

Entrepreneurial Activity and American Economic Progress*

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I

It is to some extent heartening to know that economists are once again concerned with entrepreneurship and its role in economic life. Lest one be overwhelmed with joy, though, it is useful to recall that economists have toyed with this subject before, and with little enough direct impact upon the central body of economic thought as it is propagated by text and lecture from one generation of economists to the next. In the timeless equilibrium world of the professor's blackboard, where institutional, political, social and technical change are usually absent, consumers, producers, buyers and sellers can all achieve satisfaction in effortless optimality, and the system rests. The role of individual persons in the processes of price and quantity change is either part of an abstraction or irrelevant.

Thirty years ago a major effort was made to change this, and to insert entrepreneurial reality into economics. Professor Arthur Cole and his colleagues at the Harvard Research Center in Entrepreneurial History created a literature, a journal and, for a brief season, even a fledgling sub-discipline called Entrepreneurial History.¹ Cole was explicitly following in Schumpeter's footsteps, and those earlier pre-Marshallian economic writers who considered a nation's stock of entrepreneurial talent to be a factor of production.²

Ultimately, interest in the subject largely died off, the research money dried up, the Center closed, the journal fell dormant, and the entire enterprise seemed to sink without a trace. In fact, in 1973 Israel Kirzner's major effort to establish the place of the entrepreneurial factor in the theory of price, *Competition and Entrepreneurship*,³ never mentioned this dead literature. I do not mean this as a criticism of Kirzner, by the way, but as a commentary on the difficulty that has plagued all who have labored in this vineyard. If past performance is any guide, Kirzner will be fortunate if, in

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20 years, his book is not ignored, or else is listed as a footnote variant on Schumpeter's own great and largely unread works.⁴ As Kirzner points out himself, some of the greatest figures in the history of economics have tried to breathe life into this subject, and yet it remains outside the mainstream.⁵

But the subject must remain feebly alive so long as economists are interested in the real world at all. The study of entrepreneurship survived these last three decades hidden away in such relatively unimportant places as economic history, and to a lesser extent, in studies of economic development. In the former case, the historian, faced with the bald facts of past economic development, found it difficult to ignore entrepreneurs altogether. The reason has been the occasional need, even in the most rigorously quantitative treatments, to mention individual business firms and the awkward fact that such firms tended to be founded by actual persons, and not by market conditions or equilibrium forces. In the latter case, students of modern economic development have noticed that entrepreneurship is not homogeneously distributed across all economies and peoples, and this has been the subject of remark.⁶ Adelman and Morris, for example, have found a tendency for economic development to proceed more generously in countries where circumstances encouraged entrepreneurial activity than in those where it was inhibited.⁷

The economist has additional trouble with entrepreneurial activity because it is hard to generalize about the study of individual cases (and that is what the history of entrepreneurship is). The scholar encounters a profusion of idiosyncratic, unique, even bizarre personalities and actions. Moreover, there have been and are so many millions of entrepreneurs that the supply seems to have been automatically produced and therefore subsumed in the investment, cost and performance data of the firm. So why separate entrepreneurship out? If profits are maximized, is that not all there is to be said? No, say Kirzner and his predecessors. The market is a process, and profits are won by persons who see opportunity where others do not. Not all persons are capable of entrepreneurial action.

If such were not the case, how would any economist ever explain innovation in technology, in product, in the dynamics of business organization? For most students of economic life it really is too much to assume that had Henry Ford not appeared, Henry Smith would have come along and built Smith Motor Company in just the same way, with the same consequences.⁸ Once that much is admitted, the problem of the entrepreneurial role is out in the open and will not go away—although it certainly can be ignored by economists and has been.

II

If an economy could be organized, set going, maintained and changed by a cosmic computer, we would not need to concern ourselves with the people and institutions of our little world. As it is, though, people and institutions set the boundaries of possible economic achievement and advance (or pos-

sibly regress). So each economy existing at any moment is really an historical artifact, the surviving sum of past actions. When one presses a light switch, what turns on the filament is the work of many: those inventors and innovating entrepreneurs who created the technical apparatus and organized the companies that introduced electrical power into the economy, those investors who bought the stock, those workers whose labor put in the lines. From anonymous workers and investors to the great luminaries of the past—Edison, Westinghouse, Pierpont Morgan—the entire history of the industry is at work.

The problem of comprehension of such a past is immense in an economy as vast and intricate as this one. The entrepreneurial factor is a blur of personalities, whether they merely observed the actuality of change and capitalized on it (a Kirzner entrepreneur) or whether they were in the more heroic Schumpeterian innovative role and personally pioneered historic changes in the conditions of production.

Those who have written on this theme have employed a variety of intellectual devices to reduce the mass of historical evidence to manageable proportions. Due to the curiosities of American intellectual life the most widely accepted view of our entrepreneurial past has been that of great-man muck-raking. The creators of our foremost private companies have been painted as malefactors of great wealth who systematically robbed the widows and orphans in order to profit monopolistically from their miseries.⁹ There has also been an abundance of the opposite, a shameless hagiography of men of wealth and power.

This is just name-calling and is unhelpful to any kind of analysis. I personally followed, in my study of American entrepreneurship, *The Vital Few*,¹⁰ the Marxian concept of the "great man" as it was formulated by Lenin's teacher, George Plekhanov:

The more or less slow changes in "economic conditions" periodically confront society with the necessity of more or less rapidly changing its institutions. This change never takes place "by itself"; it always needs the intervention of *men*, who are thus confronted with great social problems. And it is those men who do more than others to facilitate the solution of these problems who are called great men.¹¹

Applied to the mundane sphere of economics such men are also called entrepreneurs. The conception drawn here is nearer to Kirzner's entrepreneurs than to Schumpeter's fomenters of creative destruction. Thus Kirzner writes:

For me the function of the entrepreneur consists not of *shifting* the curves of cost or of revenues which face him, but of *noticing that they have in fact shifted*.¹²

Kirzner's entrepreneurs help stabilize the system, while Schumpeter emphasized their destructive-creative role. I doubt that the two ideas are mutually exclusive. As Burton Klein¹³ explains, it is micro-instability, active

entrepreneurial competition creating and exploiting disequilibria, that creates macro-stability: growth and full employment.

To cope with the entrepreneurial facts one must employ *some* simplifying system. To reduce the historic mass of the economic past, I used in *The Vital Few* the notion of surrogate entrepreneurial figures, together with a functional categorization of economic life into the product of abstract ideas, practical invention, innovation, organization and bureaucratic stasis. With this, I could select a small number of archetypal entrepreneurs and through their biographies show how the economy was created over time by individual decision-making, given the relevant historical milieu.

Without such a system one is faced with historiographical anarchy—inventions appear magically in response to changes in tastes and prices, mobile factors shift employments, new industries spring into existence, economies grow, etc. This is in many ways the easy way out—a system of discrete equilibria at any moment of time—but it leaves the processes of change in the form of a religious mystery. To avoid this, the entrepreneurial figure must be introduced. The ballpoint pen does not exist because of relative prices alone: you need the Biro brothers; the British financiers, Henry Martin and Frederick Miles; the American opportunist Milton Reynolds who found a loophole in the patent; the French company, Bic; and others to flesh out the real story.¹⁴ Without them the appearance of the ballpoint pen in history makes no sense. Nor does *Hamlet* without the Prince of Denmark. Economic enterprises do not spring into existence automatically.

As Kirzner emphasizes, pure profit is the stimulus to entrepreneurship, the motivation for risk-taking. There must be an institutional environment which allows it, however, and that is where Americans, in the past at least, were most fortunate. For the American economy never had a plan. There was no great brain, or even a collection of them, to decide what we would become. We began with a set of (English) constraints, and from the earliest settlements began to rely upon individual profit-seeking to spur the country's settlement and development. The interaction of opportunities grasped, and changes in tastes, technology and prices explain much of our development in the colonial era, and probably a much greater part of it from Independence to World War II. Since that time the long-developing reliance upon government to make crucial economic decisions has gained the ascendancy,¹⁵ and one can now legitimately wonder what the future of entrepreneurship is going to be. I will turn to that in the last section of this paper.

III

The prospect of entrepreneurial profit was there, from the beginning, in the nature of the land tenure guaranteed in the colonial land grants. It would become our version of fee simple, allowing the owner of real property to exploit its surface and subsurface wealth, to change its nature, to sell it, to

devise it by will, to be inherited directly by heirs—all these rights acquired by mere purchase and the fixed obligation to pay property taxes. Common law embraced property rights in chattel goods to items held in bailment, to goods distrained for debt. The forms of contracts, deeds and wills were already settled in law before the American Revolution, and all this survived that Revolution and the era of constitutional originality, as *Dartmouth College v. Woodward* (1819) showed dramatically.¹⁶

One is impressed in this history by the inherent assumption that there always would be a vital entrepreneurial factor, that a dynamic private sector would exist that needed only to be constrained and guided by common standards as it grew. One does not see in American history, at the beginning, either the fear that a purposeful private economy might fail to prosper, or that it might be regulated out of existence by the power of government. Poor and primitive as we were, we were not in the modern sense "underdeveloped."

Historically, the American entrepreneur's options were determined by his position in the flow of economic transactions, by his ability to see or create change. He had only to act within four very general boundaries:

1. Changes in the institutional environment
2. Established property rights
3. External economic events (external to the entrepreneur)
4. Technological progress

A classical period of American entrepreneurship falls roughly in the years from 1789 to 1932. The peak of private power probably can be traced to 1877, and from then on a slow decline begins. Until as late as the 1930's, (wars apart) government plays mainly a watchman's role, and entrepreneurial abilities to make innovations for profit, to receive economic information and to act on it, made American business promoters perhaps the major dynamic force in the nation's development. The changing structure of the economy over time was guided and promoted by the entrepreneurial interest. As Morton Horwitz¹⁷ shows, even the courts altered the balance of property rights repeatedly in order to favor the private entrepreneurial interest against the rights of quiescent owners, at least until 1860. Central government, with the exception of the Federal "interference" with southern property rights in 1861-65, played a limited role. The weakness of organized labor limited workers to the residual decision to accept or to decline the wages and working conditions offered.

By the last decade of the 19th century what we see now as dramatic changes in the rules of this game had occurred. Elected politicians, playing an entrepreneurial role of their own, and always alert to the opportunities of political disequilibria, began to react to industrial and urban growth and to exploit demands of disenchanting farmers, workers and consumers for government intervention. Paradoxically, the very success of American busi-

ness enterprise in promoting the nation's growth, while pursuing private gain, became the occasion for the demand that business be reined in the interests of "higher values."

IV

When the Sherman Antitrust Act was passed in 1890 there began the first of the ubiquitous federal controls over business organization and behavior. The Interstate Commerce Act, establishing the ICC in 1887, created the first permanent federal regulatory agency. Until those dates and events, government controls over private business life had been the continuation of the traditional "police power" controls, whose origins in business restricted numbers, sometimes fixed prices, and more often were invoked to enforce product quality.¹⁸ In addition, the traditional controls over instruments and vehicles of long-distance commerce had been maintained. So controls over inns, taverns, carters and draymen, ferries and toll bridges were extended to turnpikes, to canals, and then to railroads. The common law and the courts maintained and extended such controls as the nation expanded westward and new jurisdictions were created, requiring new ordinances, new acts of legislatures. Business entrepreneurs had never operated in America free of such controls, however variously they were enforced. But the federal power had been stayed, apart from controls over foreign trade and the public lands.

Meanwhile the nation's entrepreneurial genius had created new forms of business organization to enable more profitable development and exploitation of markets. So, alongside the replication of special franchise incorporations, copiously supplied by state legislatures, there developed the technique of general incorporation, beginning in New York in 1811. By 1875, New Jersey had eliminated all capital requirements, and by 1888 allowed her corporate creations to do *all* of their business out of state. In 1890, Delaware enacted similar laws and entered the competition for corporate flags of convenience.¹⁹ Some businesses growing out of these forms expanded to greater magnitudes than had been known before, and the characteristic giant enterprises of corporate America appeared upon the stage of history. Mergers and coalitions of such companies raised the spectre of private economic power that exceeded that of the states themselves.²⁰

The public reaction, focused by the "populist revolt" of the eighties and nineties, is well known and need not be explored here. It was in general one of hostility; as President Cleveland said in 1888, these new business forms—trusts, combinations, monopolies—were a danger to the nation and were "fast becoming the people's masters."²¹ The railroads were the first targets of the reaction. Spread over many states, with huge capital structures, they seemed likely to elude the state controls altogether. In the Granger laws the states made a final bid to control railroads, and in *Munn v. Illinois* (1877),²²

the U.S. Supreme Court validated those laws. By 1886 there were 25 state railroad regulation commissions, and the railroads, suing in *Wabash v. Illinois* (1886)²³ to escape those controls, were caught a year later in what became the federal net, the ICC.²⁴

The decade between 1877–1887 lies across American economic history as a vital inflection area. In the Granger cases, one sees that the old traditional powers were at their outer limits facing the new firm sizes the railroads represented. The ICC showed that the traditional nonmarket controls could be federalized. It has been argued that the Sherman Act was really the same kind of power play, effectively the federalization of the common law regarding monopolies and restraints of trade.²⁵ Thus the control power “caught up” with the American entrepreneur at the federal level in response to his own organization genius. There would not be a time, or scale of operations, without the control power present, no matter how corrupt, incompetent, virtuous or unenforced. The ICC was the “granddaddy” of the myriad agency–industry controls, the boards, powers, commissions we know so well; and the Sherman Act, an organizational sumptuary law for business, was the first federal general control, now so familiar in forms like EPA and OHSA. If in 1890 they looked no larger than a small cloud on the horizon, they came, with the passage of time and events, to be a separate form of government.

By 1914 the Pure Food Act, the FTC, the FRS and the Clayton Act had been added. In 1886 none of these had existed. So the period of 1877–1914, while credited as the “triumph of American capitalism,” the “transformation of the American economy”—and whatever—also saw the triumphant entry of continuous and potentially ubiquitous nonmarket control power at the federal level. Then came the income tax, the proliferation of federal powers in World War I, the intercession of the federal power in the wage bargain, the New Deal agencies and reforms, World War II, the cold war and the growth of the enormous mass of nonmarket control power we see in Washington, D.C. today.²⁶

The classical age of the American entrepreneur had closed. It had essentially been a period when business leadership, at least on the larger scale, by “running ahead” of local control powers, had enjoyed a substantial measure of freedom from nonmarket control and then lost it. Frederick Jackson Turner noted that the true heir of the frontier squatter in the later 19th century was the industrial entrepreneur.²⁷ Just as the frontier of physical freedom passed from the squatter, so did the 19th century organizational frontier pass for American businessmen. Their creatures lived on in corporate immortality ruled by committees and professional managers. Their historically creative role was now much diminished. They could merge and reorganize, within the new antitrust laws, but their influence, power and even self-confidence waned.²⁸ Once the federal nonmarket control power was energized, and the federal bureaucracy itself became a mass of budget-

maximizing entrepreneurial firms,²⁹ the federal government would largely determine the future course of American economic development—or decline.

V

What can the future role of the entrepreneur be? Presumably there will always be situations of temporary disequilibria (where the same goods and services sell for different prices) in which the Kirznerian entrepreneur has the opportunity to perform arbitrage functions and thereby produce equilibria. Even in “planned” economies like the USSR there seems to be ample scope for such activities.

But what of future technical change? We are not at the end of our technological string, anymore than was Britain in 1870 when it was, compared to others, a “mature” economy. New generations of technical change lie ahead. Who will decide when, where and how they will be introduced? In the past such decisions called for Schumpeterian entrepreneurs, and we had them. They created new industries, drove old economic forms out of existence and realigned the nation’s productive capacities. We live today surrounded by their creations. J.P. Morgan’s hand is still in steel; Henry Ford, Walter Chrysler and William Durant still make our motor cars. Old Rockefeller still plays his role in the oil industry. The influence of Harriman and Hill are still felt in the railroads. How much of the currently used, intact physical capital and what proportion of its major firms were created before 1933? These things cannot last forever. Will the Corps of Engineers, HEW and FHA combine to determine the next generation of housing stock? Will the Commerce Department, the SEC and EPA decide what our new industries will be? If not, then who will?

We now live in a society in which some 40 percent of national income is disposed of by government. In 1929, the last good year of the *ancien regime*, that figure was 11–12 percent.³⁰ In that year the ratio of private investment to the Federal budget was 5 to 1. It now is about 1 to 2.³¹ Ten percent of current output is under the control of the traditional federal regulatory agencies. Eighty percent of GNP is generated by firms subject to the antitrust laws.³² No one has yet counted the impact of the new generation of ubiquitous controls, OSHA, EPA, and CPSC.³³ One hears fantastic scare stories about the negative effects of them on new enterprise. It is estimated that the *direct* costs of regulation in 1979 will top \$100 billion.³⁴ That is a third of projected private net investment.

Somehow, innovation must continue or we will fall behind hopelessly. It is bad enough already, when a Japanese industrialist can patronizingly explain to us our own backwardness.

Our processing industries are simply better than [those] in the United States. . . . If the United States wants to sell us finished consumer prod-

ucts, they don't have a chance. . . . The Americans are good at inventing new machines, but in the ability to apply those inventions, well, maybe the Japanese have more ability.³⁵

The application of invention is innovation, the product of the Schumpeterian entrepreneur. We once considered our own abilities here to be without peer in the world of industry. It would seem that the world has turned elsewhere for this kind of "ability."

Fantastic as it seems, we have already arrived at the point in time where annual federal expenditures alone are greater than the amounts that can be mustered by the private sector for investment—its own future. Is *government innovation*, federal entrepreneurship, the answer? How are they to perceive what is needed in the millions of daily decisions that enter the investment calculation? I haven't the slightest idea what the answer is.

We still must have Schumpeterian entrepreneurship, but it seems entirely unlikely to come from its former sources. Moreover, there is no public demand for it. We acquired *two* traditions which we treasure from the great age of the American entrepreneur: we got a taste for the virtues of economic development *via* the free market, and also we came to value the use of government to regulate or alter the outcome of free-market transactions when significant coalitions found those outcomes objectionable. The competitive political system exploits both sentiments. As a result, everyone who mattered politically got what they wanted; and, paradoxically, what we have is mostly unsatisfactory to all parties. The government control sector is merely a pile of historical debris representing no overall plan or theory—agencies piled up in the past 90 years, some of them canceling out the effects of others. It is a nonsystem of regulated economic malfunctioning. It is a mighty barrier to future entrepreneurship even if investment resources should be available.

NOTES

1. For a discussion and summary of the work of the Harvard Research Center in Entrepreneurial History, see H. G. J. Aitken, *Explorations in Enterprise* (Cambridge: Harvard University Press, 1965).
2. Arthur H. Cole, "An Approach to the Study of Entrepreneurship," *Journal of Economic History* 6, supplement (1946). Reprinted in Frederic C. Lane and Jelle C. Riemersma, eds., *Enterprise and Secular Change* (Homewood, Illinois: Richard D. Irwin, 1953), pp. 182–186.
3. Israel Kirzner, *Competition and Entrepreneurship* (Chicago: University of Chicago Press, 1973).
4. Joseph Schumpeter, *The Theory of Economic Development* (Cambridge: Harvard University Press, 1949); *Business Cycles*, 2 vols. (New York: MacGraw Hill, 1939). Schumpeter's ideas of the entrepreneurial role were probably best summarized by him in his book *Capitalism, Socialism and Democracy* (London: George Allen and Unwin, 1943), ch. 7, "The Process of Creative Destruction."
5. Kirzner, *Competition*, pp. 75–87.
6. John R. Harris, "Industrial Entrepreneurship in Nigeria" (Doctoral diss. Northwestern University, 1967).

7. Irma Adelman and Cynthia Taft Morris, *Economic Growth and Social Equity in Developing Countries* (Stanford: Stanford University Press, 1973).
8. For the argument that such is a theoretically reasonable expectation, see Robert Paul Thomas, "The Automobile Industry and Its Tycoon," *Explorations in Entrepreneurial History*, 2nd ser. (Winter, 1969).
9. The all-time champion of this genre is Matthew Josephson, *The Robber Barons* (New York: Harcourt Brace, 1934).
10. Jonathan Hughes, *The Vital Few* (New York: Oxford University Press, Galaxy ed., 1973). First published by Houghton Mifflin in 1966.
11. G.V. Plekhanov, *The Role of the Individual In History* (London: Lawrence and Wishart, 1940), p. 61.
12. Kirzner, *Competition*, p. 81.
13. Burton H. Klein, *Dynamic Economics* (Cambridge: Harvard University Press, 1977).
14. Edward De Bono, ed., *Eureka!* (New York: Holt, Rinehart and Winston, 1974), p. 62.
15. Jonathan Hughes, *The Governmental Habit* (New York: Basic Books, 1977).
16. 4 Wheaton, 518.
17. Morton Horwitz, *The Transformation of American Law, 1780-1860* (Cambridge: Harvard University Press, 1977).
18. Jonathan Hughes, "Transference and Development of Institutional Constraints Upon Economic Activity," in *Research in Economic History*, ed. Paul Uselding, vol. 1 (Greenwich, Connecticut: JAI Press, 1976).
19. James Willard Hurst, *The Legitimacy of the Business Corporation* (Charlottesville: The University Press of Virginia, 1970), pp. 146-154.
20. Harry Scheiber, "Federalism and the American Economic Order, 1789-1800," *Law and Society Review*, (Fall 1975): 99.
21. Quoted in Carl Brent Swisher, *American Constitutional Development* (Boston: Houghton Mifflin, 1954), p. 422.
22. 94 U.S. 113 (1877).
23. 118 U.S. 557 (1886).
24. Those who believe that the ICC was effectively a government-sponsored railroad cartel should consult Albro Martin, *Enterprise Denied: Origins of the Decline of American Railroads 1897-1917* (New York: Columbia University Press, 1971).
25. William Letwin, *Law and Economic Policy in America: The Evolution of The Sherman Antitrust Act* (New York: Random House, 1962), ch. 2; Milton Handler, *Trade Regulation* (Brooklyn, New York: Foundation Press, 1960), ch. 2.
26. Hughes, *The Governmental Habit*, ch. 6.
27. Frederick Jackson Turner, *The Frontier in American History* (New York: Henry Holt, 1921), pp. 320-321.
28. Herman Krooss, *Executive Opinion: What Business Leaders Said and Thought, 1920's-1960's* (New York: Doubleday, 1970).
29. An analysis of bureau-as-business firm is the subject of William Niskahen's book *Bureaucracy and Representative Government* (Chicago: Aldine, 1971).
30. In 1929 the GNP (current prices) was \$104 billion; federal expenditures were \$3.1 billion; state and local government expenditures were about \$8 billion.
31. Private investment in 1929 was \$16.2 billion. In 1978 federal expenditures were running at an annual rate of about \$500 billion, private investment at perhaps \$270 billion.
32. F. M. Scherer, *Industrial Market Structure and Economic Performance* (Chicago: Rand McNally, 1970), p. 518; A. D. Neale, *The Antitrust Laws of the United States* (Cambridge: Cambridge University Press, 1970), p. 5, n. 2.
33. See Murray Weidenbaum on the new generation of controls, *Business, Government and the Public* (Englewood Cliffs, New Jersey: Prentice-Hall, 1977).
34. According to congressional testimony of Commerce Secretary Juanita Kreps, *Chicago Sun-Times*, 12 April 1978.
35. Comments of Mr. Kazutoshi Satta, San Francisco Manager of Mitsui Trading Company. Quoted, *Washington Post*, 31 July 1978.