set in motion by entrepreneurial activity apart from land, labor, and capital, and it cannot emerge from land, labor, and capital apart from entrepreneurship. It is the integration of entrepreneurship with land, labor and capital that sets in motion economic growth. The link to this integration is provided by the pool of funding (Strigl 1999, p. 30). This pool comprises of various goods and services that are required to accommodate individuals's needs.

An increase in the pool of funding permits the lengthening of the production structure, which permits increases in the output of consumer goods and permits the production of goods that previously could not be produced at all. Any lengthening of the production structure must accord with what the pool of funding can support. Thus, if the size of the pool of funding is sufficient to sustain a production structure of one year, any attempt to lengthen the structure beyond the one year must fail. The pool of funding therefore sets a brake on the use of the more productive but longer stages of production.

Individual time preferences, as manifested by the pure rate of interest, determine how much of a given flow of real wealth is allocated towards consumption and how much towards saving, and hence towards the pool of funding. A lowering of time preferences, i.e., lowering of the pure rate of interest, implies that people are now more willing to wait for any given amount of future output (Rothbard 1993, p. 488), implying that they are ready to allocate means of sustenance towards longer stages of production. A rise in the time preferences and in the pure rate of interest means that people are less willing to wait. This means that they will allocate proportionately more of the means of sustenance towards the production of consumer goods and less towards the longer production stages (ibid.). Following the law of diminishing marginal utility, it is possible to infer that (all other things being equal) increases in real wealth correspond to declining pure rate of interest. This decline in turn gives rise to more real wealth and in turn to a further decline in the pure rate of interest (p. 380). It follows then, that a growing economy establishes, as it were, a self-reinforcing mechanism which expands the pool of funding. According to Mises, "at the outset of every step forward on the road to a more plentiful existence is saving—the provisionment of products that makes it possible to prolong the average period of time elapsing between the beginning of the production process and its turning out of a product ready for use and consumption" (Mises 1966, p. 867).

The pure rate of interest fulfills the crucial role of coordinating between the length of the production structure and the pool of funding. The introduction of money does not alter the essence of the analysis we have presented so far. To fulfill the role of the medium of the exchange, the money stock must remain unchanged. This will guarantee that production will precede consumption. It will also guarantee that money is fully backed up by the saved means of sustenance. Whenever a producer exchanges his goods for money he acquires a permit to access the pool of funding whenever he requires. By exchanging his goods for money he enables the buyer of his goods to engage in production, thereby allowing the overall production flow to stay intact.

Economists following the writings of Frank Knight hold that savings are of little importance in the modern economy. The modern infrastructure, it is held, automatically generates its own funding, which in turn is employed for its maintenance and expansion (Rothbard 1993, p. 343). An infrastructure, however, cannot maintain itself automatically since if people decide to save less, then less funding will become available. Irrespective of the complexity and sophistication of the production structure, without the expansion in the pool of saved means of sustenance no economic growth can occur. According to Menger, "the process by which goods of higher order are progressively transformed into goods of lower order and by which these are directed finally to the satisfaction of human needs is . . . not irregular but subject, like all other processes of change, to the law of causality" (quoted in Salerno 1999, p. 81). Salerno argues that "by proceeding this way, Menger was able to perceive immediately that the process of want satisfaction is not purely cognitive and internal to the human mind, but depends crucially upon the external world and, therefore, upon the law of cause and effect" (ibid., p. 79).

To convert elements of nature into means of sustenance, people must employ tools that are suitable for this task. According to Holcombe however, what causes the expansion in the means of sustenance is entrepreneurship. However, entrepreneurship cannot fulfill the role of a factor of production as such. For it cannot be employed in the direct process of converting elements of nature into the means of sustenance. This doesn't mean that entrepreneurship is not important; indeed, it is indispensable in every stage of every production process. According to Rothbard (1993, p. 9) for any action there must be always a plan or idea about how to use things as means to particular ends. Without such ideas there cannot be actions.

Yet, the implementation of entrepreneurial ideas cannot be done in a vacuum. The entrepreneur must mobilize the necessary funding for this task. Only with a pool of funding can entrepreneurship become effective. As Rothbard (1997b, p. 247) writes, "Entrepreneurial ideas without money are mere parlor games until the money is obtained and committed to the project." Salerno (1999, p. 90) further argues that "Menger states explicitly that command of the services of capital is a 'necessary prerequisite' for performing economic activity." Mises warns that, "Neither have capital or capital goods in themselves the power to raise the productivity of natural resources and of human labor. Only if the fruits of saving are wisely employed or invested, do they increase the output per unit of the input of national resources and of labor. If this is not the case, they are dissipated or wasted" (Mises 1972, pp. 84–85). He also writes that the "accumulation of net capital and the utilization of capital for raising the productivity of human effort are the fruits of purposive human action" (ibid.). It follows then that it is not the Kirznerian entrepreneur who contributes to economic growth, but only an entrepreneur who employs funding in accordance with consumers' most urgent needs.

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