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*dedicated to my late grandfather*

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# Introduction

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Today, writing about the philosophy of economics is in many ways a difficult venture. It seems that these two disciplines have drifted away from each other during the last centuries. Philosophy has been dominated by the approaches of idealism, phenomenology, philosophy of language, and many other ways to look at the world that seem to have no ability to cover the questions arising in the science of economics. Economics, on the other hand, seems to have been captured fully by mathematics. If one is not able to construct complex models with many variables and integrals, one cannot understand nor explain what is going on in the economy.

This was different in the past. Adam Smith, nowadays considered as one of the first economists, was in fact a moral philosopher. Even earlier in the medieval period the scholastics were concerned with questions of the just price, of markets, of the nature of money, and other economic concepts that were part of their debates on ethics and morality. We can go even further back to ancient Greece and find in the writings of these philosophers the very first questions on economics.<sup>1</sup>

One of the best examples in the philosophy of ancient Greece is the story of Thales the Milesian that is discussed by Aristotle in his *Politics*<sup>2</sup>:

There is the anecdote of Thales the Milesian and his financial device, which involves a principle of universal application, but is attributed to him on account of his reputation for wisdom. He was reproached for his poverty, which was supposed to show that philosophy was of no use. According to the story, he knew by his skill in the stars while it was yet winter that there would be a great harvest of olives in the coming year; so, having a little money, he gave deposits for the use of all the olive-presses in Chios and Miletus, which he hired at a low price because no one bid against him. When the harvest-time came, and many were wanted all at once and of a sudden, he let them out at any rate which he pleased, and made a quantity of money. (1259a8-18)<sup>3</sup>

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<sup>1</sup> cf. Joseph Schumpeter, *Economic Method and Doctrin*, New York 1954 and Jesús Huerta de Soto, *Die Österreichische Schule der Nationalökonomie – Markt und unternehmerische Kreativität*, Wien 2007

<sup>2</sup> Aristotle, *Politics*, Mineola 2000

<sup>3</sup> We use Bekker Numbers to indicate the passages in Aristotle's writings.

In this simple and short story several topics of economics and particularly entrepreneurship are already addressed. First of all: what is the purpose of human action and are we really driven by utility maximization? Even if we discover a profit opportunity, we are not compelled to exploit it. But if we want to act in order to gain that profit we still need an ability of superior foresight just as Thales had special knowledge of the future harvest. Aristotle is not talking about the uncertainty of the future in this particular story.<sup>4</sup> But what if Thales would have been wrong with his forecast? He would have suffered a loss. Thales' mere ability of superior foresight is also not sufficient to characterize his venture as an entrepreneurial act.<sup>5</sup> He has to carry out his opinion about the future and the plan to interfere in this future state of affairs. He has to have some money to pay the rent, he has to bargain and he has to set up a system of distribution for the presses. Aristotle portrays with this example an arbitrage-entrepreneur<sup>6</sup> who is only interested in using a difference in prices in order to gain profit.

But let's look at the situation from a slightly different angle. Again, Thales has the superior foresight that the olive harvest will be good this year. But let's assume now that olive presses are not yet invented. Thales envisions a way that olives could be pressed much faster and in a much more efficient way than before. Due to his forecast, he estimates that there will be a need for this technology and he decides to use his money to buy the raw materials he needs to produce the olive presses. At that time he probably has owned slaves that would help him to carry out his plan, but nowadays he would have to hire workers who would put together the machines under his managerial control. Again the summer comes and Thales is the only one who is providing olive presses. Again he can let them out at any rate he wants. But now there are even more uncertainties involved: (1) Is his forecast on the olive harvest correct? (2) Will he be

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<sup>4</sup> Aristotle proposes a physical concept of time that is made up of points of now. This might be a reason why this particularly human aspect of time, to perceive the future as uncertain, plays no role in his assessment of time. Cf. Aristotle, *Physik*, Hamburg 1987, Book IV Part 10-11

<sup>5</sup> We will talk about this later when we discuss the essence of entrepreneurship. We will see that, what Israel Kirzner calls 'alertness' which means the ability of superior foresight, is only one element of entrepreneurship. There are other components that are also important.

<sup>6</sup> This term relates to Kirzner's picture of the entrepreneur. Joseph Schumpeter contrasts the arbitrage entrepreneur with the creative entrepreneur.

able to produce the presses he has envisioned? (3) How many of them shall be produced? (4) Will the farmers use his technology or will they reject it because it is too complicated, produces not the right quality or for other reasons? In the end, we face again the question of whether the profit he gained is just because he had a monopoly on market. But now this monopoly has contributed to some sort of social progress because more olives can be pressed in a more efficient way.<sup>7</sup>

From this short story we can derive the main questions for this project: What is a human being? Why do human beings act? What is the essence of an entrepreneurial act? What role does the uncertainty of the future play in the regard to entrepreneurship? What is the most appropriate anthropological foundation for entrepreneurship?

We will try to answer these questions by assessing some schools of thoughts and debates in the 20<sup>th</sup> century. Since these discussions are often an application of the fundamental questions that have been raised since the emergence of philosophy, we will also reflect on these debates with the terms and understanding of Aristotle's philosophy.<sup>8</sup> Of course there are some parts of his philosophy that are not appropriate for contemporary philosophy: slavery was abolished a long time ago, he had no concept of the human being as person (the individual was a substance), his idea of human action was limited to actions of citizens in the community and his concept of time was mainly physical and missed anthropological aspects. But as we will observe, his understanding of real things as composites of matter and form, his virtue-ethics, his concept of the human being as *zoon politikon* and his ideas of the relationship between potency and actuality will be very helpful in better understanding entrepreneurship in modern economic theory.

We will start our investigation with a discipline of philosophy that is called Philosophical Anthropology. With the writings of Helmuth Plessner, Arnold Gehlen and

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<sup>7</sup> One might argue of course that invention of new technology also replaces human labor and thus is not contributing to social progress. We will not explore into depth the moral implication of technological progress and innovation.

<sup>8</sup> Among the economists we will discuss especially Carl Menger was heavily influenced by the philosophy of Aristotle and explicitly applied these philosophical concepts to his economic analysis. Since the economists that succeeded Menger somehow share the same worldview it will be valuable to reflect their arguments with an Aristotelian understanding.

Max Scheler we want to discuss “what a human being really is”. Aristotle stated that all human action is motivated by the quest for happiness (*eudaimonia*).<sup>9</sup> (1095a14-20) This is valid for his concept of acts within the political community. With Philosophical Anthropology we will also discover other reasoning for the motivation of human action.

Of particular interest, especially for economic and entrepreneurial action as we have seen in the little anecdote above, is the concept of uncertainty. We will explore four applications in philosophy where uncertainty is involved in different approaches to philosophy in order to gain an understanding how this principle is employed. We will start with skepticism in ancient Greek, we will look at Descartes’ method of methodological doubt, and we want to understand for what reasons Kant talks about “the thing itself”. In ethics uncertainty was particularly addressed by John Rawls. He uses the concept of uncertainty as method to create the thought experiment of the ‘veil of ignorance’ in order to derive principles for justice. In economics, the importance of uncertainty has at least been widely discussed since Frank Knight’s *Risk, Uncertainty and Profit*. Uncertainty for Knight is linked to entrepreneurship.

We then want to follow a debate on entrepreneurship and entrepreneurial acts during the 20<sup>th</sup> century. Entrepreneurship was widely neglected in economic theory of the 20<sup>th</sup> century. Currently, entrepreneurship is taught in many schools and universities in its regard to business administration – how to become a successful entrepreneur, how to make decision under uncertainty, and many other topics are addressed. The role of entrepreneurship in the economy has not been addressed very thoroughly and a discussion of the essence of entrepreneurship from a philosophical perspective has been even more neglected. This investigation shall contribute the view of philosophy to entrepreneurship and employ an Aristotelian understanding to the concepts that are discussed. We can find again the metaphysical and ethical questions Aristotle tries to answer in the writings of Mises, Hayek, Kirzner, Salerno, and their contemporaries. Concepts such as alertness, ownership, and judgment are very similar to each other and try to emphasize different aspects that are part of the essence of entrepreneurship. Sometimes it is difficult to understand what separates these concepts and some of the

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<sup>9</sup> cf. Aristotle, *Metaphysics*, Sioux Falls 2009

terms face a problem found also in other philosophical disciplines: in the theoretical framework they have a different meaning (and sometimes mean the contrary) or have a different connotation than in everyday language. One of the best examples is the term profit. We usually associate with this term some kind of injustice, a surplus received by someone who does not deserve it. If someone gains profit, someone else has to suffer a loss. At least, it is unfair that some people have superior foresight (like Thales) and if they use this ability to make money this is generally perceived as not fair and selfish and they are obliged to give a larger share of what they have obtained back to society.

In the debate about entrepreneurship we will look at, the term profit is generally employed for any incentive that motivates human action. We would not act if we would not expect profit. This is a pure psychic phenomenon which, as Mises expresses it, equals the reduction of uneasiness.<sup>10</sup> Monetary reward, which is usually perceived as profit, is the response of the costumers how the entrepreneur has forecasted their future needs and carried out his plans to meet these needs and to reduce their uneasiness. In our investigation we use the terms like they have been employed by the authors and we will not consider any differences in everyday language.

In our final assessment of the anthropological foundation of both economics and entrepreneurship, we will build upon the economists discussed before. The term methodological individualism has been used particularly to reject any kind of collectivist and central planning approach to economics. Since economics has been hijacked by mathematics and statistics<sup>11</sup>, the anthropological concept of methodological individualism has been somehow misleading. We will see that in today's understanding, it is not the uniqueness of human action and the human person that is associated with methodological individualism but rather an understanding that man is rational, man can be grouped by certain properties and therefore we can forecast the future through a mathematical assessment of the economy. Modern economics, like modern science, entirely neglects the question, "what is it?" In other words, it reduces knowledge to what is makeable or producible. And so, only reproducible statistics have value – if we

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<sup>10</sup> Ludwig von Mises, *Human Action: A Treatise on Economics*, San Francisco 1996, p. 289

<sup>11</sup> like many other branches of modern sciences as well

follow a certain mathematical formula, we can predict the end results. This fails to acknowledge that economics is a “product” of humans and not the other way round.

We will therefore argue for a concept that is called ‘economic personalism’. Personalism emerged as a philosophical and theological approach; its application to economics better supports arguments that were originally made by methodological individualism at the end of the 19<sup>th</sup> and beginning of the 20<sup>th</sup> century. Personalism is rooted in the philosophy of Aristotle and has its foundation among other traditions in philosophical anthropology. The main principles are the uniqueness and dignity of the human person, the ability of self-determination and the expression of this ability through acting or not-acting, and the connectedness to other persons within a community. This will provide us with a sufficient anthropological basis for our understanding of entrepreneurship.

# 1. Philosophical Anthropology

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Anthropology is implicitly a discipline of philosophy since the beginning of philosophy in ancient Greek. The term anthropology [*anthropos* = human being, *logos* = science] was first used in the 16<sup>th</sup> century.<sup>12</sup> Immanuel Kant was the first to distinguish anthropology from a physiological and a pragmatic perspective in 1789.<sup>13</sup> The former is the field of medicine and ethnology; the latter describes the philosophical investigation of the nature of the human person. A tradition of a philosophical anthropology was not established until the beginning of the 20<sup>th</sup> century. The anthropological questions were always considered as subcategories of metaphysics, ethics and other disciplines of philosophy.

According to Rowohlt's *Philosophielexikon*, the reason for the late emergence of anthropology as a separate philosophical discipline can be found in the history of philosophy and its main topics. In ancient Greece, the concept of the cosmos dominated philosophy. The medieval theologians and philosophers were primarily concerned with God and the right place of man in God's creation. With the Enlightenment man himself became the center of philosophical questions. But still, the philosophical approaches were dominated by epistemological and metaphysical discussions until, particularly in the German-speaking philosophy, the questions of being and reason were applied to a comprehensive theory of human nature. The three main philosophers in the 20<sup>th</sup> century dealing with this particular issue are: Helmuth Plessner, Max Scheler and Arnold Gehlen.<sup>14</sup>

Within the metaphysical investigations, the analysis of human nature began in ancient Greece. Throughout the history of philosophy, many different concepts were proposed that oscillate between realism and idealism, between the primacy of nature and of form and between empiricism and rationalism. Philosophical anthropology starts its inquiry from the fact of a special ontological status of the human being in the world and is eager

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<sup>12</sup> cf. Anton Hügli/Paul Lübcke, *Philosophielexikon*, Reinbeck bei Hamburg 2005, p. 44

<sup>13</sup> cf. Immanuel Kant, *Anthropologie in pragmatischer Hinsicht*, Stuttgart 1983

<sup>14</sup> cf. Anton Hügli/Paul Lübcke, *Philosophielexikon*, Reinbeck bei Hamburg 2005, pp. 44 et seq.

to find the right approach to justify this fact. Before we go into depth, we want to give a short introduction to the main arguments of philosophical anthropology.

For Helmuth Plessner, man is characterized through excentric positionality, which distinguishes him from animals (closed organic forms with central positionality) and plants (open organic forms). He states three fundamental anthropological laws. Natural artificiality describes the fact that man expresses himself in discovering the already existing reality and through this discovery process artificially transforms reality and creates culture. With the concepts of mediate immediacy and the utopian standpoint, Plessner tries to reconcile various anthropological concepts and wants to outline the limits of anthropology.<sup>15</sup>

Max Scheler who, like Plessner, was influenced by Edmund Husserl, talks about the person as the structural order of acts that are performed by the spirit. The spirit is the essential human ability to objectify things and is itself unbound from any kind of organic reality. His concept of man as an acting person rather than a substance is a crucial foundation for later developed concepts of personalism and will also serve as a philosophical foundation for our further investigation of human action in an economic environment.<sup>16</sup>

Arnold Gehlen has similar conclusions like his fellow philosophical anthropologists. However, he chooses a different approach than Plessner and Scheler. He rejects the assumption that the organic world is built up in stages and that there is a highest level that includes all of the criteria below and is characterized by a particular concept such as excentricity or the spirit. For Gehlen, man is a *Mängelwesen* [deficient being] and his deficiencies urge him to act in order to survive. Customs are similar to the animal instincts and these customs become institutions in a culture that unburden man from the pressure of his instincts. Man, as an acting person, is able to postpone the satisfaction of his wants and this is the main reason why he is able to survive in this world although

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<sup>15</sup> cf. Helmuth Plessner, *Die Stufen des Organischen und des Menschen. Einleitung in die Philosophische Anthropologie*, Berlin 1965

<sup>16</sup> cf. Max Scheler, *Die Stellung des Menschen im Kosmos*, Bonn 1995

there is no particular sector of the world that is appointed to him by the wisdom of nature.<sup>17</sup>

### **1.1 What is man? (Kant)**

As mentioned before, Immanuel Kant is the first philosopher who delivered a comprehensive discussion on human nature. In *Logic* he argues that philosophy can be separated in four different fields guided by four main questions: 1. What can I know? 2. What ought I to do? 3. What may I hope? 4. What is man? The first question is answered by metaphysics, the second by moral philosophy, the third by religion and the fourth by anthropology. But Kant also believes that the first three questions are all related to the last one and all philosophical inquiry is part of anthropology.<sup>18</sup>

In *Anthropology from a Pragmatic Point of View*, Kant distinguishes between physiological and pragmatic anthropology – the former is concerned with how nature shapes man, the latter with how man shapes himself as a free acting being. Kant's anthropology contains different approaches of psychology and a chapter on the human character. His philosophical definition of human nature is that the human being is determined by his reason to be in society with other man and to cultivate, civilize and moralize himself through art and science.<sup>19</sup>

Kant's anthropology is more like a textbook of empirical psychology than a thorough philosophical discussion of human nature. This might be one of the reasons why anthropology in the following century was dominated by medicine and biology; it may also be the reason why philosophers were not particularly concerned with human nature and the special place of human beings in the world until the beginning of 20<sup>th</sup> century.

### **1.2 Excentric Closed Organic Form (Plessner)**

Helmuth Plessner distinguishes in *the Stages of the Organic World and Man* living things from non-living things. A living thing is characterized by the boundary nature of its layer. A living thing also has border traffic in relation to its environment. The distinct

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<sup>17</sup> cf. Arnold Gehlen, *Der Mensch. Seine Natur und seine Stellung in der Welt*, Bonn 1955

<sup>18</sup> cf. Immanuel Kant, *Logik*, Königsberg 1800, p. 25

<sup>19</sup> cf. Immanuel Kant, *Anthropologie in pragmatischer Hinsicht*, Stuttgart 1983, A 324

setting of a living thing is positional. Within the organic forms there are three different stages. Plants have an open form – the organism is in all its expressions of life immediately embedded in its environment and is a dependent sector of its circle of life. Plants have no central organs. Animals are closed forms – the organism is mediated embedded in its environment and is an independent sector of its circle of life. Within the closed organic form, an antagonism between the organs has to be organized by a centre of the body. The body is the layer between the living thing and the medium. The body of the living being shares a border with the medium but has also gained a reality “behind” or “in” the body. The organism is therefore on a higher level of being.<sup>20</sup> The animal is centrally organized, has a central positionality and cannot observe its own existence/being.

The human living being stands in the center of existence, knows about this center and experiences it and is surpassing this center. The center of the positionality in the human being has to have a distance to it. This relationship is described by Plessner as total reflexivity. This relationship breaks a gap between the center and its experience – it removes the center of the self from the center of the body and with this excentricity the phenomena of inner field, outer field and consciousness follow. The inner field is the center of the experience, the outer field is the media that is bordering with the body and the consciousness is the excentric positionality of the human being where man becomes aware of his own existence. Man can experience himself as a person only if another person is present if he is in a *Mitwelt* [social environment]. The person is entwined with the contemporaries – the person bears its social environment and the social environment bears the person. Between persons is the sphere of the spirit. Spirit, soul and consciousness are different in the way that the soul is the real existence of the person, consciousness is the aspect in which the world is perceived through the excentricity of the personal existence and spirit is not a real existence but is the sphere that is created through this particular positionality and is realized in the social environment as long there is at least one other person existing.<sup>21</sup>

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<sup>20</sup> cf. Helmuth Plessner, *Die Stufen des Organischen und des Menschen. Einleitung in die Philosophische Anthropologie*, Berlin 1965, p. 231

<sup>21</sup> cf. Plessner, *Die Stufen des Organischen und des Menschen*, 1965, p. 303

Plessner describes three anthropological fundamental laws<sup>22</sup>: (1) natural artificiality, (2) mediated immediacy, and (3) the utopian standpoint. Man has lost his security through instincts through his freedom and is aware of this unreachable naturalness of the other living forms. His natural existence is artificial. Due to his excentricity man is not in balance, he is without a specific place or time – he is genuinely homeless. His excentricity and the need to become something move man in the same direction – with all artificial means and his acts and tools he creates culture. Everything that becomes part of culture is in some way bound to the human author and at the same time independent from him. Human invention is in fact discovery. Man can only discover what already exists. Creativity is characterized by Plessner as a lucky snatch. The creative snatch is a form of human expression and is therefore artificial.<sup>23</sup>

With the concept of mediated immediacy Plessner wants to reconcile idealist and realist concepts of epistemology. The excentric position of the human being causes immediate contact with reality and at the same time a mediated experience of the world from the excentric self-awareness and self-experience. The utopian standpoint expresses that it is not known to the human being from where it observes his own existence. This question is left to be answered by religion – man cannot answer this by himself. Religion reveals the order to the human being thus giving him a home.<sup>24</sup>

### **1.3 The Person as the Structural Order of Acts (Scheler)**

Max Scheler was a student of Edmund Husserl. Influenced by his teacher's approach of phenomenology, he develops philosophical anthropology as a particular concept that should explain the *Sonderrolle* [special role] of man in the world. In his last book *Man's Place in the Cosmos* he writes about the relationship of *Geist* [mind/spirit] and *Leben* [living being]. He believes that man is neither a part of a hierarchy of the living world nor is he primarily dominated by the spirit. Man has a soul (the psychological aspect of the living being) and a body (the physiological aspect of the living being). But the X<sup>25</sup>

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<sup>22</sup> cf. Plessner, *Die Stufen des Organischen und des Menschen*, 1965, pp. 288 et seqq.

<sup>23</sup> cf. Plessner, *Die Stufen des Organischen und des Menschen*, 1965, pp. 309 et seqq.

<sup>24</sup> cf. Plessner, *Die Stufen des Organischen und des Menschen*, 1965, pp. 341 et seqq.

<sup>25</sup> Scheler uses the term "X" when he refers to the human spirit

that is aware of the unity of body and soul surpasses at the same time this unity and is not part of this world. The spirit is surpassing space and time and is pure actuality. The structural order of these acts is the person.<sup>26</sup>

The person and the spirit are not objects and cannot be seen as objects. The spirit by acting is not discovering the objective reality but is co-creating it. Scheler calls this the *Akt der Ideierung* [act of the spirit in the world]. This act is fundamentally different from all kinds of forms of intelligence or reasoning, it is the recognition of the essence of things and the world itself. It is not only being conscious but it is consciousness of being conscious. For Scheler, there exists a structural unity of consciousness of the world and of the self (and also of God).<sup>27</sup>

Scheler elaborates his concept of the living being in order to overcome the misconceptions of the past that either described man as rational animal or on the other hand described the non-human world with mechanic concepts. For Scheler there are four different aspects of the living being:<sup>28</sup> (1) the urge to feel, which is shared by all living entities; (2) instinct, which is shared by animals and human beings and is basically oriented towards life – it is a kind of fixed rhythm of reaction to the world; (3) associative memory, which can be gained and exercised and is present in animals related to the characteristic of conditional reflexes; and (4) Scheler believes that there are some acts of animals that can be considered as influenced by organically bound practical intelligence. Nevertheless this form of intelligence is genuinely an aspect of the nature of the human living being.

Of course all of these aspects are part of the human nature as well. But the spirit that is crucial for human beings is existentially unbound from the organic reality and is therefore open to the world and free from the environment. Animals experience their environment and Scheler argues that they also experience some sort of resistance that is originated there. They can react to this resistance but they are bound to their environment. Only human beings have a capacity to negate this resistance and therefore

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<sup>26</sup> cf. Max Scheler, *Die Stellung des Menschen im Kosmos*, Bonn 1995, p. 48

<sup>27</sup> cf. Scheler, *Die Stellung des Menschen im Kosmos*, 1995, p. 89

<sup>28</sup> cf. Scheler, *Die Stellung des Menschen im Kosmos*, 1995, pp. 16 et seqq.

objectify<sup>29</sup> the things in the world as things and at the same time objectify the world as such. Scheler introduces three key concepts for man's nature: *Neinsagenkönnen* [he who can say no], *Weltoffenheit* [openness to the world] and the ability to objectify the environment. The ability of negating the resistance of the environment adds an additional level of reflection to the form of consciousness of animals. Only the human being has the full established *Ding- und Substanzkategorie* [category of thing and substance].<sup>30</sup>

#### **1.4 Deficient Being (Gehlen)**

Arnold Gehlen published his main work *Man, his nature and place in the world* on philosophical anthropology in 1940. He has been influenced among others by Max Scheler. He employs phrases such as 'openness to the world' that have been coined by Scheler before but he develops a fundamentally different approach to justify the special role of the human being in nature. Gehlen rejects the notion of stages of the living world as it is described by Aristotle or Scheler. He undertakes a biological argumentation for the differentiation between animals and human beings.

Animals are equipped with morphological elements, dynamism and drive to deal with the environmental demands. Within their space of life they couple instinctively perceptions and patterns of movement. Their circle of functions is a rhythmical circulation. In human beings this instinctive behavior is reduced and not applied to a particular *Ausschnitts-Milieu* [sector milieu]. Man is not specialized in any specific way and is therefore determined mainly by deficiencies (he is not covered with hair that would protect him against weather, has no means to attack an enemy and also no ability to escape quickly). There is no single characteristic that distinguishes man from the rest of the living world (like Scheler's spirit or Aristotle's rational part of the soul). Therefore man is genuinely a *Mängelwesen* [deficient being].<sup>31</sup>

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<sup>29</sup> By the term 'objectify' Scheler means that man has the capacity to experience himself as the subject and the relationship he has to objects like other things and the world as such.

<sup>30</sup> cf. Scheler, *Die Stellung des Menschen im Kosmos*, 1995, p. 44

<sup>31</sup> cf. Arnold Gehlen, *Der Mensch. Seine Natur und seine Stellung in der Welt*, Bonn 1955, p. 35

Man is open to the world and at the same time burdened with the pressure of his instincts and stimulus satiation. This burden urges man to act and to unburden himself by transforming the existing reality into something that is *lebensdienlich* [useful for his life]. Man is not a natural being but always a cultural being. Man could not survive in nature but always has to transform it into culture (starting with the simplest acts such as creating clothes, using weapons or making fire). Hence, animals are surrounded by environment, man is surrounded by culture. Culture is man's second nature.<sup>32</sup>

Man is exposed to an undirected complexity of external stimuli and internal drives, he finds himself in a natural co-dependency of dynamic relationship between perception and behavior, between inside and outside. This relationship is *entsichert* [made unsecure] and is a burden for human beings. Therefore man wants to secure this relationship by action. Because man is *unfertig* [unfinished] and has no particular sector in this world that the higher wisdom of nature has provided for him, where his instincts naturally meet the environmental demands, man has to act in order to survive. Man's only means to balance his deficiencies is action. Gehlen describes man as an acting being. Action unburdens man from the pressure of instincts. Man has the ability to restrain drives and needs and postpone them in order to fulfill them at a later point in time. Man creates a hiatus. The hiatus is the emptiness between drive and fulfillment. It is one of the essential characteristics of human action. Man has to plan his work because he always has to secure what he needs and it is never already provided for him. Therefore he must restrain his drives and act now according to his forecasting of what he will need for his existence in the future.<sup>33</sup>

This process of *Entlastung* [unburdening] is an essential anthropological category according to Gehlen. Unburdening can be gained especially through *Gewohnheit* [customs]. Customs in culture resemble instincts in nature. Customs are quasi-instinctive behavior of human beings. These customs result in a concept that Gehlen calls institutions. His concept of institutions is very broad. Institutions can be technology (tools, etc.), language and rituals, but also the state, church and other terms that characterize the peculiar nature of social relations among human living beings.

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<sup>32</sup> cf. Gehlen, *Der Mensch. Seine Natur und seine Stellung in der Welt*, 1955, p. 40

<sup>33</sup> cf. Gehlen, *Der Mensch. Seine Natur und seine Stellung in der Welt*, 1955, p. 361

Upon summation we can see that Gehlen also defends a concept of the acting human being that is driven by man's deficiencies. In his concept of culture he is mainly concerned with the basic needs of human beings for their existence but this fundamental culturality of human beings is an interesting point to think through further when it comes to institutions such as the market, money or other customs that enable man to balance his deficiencies even better than he would be able by transforming nature by himself.

### **1.5 Economic Actions**

Philosophical anthropology equips us with three arguments regarding human nature that will be the basis for our further investigation: (1) action is a particular human category and essential for human nature and the concept of the person; (2) man is a deficient being and is urged to act in order to survive; and (3) man's actions transform the natural reality and create an artificial culture.

In the next chapters we want to explore how the concept of human action can be applied to an environment of scarce resources. We want to build our arguments on the assumption that man is always urged to act because he is a deficient being and always has needs. This urgency to action is not limited to the satisfaction of needs in order to survive but this is a fundamental category of human nature and motivates human action. Furthermore, needs do not determine actions – man is free and has the ability to say no and to postpone the fulfillment of his needs (and drives) or to neglect their fulfillment all together.

The urgency to action and the freedom to postpone and neglect needs are essential feature of human nature especially in the reality of an economic environment. We want to see how economists describe *Akte der Ideierung* and which arguments are employed to consider them either as co-creation or as discovery of an already existing reality. Entrepreneurship is action that is genuinely transforming nature, combining resources and creating artificial things and services that do not naturally exist. We will argue that entrepreneurship also involves the employment of capital and some sort of ownership

and hence we will also see that the ability to postpone consumption (the fulfillment of needs in an economy) is a crucial prerequisite for entrepreneurship.

But man is motivated to act not only by his physiological deficiencies but also by his ontological deficiencies. Man is aware of his existence but existence does not only involve locality but also temporality (as we can already see in the fact that postponement involves time). We will argue that the future is ontologically different from the past and the present.<sup>34</sup> The genuine uncertainty of the future also motivates human beings to act. If the future would be certain, there would be no necessity to freely perform actions but humans would react mechanically to the already predetermined future events. Uncertainty in the human sphere cannot be reduced but can be borne through leadership.

The concept of uncertainty has been an implicit issue throughout the history of philosophy. In the next chapter we want to reflect briefly on some of the implications of uncertainty on philosophical concepts before we apply uncertainty to the sphere of economics. This will lay the foundation for the following assessment of entrepreneurship and how it is related to uncertainty.

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<sup>34</sup> The difference in the ontological status of future, past and present can be understood from an anthropological perspective. The past consist of facts and experiences that can be remembered. The future is fundamentally uncertain and motivates human action. The present is where human acts are located that are performed by the individual in order to react to the uncertainty of the future informed by the facts and experiences of the past.

## 2. Uncertainty

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In this investigation into the nature and history of uncertainty we want to distinguish the term uncertainty from risk in the same way like Frank Knight.<sup>35</sup> Both concepts describe a relationship of the human person to the future of objective reality of the world. The human person is ignorant about the future. There is no way to have certainty about what is going to happen. But the human person wants to deal with his ignorance. If there is a way to forecast the future on a measureable, quantitative basis then we will use the term risk. If this future is immeasurable and fundamentally non-quantitative we will speak of uncertainty.

Before we look at the implications of uncertainty in economics we want to explore some concepts in the history of philosophy that dealt in different ways with principles of uncertainty or ignorance. This will provide us with a better understanding of how these principles are employed to argue various philosophical concepts. We will also see that uncertainty is used in economics e.g. to justify profit as legitimate residual income from entrepreneurial action or to reject any sort of central planning.

In the history of philosophy we will investigate four different approaches and ways of involving some sort of uncertainty in a philosophical theory. These examples shall show how philosophers use uncertainty to develop their metaphysical, anthropological or ethical arguments. Scepticists rejects any form of judgment and systematic theory because in their opinion certain truth criteria do not exist. But their ultimate goal is not the disproof of the validity of any other theory but they are pursuing the peace of the soul.<sup>36</sup> Uncertainty about sensorial experience leads Descartes to formulate his principle of methodological doubt and the conclusion, that the only certain principle in the world is the *cogito*.<sup>37</sup> The uncertainty, if our sensory experience may be able to correspond

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<sup>35</sup> cf. Frank H. Knight, *Risk, Uncertainty and Profit*, Mineola/New York 2006, p. 31

<sup>36</sup> cf. Anton Hügli, Paul Lübcke, *Philosophielexikon*, Reinbeck bei Hamburg 2005, p. 581

<sup>37</sup> cf. René Descartes, "Discourse on the Method of Rightly Conducting the Reason", in: *Great Books of the Western World. Desartes, Spinoza*. Chicago, London, et al. 1984

with the world, was urging Kant to coin the terms of phenomena and noumena.<sup>38</sup> In modern political philosophy John Rawls employed the principle of uncertainty in his theory of justice in a methodological way.<sup>39</sup>

The concept of uncertainty plays an important role in a particular strand of modern economic theory that we want to investigate in depth and use as a foundation for the following assessment of entrepreneurial theories. Frank Knight differentiated in 1921 between uncertainty and risk and related these concepts to entrepreneurship.<sup>40</sup> Ludwig v. Mises elaborated more on the intimate relationship between uncertainty and human action in an economic environment<sup>41</sup> and Friedrich A. v. Hayek concentrated his arguments on the dispersion of knowledge and the epistemic sphere of uncertainty.<sup>42</sup>

## 2.1 Philosophy

One philosophical approach uses uncertainty as guiding principle: Skepticism doubts that one could know anything with certainty. Sceptics believe that there are no criteria that could prove an assertion true. Pyrrhon from Elis was the first in ancient philosophy to systematically doubt all kinds of objective truth. He rejected to make judgments. He believed that things were not perceivable how they really are. For Pyrrhon, these insights are a prerequisite for happiness. In order to achieve happiness and peace for the soul (*ataraxia*) he developed skepticism as a method and an attitude towards life. The skeptics in ancient Greece criticized other approaches to philosophy (particularly stoicism) as dogmatic.<sup>43</sup> Hence, for the early skeptics the uncertainty about the existence of truth-criteria in the world provided a basis particularly for ethical implications and for a concept of how to live their lives. Skeptics deal with uncertainty in the way that they don't want to be troubled by uncertainty and therefore don't judge and develop any kind of teaching.

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<sup>38</sup> cf. Immanuel Kant, "Critique of Pure Reason" in: *Great Books of the Western World. Kant*. Chicago, London, et al. 1984

<sup>39</sup> cf. John Rawls, *A Theory of Justice*, Cambridge 1971

<sup>40</sup> cf. Frank H. Knight, *Risk, Uncertainty and Profit*, Mineola/New York 2006

<sup>41</sup> cf. Ludwig von Mises, *Human Action: A Treatise on Economics*, San Francisco 1996

<sup>42</sup> cf. Friedrich A. Hayek, "The Use of Knowledge in Society", in *The American Economic Review* 1945

<sup>43</sup> cf. Anton Hügli, Paul Lübcke, *Philosophielexikon*, Reinbeck bei Hamburg 2005, p. 581

René Descartes is concerned with the fact that opinions are uncertain to some degree and sensory experience is often times erroneous. Thus, he wants to find a ground of absolute certainty as a first principle for philosophy and uses the concept of doubt as a method. In *Discourse on Method* Descartes writes: “I thought that it was necessary for me [...] to reject as absolutely false everything as to which I could imagine the least ground of doubt, in order to see if afterwards there remained anything in my belief that was entirely certain.”<sup>44</sup> Since all thoughts and conceptions that human beings have while they are awake can also be part of their dreams, Descartes decides to treat everything that enters the human mind as no more true than the illusions of dreams. He doubts anything that we perceive or think. And then he concludes that the only ground he cannot doubt while he is doubting is the “I” that is doubting:

[Whilst] I thus wished to think all things false, it was absolutely essential that the “I” who thought this should be somewhat, and remarking that this truth “*I think, therefore I am*” was so certain and so assured that all the most extravagant suppositions brought forward by the skeptics were incapable of shaking it.<sup>45</sup>

For Descartes the ground of certainty in the world is the *res cogitans*, the thinking substance, a substance that is totally distinct from the body. This kind of dualism is the metaphysical and anthropological implication that can be derived, according to Descartes, from the fact that perceptions and thoughts of the world are uncertain and have to be doubted in order to develop the first principle of philosophy.

Kant’s approach to deal with the uncertainties in the world is different from Descartes’. With the question, “What can I know?”<sup>46</sup>, he sets out in the *Critique of Pure Reason* to explore the limits of human sensual experience and human understanding. We cannot know how things in themselves, the noumena, are. But this uncertainty is not a fact that can be removed by collecting new data about the thing in itself, but it is a fundamental reality of reason and has a limitative implication on human sensibility. We can only deal with the phenomena, with the perception of how things appear.

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<sup>44</sup> Descartes, “Discourse on the Method of Rightly Conducting the Reason”, 1984, p. 51

<sup>45</sup> Descartes, “Discourse on the Method of Rightly Conducting the Reason”, 1984, p. 51 [italics in original]

<sup>46</sup> Kant, “Critique of Pure Reason”, 1984, p. 236

The conception of *noumenon*, that is, of a thing which must be cogitated not as an object of sense, but as a thing in itself (solely through the pure understanding) [...] is necessary to restrain sensuous intuition within the bounds of phenomena and thus to limit the objective validity of sensuous cognition.<sup>47</sup>

By applying this confinement to human perception, the human understanding is limiting itself. This is a fundamental principle in the philosophy of Kant: Man draws the lines between what he is able to know with some sort of certainty and what is just a mere form of thought. Kant rejects the interpretation that the concept of noumena is dividing the world into a *mundus sensibilis* and *intelligibilis* and that noumena are particular intelligible objects of our understanding. Kant calls this conception problematic because it contains no contradiction in itself. Thus for Kant, we possess an understanding that is extending problematically beyond the sphere of phenomena and the sensual uncertainty about the thing in itself limits human intuition. The concept of noumena limits the objective validity of sensible knowledge.<sup>48</sup>

John Rawls was one of the few philosophers who employed the principle of uncertainty explicitly in his ethics and political theory.<sup>49</sup> In *Theory of Justice* he describes the concept of the veil of ignorance, a pure thought experiment of a situation where everybody would be absolutely uncertain about his future position in society. He employs the uncertainty of the future (no one can forecast with any certainty his future position in society) as a methodological principle: “I assume that the parties are situated behind a veil of ignorance. They do not know how the various alternatives will affect their own particular case and they are obliged to evaluate principles solely on the basis of general considerations.”<sup>50</sup> From this situation he derives two principles of justice<sup>51</sup> on

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<sup>47</sup> Kant, “Critique of Pure Reason”, 1984, p. 97

<sup>48</sup> cf. Kant, “Critique of Pure Reason”, 1984, p. 97 et seq.

<sup>49</sup> Rawls generally uses the term “ignorance” to describe the situation of what he calls “original position” where everybody has no knowledge - is fundamentally uncertain - about his individual situation in the future. We can look at ignorance and uncertainty as two sides of the same coin. Ignorance is related to the status of knowledge about the future of the individual, uncertainty is related to the objective world with space and time.

<sup>50</sup> Rawls, *A Theory of Justice*, 1971, pp. 136 et seq.

<sup>51</sup> Even though it doesn't contribute to the understanding of uncertainty, the two principles of justice shall be mentioned here (Rawls, *Theory of Justice*, 1971, p. 302): (1) Each person is to have an equal right to the most extensive total system of equal basic liberties compatible with a similar system of liberty for all. (2) Social and economic inequalities are to be arranged so that they are both: (a) to the greatest benefit of

which, he argues, everybody could agree from the perspective of the original position.<sup>52</sup> Rawls wants to develop principles of public justice that can effectively regulate a society. He uses the veil of ignorance to exclude any form of self-interest from his reasoning and to create a theoretical situation that enables us to find out some fundamental principles. Rawls uses uncertainty exclusively in a methodological way. For his further assessment there is no further consideration what role uncertainty plays for the individual in the society regulated by principles of justice.

## 2.2 Economics

One of the first economists addressing the issue of uncertainty in the economic world was Richard Cantillon<sup>53</sup>. In his *Essai sur la Nature du Commerce en Général* published in 1755 he describes how undertakers (his word for entrepreneurs) buy from the producers a certain price and sell it to their customers at an uncertain price. This uncertainty justifies the profit they gain through the price difference. But also undertakers, who take charge of mines or buildings and also undertakers that live of their own capital and need no labor, live at uncertainty. Besides the landowners and the nobles Cantillon distinguishes two classes of people: undertakers and hired people. Undertakers live at uncertain wages, others at fixed wages.<sup>54</sup>

### ***Knight***

In the sphere of economics the term uncertainty is ultimately connected with the name Frank Knight. He was the first economist to explicitly develop a comprehensive theory of uncertainty that is linked to profit and entrepreneurial activity. In his master piece *Risk, Uncertainty and Profit* in 1921 he starts an assessment of different theories of profit, especially those related to risk. He examines the theories of German, French and British economists in the 19<sup>th</sup> century. According to Knight, the German ones generally believe that profit is a residual income. However, they are more concerned with the

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the least advantaged, consistent with the just savings principle, and (b) attached to offices and positions open to all under conditions of fair equality of opportunity.

<sup>52</sup> Rawls, *A Theory of Justice*, 1971, pp. 60 et seqq.

<sup>53</sup> cf. Jesús Huerta de Soto, *Die Österreichische Schule der Nationalökonomie – Markt und unternehmerische Kreativität*, Wien 2007, p. 51

<sup>54</sup> cf. Richard Cantillon, *Essai sur la Nature du Commerce en General*, London. 1959, Part I Chapter XIII

social justification of profit in their debate with German socialists. The French tend to consider profit as a form of wage and the English view is classifying profit as a return on capital.

Knight builds his own concept on two theories developed at the beginning of the 20<sup>th</sup> century, the “dynamic theory” of J.B. Clark and the “risk theory” of F.B. Harley.<sup>55</sup> Professor Clark distinguishes between a static and a dynamic state of the economy. The static state is the state of natural adjustment, where change is absent and no profits besides wages for supervision exist. The dynamic state is differing because change exists. Dynamic change produces temporary profits that through competition could be annihilated again. Knight criticizes the missing distinction of foreseen change and unforeseen change. The relation between change and profit is always indirect – change can only create a situation in favor of profit, if it brings about ignorance of the future but it is not the reason for profit.

But Uncertainty must be taken in a sense radically distinct from the familiar notion of Risk, from which it has never been properly separated. The term "risk," as loosely used in everyday speech and in economic discussion, really covers two things, which, functionally at least, in their causal relations to the phenomena of economic organization, are categorically different. [...] The essential fact is that "risk" means in some cases a quantity susceptible of measurement, while at other times it is something distinctly not of this character; and there are far-reaching and crucial differences in the bearings of the phenomenon depending on which of the two is really present and operating. [...] It will appear that a measurable uncertainty, or "risk" proper, as we shall use the term, is so far different from an unmeasurable one that it is not in effect an uncertainty at all. We shall accordingly restrict the term "uncertainty" to cases of the non-quantitative type. It is this "true" uncertainty, and not risk, as has been argued, which forms the basis of a valid theory of profit and accounts for the divergence between actual and theoretical competition.<sup>56</sup>

As we shall see later, Knight also assesses the existence and different forms of probabilities. This is important especially for how man deals with risk and uncertainty.

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<sup>55</sup> cf. Knight, *Risk, Uncertainty and Profit*, 2006, p. 31

<sup>56</sup> Knight, *Risk, Uncertainty and Profit*, 2006, p. 19

Risk can be measured through grouping instances of a single class and thus calculating a probability that might be regarded to as being “somehow objective.” Uncertainty on the other hand would be paralyzing, if it would be addressed in the same way like risk. Apparently, even if it was objectively impossible and there was no quantitative probability, man has the tendency to form classes of cases and group individual decisions. According to Knight, we then talk about judgment. Judgment is the anticipation of an uncertain future. An important role for the subjective part of uncertainty that is experienced by the judging person is also the nature of his character. The higher the confidence in his estimation, the lower is the subjective uncertainty.

### *Mises*

Ludwig v. Mises dedicates a whole chapter of his opus magnum *Human Action* to the examination of uncertainty. For him, uncertainty and human actions are two sides of the same coin. The uncertainty of the future is the reason for human action. “If man knew the future, he would not have to choose and would not act. He would be like an automaton, reacting to stimuli without any will of his own.”<sup>57</sup> For Mises, the fact that the future cannot be known, opens the room for human self-determination. He calls the science dealing with human action *praxeology*<sup>58</sup>.

According to Mises, natural sciences have the ability to foretell results obtained by definite actions except in two unpredictable spheres: insufficiently known natural phenomena and human acts of choice. He admits that natural sciences, such as physics and chemistry, deal with theorems of extremely high probability in order to be called certain for practical reasons. But this contains no practical importance to *praxeology*.

If we look at the individual level of an entrepreneur who produces industrial goods, we can observe that he might be able to scientifically forecast the working of a machine. But this is only part of the whole process of producing a good to satisfy the consumer’s wants. There is no scientific method to find out the future desires of costumers and the best ways to meet their expectations. This will always belong to the field of speculation that has to be carried out by human action. The entrepreneur has to forecast these future-

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<sup>57</sup> Ludwig von Mises, *Human Action: A Treatise on Economics*, San Francisco 1996, p. 105

<sup>58</sup> derived from the Greek words for human action (praxis) and the Greek word for science (logos).

wants and decides on the quality and quantity of a good that he wants to produce. And then he designs the machine that shall enable him to do so.

The primary problem of *praxeology* is that of probability. Mises condemns the strong influence of mathematics in probability. He distinguishes (1) class probability and (2) case probability.<sup>59</sup> With *class probability* he describes the fact that we know everything about the behavior of a class of events but nothing about the individual, singular event besides that this event is part of the class (lottery or dice game). Our knowledge about the singular event is incomplete and at the same time cannot be completed. Mises points out that a translation into mathematical language does not change anything about the knowledge we already had beforehand. Also, insurance has nothing to do with taking on the risk of a certain singular event to happen – this would be mere gambling and a substitution for the existing risk. Insurance may be rather understood as a pooling of risk, where an insurer can assess the probability of a whole class of events and therefore calculate the risk of the occurrence of one event, even though he does not know which particular client will eventually suffer the loss. There is also no uncertainty for the organizer of a lottery (given that the tickets are sold) that he will lose money with his business.

*Case probability* is entirely different from class probability except for the principle of the incompleteness of knowledge. In case probability, we know some of the facts that determine the specific outcome of a particular event and also other factors we do not know. In case probability it makes no sense to refer to any kind of frequency because we deal with unique events that are not members of a specific class. Mises illustrates the concept with what he calls the “gambler’s fallacy”. This refers to a misconception, e.g. when a doctor tells a patient that from a particular surgery 30 out of 100 are dying and the patient is thus asking him, if the maximum number of deaths had already been reached. Case probability is therefore a feature particularly dealing with human action rather than with classes of events or data.

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<sup>59</sup> cf. von Mises, *Human Action: A Treatise on Economics*, 1996, pp. 107 et seqq.

Mises distinguishes three different modes for dealing with the future<sup>60</sup>: (1) gambling, (2) engineering and (3) speculating. The *gambler* only knows a certain frequency of outcomes of events. This knowledge is useless for the undertaking. He trusts only in his good luck. The *engineer* knows everything necessary he needs to know in order to technically solve a problem. The fringes of uncertainty he tries to eliminate by taking safety margins. His operating principle is to act in an orbit of certainty. Man in general is a *speculator* due to his need for adjusting to other people's actions. His success depends on his ability to forecast the future.

To explain how men interact with each other with regard to uncertainty, Mises uses three different terms to explain their behavior. (1) *Betting* describes the act of risking to lose or win money against another man over the outcome of an event, of which we only have partial knowledge. (2) *Gambling* means risking money without having any knowledge of the actual outcome. (3) *Playing Games* is used for situations where one partner has to be defeated by the other according to the rules of the game. Though playing a game can be considered as human action, Mises denies any analogy to the conduct of business. "The card player wins money by outsmarting his antagonist. The businessman makes money by supplying customers with goods they want to acquire."<sup>61</sup> Business based on a right order is serving the members of society – as soon as there is antagonization, social disintegration follows.

Mises points out that the only appropriate method to deal with the uncertainty of the future is *understanding*<sup>62</sup>. By the law of supply-and-demand we can predict that the price for something will drop if the demand goes down. But we can estimate the extent only by the method of understanding.

### **Hayek**

In his assessment of knowledge, Friedrich Hayek is not explicitly dealing with the problem of uncertainty. But his contribution concerning the dispersion of knowledge

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<sup>60</sup> cf. von Mises, *Human Action: A Treatise on Economics*, 1996, pp. 112 et seqq.

<sup>61</sup> von Mises, *Human Action: A Treatise on Economics*, 1996, p. 116

<sup>62</sup> Mises discusses understanding as a task for the historian who assesses the value judgments and the ends people pursued in the past. But since everybody is observing the conditions of his environment, for Mises, everybody is a historian and has to use the method of understanding.

over time and place is important for our examination. The so called Hayekian Knowledge Problem<sup>63</sup> is being discussed in his famous 1945 paper, *The Use of Knowledge in Society*.

Hayek analyzes the problem of economic calculus and points out that “data” necessary for starting economic calculus, is never a given thing for the whole of society. We therefore rather face “the problem of utilization of knowledge not given to anyone in its totality”<sup>64</sup>. But the question is, who can plan the most efficient use of scarce resources and how should this plan be put into reality. It is a fact that all economic activity somehow involves planning. However, the question that Hayek explores is: Who does the planning? He distinguishes between planning done centrally, competition that implies decentralized planning, and planning in organized industries, which denotes a monopoly.

Hayek distinguishes between<sup>65</sup> (1) scientific knowledge – a form of objective knowledge on which basis a rational decision for the planning of society may be taken and (2) the knowledge of the particular time and circumstances – unorganized knowledge that gives every individual some sort of advantage over all others, because he possesses unique information that can be only put to use, if the decision is left to him. For Hayek, this is especially important, due to the fact that economic problems always arise in consequence of change. Hayek points out that change not only is a matter of long-term decisions, such as erecting a new plant. It is also the adapting to ever-changing circumstances in business life requiring particular knowledge being applied by the individual.

Hayek accuses the economists of his time of neglecting the role of the small changes in business life. He believes that one contributor to this development is the preoccupation of statistical aggregates that are suggesting more stability. The specific knowledge Hayek is concerned with, cannot be conveyed in statistical form. As a solution he

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<sup>63</sup> cf. Frédéric Sautet, *An Entrepreneurial Theory of the Firm*, London/New York: 2000, et al.

<sup>64</sup> Friedrich A. Hayek, “The Use of Knowledge in Society”, in *The American Economic Review* 1945, p. 520

<sup>65</sup> Hayek, “The Use of Knowledge in Society”, 1945, p. 521

suggests a form of decentralization to leave the decision to the people who are familiar with the particular circumstances. It is not necessary that they have the total knowledge of the causes for the change in circumstances. They only need to know how much more or less difficult it is for them to obtain things due to these changes that have taken place earlier. This problem is solved by the *price system*. “Fundamentally, in a system where the knowledge of the relevant facts is dispersed among the people, prices can act to coordinate the separate actions of different people in the same way as subjective values help the individual to coordinate the parts of his plan.”<sup>66</sup>

To the three principles derived from philosophical anthropology (action as a distinct human category, man as a deficient being and the transformation of nature by man) we can add now the following principles from our investigation of uncertainty: (1) uncertainty motivates human action and humans act in order to reduce uneasiness, (2) knowledge is dispersed among people and is best applied by acts of the individual, (3) to bear the uncertainty of the future man has to make judgment, believe in them and carry them out. With this set of principles as a basis we will now proceed with our assessment of the nature of entrepreneurial action in the economy.

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<sup>66</sup> Hayek, “The Use of Knowledge in Society”, 1945, p. 526

### 3. The Entrepreneur in Economic Theory

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In recent years, a strong increase in the interest for entrepreneurship and innovation is observable. Universities teach on how to become a successful entrepreneur, how to write a business plan and how to make decisions in an uncertain environment. There are many stories, how phenomena like globalization have supported entrepreneurial activities, especially in the developing world, and have therefore created opportunities for poor and disadvantaged people.<sup>67</sup> But this interest and these stories about entrepreneurship are limited to the fields of business administration and sociology. The debate about the entrepreneur in economics is much more limited.

The particular function of the entrepreneur has been a widely neglected role in modern economic theory.<sup>68</sup> Mainstream economic theory, especially influenced by the economists of the University of Chicago, does not really consider the entrepreneur in its teaching. For neoclassical theorists, the entrepreneur is usually just one factor in their models like many others and is not considered because he is not mathematical perceivable. Their models are based on general equilibrium theory in which there is no role for the entrepreneur.<sup>69</sup>

We will therefore explore a tradition of modern economic thought that has its origins in Austria.<sup>70</sup> These economists have put much more emphasis on the role of the entrepreneur in the economy than any other school of thought. We will start with Frank Knight. His concept of entrepreneurship is closely linked to his understanding of

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<sup>67</sup> cf. Thomas L. Friedman, *Die Welt ist flach. Eine kurze Geschichte des 21. Jahrhunderts*, Frankfurt/Main 2006, et al.

<sup>68</sup> Rahim Taghizadegan, *Unternehmer, Wertewirtschaft* 2009, p. 2

<sup>69</sup> cf. Jesús Huerta de Soto, *Die Österreichische Schule der Nationalökonomie – Markt und unternehmerische Kreativität*. Wien 2007, p. 17

<sup>70</sup> What is considered today as the Austrian School of Economics is a tradition that was founded by Carl Menger during the *Methodenstreit* with German economists. One of Menger's disciples was Eugen Böhm-Bawerk who became the teacher of Joseph Schumpeter and Ludwig v. Mises. One of Mises' students during the 1920ies and 1930ies in Austria was Friedrich A. v. Hayek. After migrating to the US Mises, taught at New York University. Israel Kirzner, one of his students there, became a professor at New York University himself. After Mises' death the Ludwig v. Mises Institute was established in 1982 in Auburn, Alabama. Most of the economists that consider themselves as followers of the tradition of the Austrian School of Economics live in the US nowadays.

For a thorough assessment of the history of the school cf. Jesús Huerta de Soto, *Die Österreichische Schule der Nationalökonomie – Markt und unternehmerische Kreativität*, Wien 2007

uncertainty that has been already discussed. The entrepreneur is acting in an environment of true uncertainty. Because of his special abilities, his confidence in his forecasting human needs and his trust in his own luck, he becomes an uncertainty-bearer. Another thinker that is widely known for his contributions on entrepreneurship is Joseph Schumpeter. He was a student of Eugen von Böhm-Bawerk and lived in Austria but turned away from the principles of the Austrian school and focused more on econometrics in his later years. His understanding of the entrepreneur is that of an innovator who disequilibrates existing situations and elevates the economy on a higher level by introducing a new technology or a new method of production.

We will talk about Ludwig v. Mises, also one of Böhm-Bawerks students, who has a very broad concept of entrepreneurial activity. He believes that there is an entrepreneurial element in every human action since entrepreneurship is always a response to an uncertain future and at the same time an uncertain future is a prerequisite for every human action. But he is also writing about a certain class of human beings who have more initiative and more venturesomeness. Though this role in the economy is not really fitting in Mises' praxeological system, he calls these people promoters and argues their existence with the phenomenon of leadership in every branch of human activity. Friedrich A. v. Hayek, a student of Ludwig v. Mises, writes particularly about entrepreneurship as a discovery process in the economy. Though he did not focus so much on the individual and his role in the ongoing market process of discovering new information, he formulates the crucial argument of the dispersion of knowledge that is part of the foundation of later entrepreneurial theories.

Israel Kirzner is the thinker who develops a consistent theory of entrepreneurship by combining the arguments of Hayek and Mises. He explores the particular entrepreneurial contribution to economics and created a concept of a pure entrepreneur who is alert to hitherto not discovered profit opportunities that he decides to exploit. Kirzner thinks, by referring to Mises, that the entrepreneur has no means of production and is therefore property-less. It is only his alertness that allows him to earn profits. This assumption is heavily criticized by Henry Hazlitt and Jack High, who stress the importance of uncertainty for economic activity, and Murray Rothbard, who emphasizes

the importance of an entrepreneur being at the same time also a capitalist. Kirzner's market theory is that of a situation of disequilibrium (due to the dispersion of knowledge) in which the entrepreneurial activity fulfills a coordinative function and therefore drives the economy towards equilibrium. This theory is challenged by Ludwig Lachmann, who argues against any theory that assumes the possibility of the existence of a direction towards equilibrium within the economy. He uses the term *kaleidic society* introduced by Prof. Shackle to describe an economy in which he thinks the subjective theory of the Austrian school of economics is consistently applied.

The last fellow of the Austrian school of economics we are exploring is Joseph T. Salerno. He advocates a different interpretation of Mises and Hayek than Kirzner does. He is emphasizing the promoter-entrepreneur of Mises and renames it as integral entrepreneur (because promoters have a different connotation nowadays than they had at the time when Mises published *Human Action*). The integral entrepreneur is at the same time also owner and risks his livelihood in order to gain profits. Hence he can also suffer real losses.

This assessment of the different concepts of entrepreneurship shall equip us with a proper understanding of the relationship between uncertainty and entrepreneurship. This is especially important for our final investigation into the true meta-anthropological foundation of economics.

### **3.1 The Judging Adventurer as Bearer of True Uncertainty (Knight)**

The Knightian approach to Entrepreneurship is based on the imperfection of knowledge (which will be one of the main arguments of Hayek as well) and the uncertainty about the future and hence the necessity to anticipate future conditions. The change of these conditions related to the prior anticipation is the underlying cause that gives rise to profit opportunities. For Frank Knight, profit is the difference between fixed costs of production and the uncertain future selling price. Entrepreneurial activity is motivated not by a stimulus in the past but by the future state of affairs and its anticipation. It is therefore characterized as spontaneous and forward-looking. "We *perceive* the world

before we react to it, and we react not to what we perceive, but always to what we *infer*.”<sup>71</sup>

This inference is twofold for Knight. On the one hand, the entrepreneur has to infer the status of the future affairs without his interference. And on the other hand, he has to predict the future conditions including his action. Hence, successful entrepreneurship according to Knight is related to the ability of more accurately anticipating the future state of affairs. But the imagination of the change in the future state of affairs through the entrepreneurial interference is not just *passive anticipation* but rather *active creation* of possible future realities and the action to achieve this future reality. Though this psychological process involves rationality to make judgments from possible future results of activities, there is an essential intuitive process involved in creating the image of the future state of affairs that goes beyond the rationalistic assessment of future profit opportunities.

Hence, entrepreneurship according to Knight requires two essential steps. First, there has to take place a creative process to find out possible outcomes of the future state of affairs. Afterwards, these possible outcomes have to be judged upon their certainty. This judgment on the probability of the results of entrepreneurial activity may not necessarily lead to a decision for the best plan (highest profits) but to the plan that is in the entrepreneur’s eyes most likely to succeed. This “probability” judgment is closely related to the concept of uncertainty. If the future is fundamentally uncertain, how can there be any sort of probability? Knight addresses this question: “More or less based on experience and observation of the outcome of his predictions, it is doubtless principally after all simply an intuitive judgment or “unconscious induction,” as one prefers.”<sup>72</sup>

To clarify the meaning of probability for entrepreneurship, Frank Knight distinguishes three types of probability.<sup>73</sup> (1) *A priori* probability: on the same logical plane as mathematical propositions and can be called as “ultimately” inductions from experience

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<sup>71</sup> Knight, *Risk, Uncertainty and Profit*, 2006, p. 201 [italics in original]

<sup>72</sup> Knight, *Risk, Uncertainty and Profit*, 2006, p. 227

<sup>73</sup> cf. Knight, *Risk, Uncertainty and Profit*, 2006, pp. 224 et seqq.

(2) *Statistical* probability. Empirical classification of instances<sup>74</sup>: evaluation of the frequency of association between predicates, not analyzable into varying combinations of equally probable alternatives. (3) *Estimates*: no valid basis of any kind for classifying instances.

He states the following examples for the three kinds of probabilities. In a game of chance, the instances form a homogenous group and an *a priori* determination of probability is possible. It is more difficult for instances of fire hazards – the probability for these events are due to empirical investigation and are used for statistical probabilities. The third kind of probability can be applied to entrepreneurial activity. Since cases of entrepreneurial action are usually quite unique and very complex and since there is a kind of uncertainty that does not lie within the scope of mathematical calculation, these probabilities are pure estimates. This uncertainty, which Knight calls *true uncertainty*, is the rationale for the existence of enterprises and the justification for the entrepreneurial profit: “It is this *true uncertainty* which by preventing the theoretically perfect outworking of the tendencies of competition gives the characteristic form of "enterprise" to economic organization as a whole and accounts for the peculiar income of the entrepreneur.”<sup>75</sup>

Due to the forward-looking character of entrepreneurial activity, there are two kinds of uncertainty the entrepreneur has to deal with: (1) he has to estimate the results of his economic activity – the quality and quantity of goods he will be able to produce with the available resources and (2) he has to estimate future human wants he would like to satisfy. Knight describes two fundamental and four additional methods of dealing with uncertainty: (1) consolidation and (2) specialization are approaches to group instances of uncertainty. The remaining methods are (3) control of the future, (4) increased power of prediction, (5) diffusion and simply (6) avoidance.

Frank Knight uses the term *adventurer* for a proper description of the process by a person who makes a venture and becomes a bearer of uncertainty. Knight points out that

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<sup>74</sup> Any high degree of confidence that the proportions found in the past will hold in the future is still based on an *a priori* judgment of indeterminateness.

<sup>75</sup> Knight, *Risk, Uncertainty and Profit*, 2006, p. 230 [italics in original]

there is no way to be certain about the future. It is this particular aspect that he is certain about his judgment and evaluation of the future state of affairs that characterizes an entrepreneur. There are some characteristics an entrepreneur should possess in order to be successful. According to Knight, these are<sup>76</sup>: (1) the capacity in *predicting* the future, especially the ability to forecast the conduct of other men, (2) the capacity to *judge means* and plan adjustment necessary for the anticipated future status, (3) the power to *execute* these plans, (4) *confidence* in his decisions and (5) the *conative attitude* to a situation upon which judgment is passed with a given degree of confidence meaning the disposition to "trust in one's luck".

Though Frank Knight is considered the founder of the Chicago school of economics<sup>77</sup>, his basic economic assumptions differ essentially from the teachings of the school today. His emphasis on the uncertainty of the future (the main entrepreneurial argument of Mises) and the imperfection of knowledge (the main entrepreneurial argument of Hayek) draw him very close to the Austrian school of economics. We will now start an assessment of the school's concept of the entrepreneur.

### **3.2 The Innovator (Schumpeter)**

We want to start with Joseph Schumpeter's concept of the entrepreneur. He is widely known for having written extensively on entrepreneurship. He is especially known for his term *creative destruction* implicit in the capitalist economic model; additionally, the entrepreneur as the main destructive force in the economy is a frequently cited passage from one of his later books: *Capitalism, Socialism and Democracy*<sup>78</sup>. This conception has to be understood in the context of his general economic framework. While in his early years he was heavily influenced by the concepts of his teachers Menger and Böhm-Bawerk, he turned very soon in his career to the marginalism of Leon Wallras.<sup>79</sup> While Menger focused on the individual human being and his behavior as most relevant for economic analysis, Wallras introduced to economics what is now known as *general*

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<sup>76</sup> cf. Knight, *Risk, Uncertainty and Profit*, 2006, p. 241f

<sup>77</sup> The Chicago School of Economics is nowadays known for being the source of neoclassical mainstream economics with a distinct econometric approach that wants to assess human behavior by formulating complex mathematical models. Several nobel laureats like Milton Friedman, Gary Becker, Richard Posner, et al. were members of the faculty.

<sup>78</sup> Joseph Schumpeter: *Capitalism, Socialism and Democracy*. New York, London, et al. 2008

<sup>79</sup> Friedrich A. v. Hayek, „Preface“ in Joseph Schumpeter, *Methodological Individualism*, Bruxelles 1980

*equilibrium theory*. This concept paved the way for the takeover of mathematics and statistics in economics and is now a dominant theory in neoclassical economics. The theory assumes that markets are in equilibrium and therefore economic activity can be assessed by building up abstract models and calculating human behavior as homogenous units that act in accordance with mathematical laws. From this point of view, entrepreneurial activity has to be disturbing for equilibrium because it changes the current state of affairs and lifts the market equilibrium on a higher level. But there is no role for the entrepreneur in the state of equilibrium: “The tendency is for the entrepreneur to make neither profit nor loss in the circular flow – that is he has so function of a special kind there, he simply does not exist.”<sup>80</sup>

In Schumpeter’s concept it is not the consumer who brings change about by developing new wants, but the producer who introduces a new combination. He outlines five different cases for new combinations (entrepreneurial activity)<sup>81</sup>: (1) introduction of a new good or a new quality of a good, (2) a new method of production that has not yet been tested by experience, (3) the opening of a new market, (4) the conquest of a new source of supply of raw materials or half-manufactured goods, and (5) the carrying out of the new organization of any industry.

The function of Schumpeter’s entrepreneur is to carry out new combinations. New combinations are not only characterized by their invention by the entrepreneur, but they have to be an innovation and have to be successful on the market. Every individual who is fulfilling this entrepreneurial function can therefore be called an entrepreneur regardless of whether he is connected to an individual firm or if he is dependent in the many ways as employee, manager or in another kind of a relationship to a firm. Schumpeter distinguishes between *entrepreneurs* who carry out new combinations and *capitalists* who own the money.<sup>82</sup> But the entrepreneurial function appears always mixed with other activities.

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<sup>80</sup> Joseph Schumpeter, *Theory of Economic Development*, New Brunswick, London 2008, p. 76

<sup>81</sup> cf. Schumpeter, *Theory of Economic Development*, 2008, p. 66

<sup>82</sup> cf. Schumpeter, *Theory of Economic Development*, 2008, p. 75

Contrary to Knight Schumpeter's entrepreneur is neither bearing risk nor uncertainty. This function is carried out by the capitalist. This is also the reason why Schumpeter sees entrepreneurial profit as a factor payment for the entrepreneurial factor input.<sup>83</sup> Profit is neither gained by the difference between selling price and costs nor by bearing uncertainty, but profit is a component of the factor costs. This is as a matter of fact a fundamentally different conception compared to Frank Knight or the views of some economists of the Austrian school of economics. We will also see that this is one of the main reasons for disputes within the tradition of the Austrian school.

### 3.3 The Promoter (Mises)

Ludwig v. Mises has a very general concept of entrepreneurship. It is directly linked to uncertainty and to human action. All human action is carried out to remove uneasiness; uneasiness exists and can be removed because time and the future matter and because there is uncertainty about the future. So all human action is done under a condition of uncertainty and has therefore entrepreneurial character. Mises rejects the notion of an *evenly rotating economy* completely (something like a general equilibrium, stressed by Leon Walras and his disciples) – he is convinced that there is no such status possible in the world because this would mean to remove all uneasiness. Since human action would not take place because there is no uncertainty, he compares this status with an ant hill.<sup>84</sup> He distinguishes the different procedures adopted by economists as either the *logical method*, which recognizes uncertainty and the role of the entrepreneur in the economy, or the *mathematical method*, which reduces these fundamental realities to a model that lies within the scope of the technique. Mises considers his own approach as an application of the logical method to economics.

For Mises, entrepreneurship has a distributive role in economics and hence has to be very broad. Nonetheless he acknowledges a narrower notion of this function in regard to persons 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

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<sup>83</sup> cf. Joseph Schumpeter, *Capitalism, Socialism and Democracy*, New York/London 2008 p. 83

<sup>84</sup> cf. von Mises, *Human Action*, 2006, p. 248

improvement.”<sup>85</sup> He calls these persons *promoters*. For Mises, the entrepreneur-promoter is not possible to be reflected properly in the praxeological system. But Mises admits that due to the inequality of men, there are people in the market who can be considered as promoters and have an important role as pacemakers and as the driving force in the market economy. The phenomenon of leadership exists in economics like in all other aspects of human life. Promoters have the supreme ability to be the first in understanding the discrepancies between what is done and what could be done and, with their speculative ventures, they are the ones who revolutionize afresh prices each day.

Though Mises has a very general concept of the entrepreneurial aspects of human action, he developed more specifically the idea of the *entrepreneurial function*: “The specific entrepreneurial function consists in determining the employment of the factors of production. The entrepreneur is the man who dedicates them to special purposes.”<sup>86</sup> Though the entrepreneur acts motivated by selfish interest, his profit depends on the approval of his conduct by the consumer – so he can only succeed if he best serves the consumer. The entrepreneur decides how much money shall be invested in particular lines of business, the size of the total business, the main sections and the financial structure. Mises calls these decisions *judgments* about the future states of the market. These decisions are made by the entrepreneur alone – any help in gathering the necessary information for these decisions by experts from the fields of law, statistics and technology are only ancillary in nature. The execution of the decision may be entrusted to managers.

The entrepreneur hires different people to carry out definite kinds of work but *qua* entrepreneur he is the one who directs his labor toward definite goals. Mises describes a *manager* as a junior partner of the entrepreneur who serves the entrepreneurial function as best as possible due to his own financial interest but whose sphere of action is limited and precisely determined. Double-entry book-keeping makes it possible for the entrepreneur to not be involved in too much detail but to be able to build a managerial hierarchy. Within this system of business calculation, the firm is separated in different entities and the entrepreneur can assign to the different management sections a great

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<sup>85</sup> von Mises, *Human Action*, 2006, pp. 254 et seq.

<sup>86</sup> von Mises, *Human Action*, 2006, pp. 290 et seq.

deal of independence. The only directive he gives to the management is to make as much profit as possible.<sup>87</sup> But the managerial function is always subservient to the entrepreneurial function that controls the factors of production and brings the entrepreneurial profit or loss. Mises thinks that it is not important if the manager's income is in proportion to the profit earned by his section because he is under any circumstances interested in the success of that part of the business that has been entrusted to him. It can even become counterproductive for the entrepreneur if he gives the manager completely free hands in his operations because he would speculate with the entrepreneur's money without being accountable for the losses.

Mises' concept of *profit* has also quite a broad meaning according to his very general concept of entrepreneurship. "Profit, in a broader sense, is the gain derived from action; [...] it is the difference between the higher value attached to the result arraigned and the lower value attached to the sacrifices made for its attainment"<sup>88</sup>. Mises characterizes profit and loss as *psychic phenomenon* and therefore not open for measurement. Applied to market economics in a context of money, profit can be gained through different prices. This profit is however a *social phenomenon* and reflects the appraisal of one's contribution to societal effort by the other members of society. Mises links entrepreneurial profit, like Knight, to the ability to anticipate future, uncertain events. The better he is able to anticipate these future states of affairs, the more successful he will be. Entrepreneurial profits and losses are created through a discrepancy between anticipated prices and real prices in future markets.

Mises distinguishes *entrepreneurial profit* in a stationary economy from that in a progressing economy. In a stationary economy profits have to be counterbalanced by other entrepreneur's losses. In a progressing economy additional capital goods are injected into the economy and the total sum of income produced is increased. This raise of income is due to an expansion of production or to the improvement of technological methods. In a progressing economy entrepreneurial profit is a share of this increase in the total sum of new generated income. But Mises points out that the laws of the market divide this additional wealth among the different participants (suppliers of labor and of

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<sup>87</sup> cf. von Mises, *Human Action*, 2006, p. 306

<sup>88</sup> von Mises, *Human Action*, 2006, p. 289

certain material factors of production) and the lion's share goes to the non-entrepreneurial groups.<sup>89</sup>

Due to a tendency of the market to always move in the direction of final prices and the final state of rest, entrepreneurial profit is not a lasting phenomenon but always temporary. And there is no relation of profit or loss to the employed capital – profit or loss is only determined by the entrepreneur's ability to adjust to the change in demands of the consumer. So the entrepreneurial function – the entrepreneur's striving for profits – is the driving force of the economy; profits and losses are devices of the consumers to exercise supremacy on the market and are also a reflection of the consumers' most urgent needs. This supremacy also shifts the means of production from less efficient to more efficient agents in the market.<sup>90</sup> What is popularly considered as profit is the dividend of a corporation. Mises clarifies that this is mere interest on the invested capital plus part of the profit that is earned and not reinvested back into the business.

### **3.4 The Discoverer (Hayek)**

Hayek's notion of the entrepreneurial process is closely linked to his knowledge argument for a free economy. Since we do not know the special circumstances of agents in the market, entrepreneurship and competition are necessary. Hayek considers competition “systemically as a procedure to discover facts”<sup>91</sup>. Hayek's approach to entrepreneurship is rather systematic. He does not focus on the procedure that takes place in the entrepreneurial act (like Knight), he does not describe the characteristics of the entrepreneurial person (like Mises) but he focuses on the results and the necessity of entrepreneurship and competition in the market process. Hayek admits that the validity of the theory of entrepreneurship can never be empirically verified because it is by definition a method to discover not yet known facts.

Hayek mentions that all discovery processes and science in general cannot be empirically proven – the established methods are employed because they have produced

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<sup>89</sup> cf. von Mises, *Human Action*, 2006, p. 295

<sup>90</sup> cf. von Mises, *Human Action*, 2006, p. 299

<sup>91</sup> Friedrich A. Hayek, “Competition as a Discovery Process” in *The Quarterly Journal of Austrian Economics*, 2002, p. 9

better results than others in the past. The difference of economic and scientific discovery process is that the former focuses on temporary circumstances while the latter is seeking general facts. Hence the theory of competition in economics cannot be used to predict particular events in the future. This would be possible only in a true economy, a uniform scale of values determining the needs that are satisfied and those that are not. Hayek therefore usually uses the word *catallaxy*<sup>92</sup> for the market economy where a spontaneous order by the process of competition is established and is a result of an inhomogeneous scale of values.

Hayek distinguishes the situation in developed and not yet developed countries. Poor countries are even more in need of sound procedures of competition because this is also some sort of impersonal coercion that can bring about changes in individual's behavior that are not possible through instructions or commands.<sup>93</sup> People who want to try out possibilities and improve their situation are necessary for competition. Hayek states that he has observed mostly the same proportion of people everywhere who are willing to act entrepreneurially unless they are prevented from that.

Some facts competition should explore are which goods are scarce, which things are goods and how scarce or valuable they are. A field in which competition is still inefficient is one factor of production: human labor. Hayek calls one of the main problems of economic policy the rigidity of wages.<sup>94</sup> Since there is no competition among workers there are a lot of implications not only for monetary theory but also for entrepreneurial activity. The shortages on the labor market due to the policies implemented by the trade unions are not only causing higher unemployment rates but are also stifling entrepreneurial ventures in the market economy because the real value of one of the factors of production cannot be discovered but is given through legislation.

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<sup>92</sup> This term was used by F.A. Hayek in *Law, Legislation, and Liberty*, Vol. 2, pp. 108–9 in order to describe the market with a better word than economy. The greek roots of economy imply some sort of shared ends – catallaxy is interaction of agents with different ends.

<sup>93</sup> cf. Hayek, “Competition as a Discovery Process”, 2002, p. 19

<sup>94</sup> cf. Hayek, “Competition as a Discovery Process”, 2002, p. 22

### 3.5 The Alert, Equilibrating Arbitrageur (Kirzner)

Israel Kirzner is considered the main thinker in the Austrian School of Economics who developed the concept of human action and the entrepreneurial element therein to a full concept of entrepreneurship. This concept is closely linked with the term *alertness*. Together with Joseph Schumpeter he is one of the main thinkers who reflects on the entrepreneur in 20<sup>th</sup> century economic theory. Kirzner works on a synthesis between Mises and Hayek and considered their writings as complementary. “From Mises the Austrians learned to see the market as an *entrepreneurially driven process*. From Hayek they learned to appreciate the role of *knowledge* and its enhancement, through market interaction, for the equilibrative process.”<sup>95</sup> He outlines a theory of a competitive market economy that is driven by the entrepreneurial discovery process and is always in disequilibrium while the coordinating function of the entrepreneur is the main reason why it tends systematically towards equilibrium.

In his first book *Competition & Entrepreneurship* in 1973, Kirzner outlined his theory of the *pure entrepreneur*, who is the price maker and exploits previously unnoticed profit opportunities. While the entrepreneurial discovery process in his early work has still quite large aspects of mechanical connotation (though he rejects these connotations and relates them to the economizing behavior in equilibrium theory), he puts more and more emphasis on the role of uncertainty and the speculative element of entrepreneurship in his later work.<sup>96</sup>

#### *Nature of Entrepreneurship*

Kirzner distinguishes the entrepreneur clearly from the capitalist and the hired manager. The role of entrepreneurship in the market is elusive. Entrepreneurial activity is an element present in all human action that is crucial to economizing activity in general but cannot itself be analyzed in terms of economizing, maximizing or efficiency criteria. Kirzner calls this aspect of human action the *entrepreneurial element*. Due to this fact that the “extraeconomic” activity of entrepreneurship is such a crucial factor in

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<sup>95</sup> Israel M. Kirzner, “Entrepreneurial Discovery and the Competitive Market Process: An Austrian Approach”, in *Journal of Economic Literature*, 1997, p. 67

<sup>96</sup> cf. Kirzner, “Entrepreneurial Discovery and the Competitive Market Process: An Austrian Approach”, 1997

economics in general, the argument of individual maximizing activities within the market process is not fully appropriate for the understanding of economic phenomena. Entrepreneurial activity is outside of the scope of maximizing behavior.<sup>97</sup> Kirzner emphasizes that his concept of the entrepreneur is pure and does not possess any capital. Kirzner calls the entrepreneurial ability to discover hitherto unnoticed profit opportunities *alertness*.

While his book was appreciated in many ways by his colleagues, some also pointed out weaknesses in his concept of the pure entrepreneur. Henry Hazlitt for example is one of the early reviewers of Kirzner's book. He gives credit to Kirzner's contribution to price theory but he criticized Kirzner of "overstress[ing] the entrepreneur's alertness and perception while under-emphasising his courage in taking risks."<sup>98</sup> Hazlitt alleges that Kirzner uses the term entrepreneur only for the successful entrepreneur. Hazlitt's view is on the contrary that the entrepreneur not only has to be alert but he also must act on his alertness. By acting he is a *capitalist plus* – a capitalist willing to take unusual risks.

### ***Decision Making and Economizing***

Kirzner criticizes harshly the Robbinsian<sup>99</sup> understanding of the market process that is made up of individuals who want to satisfy by their actions as many of their goals (according to their preference) as possible. He points out that especially this understanding of a given hierarchy of ends and the corresponding means to achieve these ends are misleading to an emphasis on equilibrium situations of markets, which Kirzner generally rejects. From Kirzner's point of view, there would be no chance for exogenous elements to change circumstances and therefore no market process could be created. Hence, Kirzner turns to the Misesian term human action with its broader meaning of the acting individual motivated not just to apply certain means to given ends but to generally remove uneasiness. Kirzner admits, the Robbinsian model of economizing man may explain the phenomenon of cost-conscious search for

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<sup>97</sup> cf. Israel M. Kirzner, *Competition & Entrepreneurship*, London/Chicago 1973, p. 31

<sup>98</sup> Henry Hazlitt, *Competition & Entrepreneurship by Israel M. Kirzner*, The Freeman 1974, p. 759

<sup>99</sup> Kirzner uses *An essay on the Nature and Significance of Economic Science* written by Lord Robbins in 1932

information in the market but the given means-ends framework is not appropriate to investigate the market process as such.

Kirzner introduces the term *alertness* for describing the entrepreneurial aspect of human decision-making.<sup>100</sup> This notion stands for the understanding of human action as active, creative and human instead of passive, automatic and mechanic. The calculating aspect in human action is present but only partially and after the decision-maker has identified the relevant circumstances. The applied means-ends framework has to be perceived before it can be used as ground for decision-making. The recognition of an entrepreneurial element in human action not only helps to complete the allocative explanation of human action but it makes it possible to view a succession of different decisions by one individual as a *sequence*.<sup>101</sup> Hence a change in individual's decisions can be considered as a learning process generated by the experience of the decisions themselves. If there occurs such a change in decisions within a given means-ends framework this has to be understood as discontinuity.

### ***In the Market***

Kirzner admits that in a world of perfect knowledge and prediction the mechanical interpretation of decision-making would work perfectly and he points out that the assumption of perfect knowledge in the economy would immediately remove all entrepreneurial elements from society. A world of imperfect knowledge gives meaning to a role in the economy that was by definition hitherto excluded and is entirely incapable of being characterized as economizing: The “*pure entrepreneur*, that is, a decision-maker whose *entire* role arises out of his alertness to hitherto unnoticed opportunities”<sup>102</sup>. The pure entrepreneur is that he is a decision-maker without any means. In a world of perfect knowledge, this concept of course would make no sense because without means no action would be possible. But in a world of imperfect knowledge unexploited profit opportunities always exist. These unexploited profit opportunities (buyers who have paid too high prices, sellers who have received too little prices) open up a scope of decision-making that is not economizing at all. The decision-

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<sup>100</sup> cf. Kirzner, *Competition & Entrepreneurship*, 1973, p. 35

<sup>101</sup> cf. Kirzner, *Competition & Entrepreneurship*, 1973, p. 36

<sup>102</sup> Kirzner, *Competition & Entrepreneurship*, 1973, p. 39 [italics in original]

maker in a world of imperfect knowledge simply has to know where the unexploited profit opportunities are. If he has alertness for these opportunities, he can only be aware of them and discovers them. This is impossible if he is trying to satisfy his ends by behaving economizing.

Randall Holcombe, a fellow of the Austrian school of economics currently teaching at Florida State University, enhances Kirzner's theory of entrepreneurship in a paper in 2003 on the *Origins of Entrepreneurial Opportunities*<sup>103</sup>. He illustrates how entrepreneurship enlarges the stock of future entrepreneurial opportunities. Entrepreneurship is portrayed as the engine for economic progress. Kirzner writes about entrepreneurial opportunities that can be discovered, but he does not cover the issue where these hitherto unnoticed entrepreneurial opportunities come from. Since the entrepreneur, according to Kirzner, only discovers and does not create the profit opportunity, we could think that there is a fixed stock of entrepreneurial opportunities and that each entrepreneurial act diminishes the amount of future profit opportunities. Holcombe points out that the opposite is true. He distinguishes between three sources of entrepreneurial opportunities: (1) factors that disequilibrate markets, (2) factors that enhance production possibilities, and (3) the effects of entrepreneurial activities themselves.<sup>104</sup> Disequilibrating factors are changes in tastes, technologies, or available resources – usually the factors for economic activity in a neoclassical general equilibrium framework. Enhancing factors of production possibility are usually the extension of markets or the increase of income that allow new production methods to produce more profit. But, as Holcombe argues, the most important source for entrepreneurial opportunities is entrepreneurship itself.

If an entrepreneur discovers a better process for producing an existing product, this also creates opportunities for potential input suppliers. Thus there is not a stock of entrepreneurial opportunities that can be used up as entrepreneurs take them; rather when entrepreneurs act on one opportunity they create additional entrepreneurial opportunities, so the more entrepreneurship there is in an economy, the more entrepreneurial

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<sup>103</sup> cf. Randall Holcombe, "The Origins of Entrepreneurial Opportunities" in *The Review of Austrian Economics*, 2003

<sup>104</sup> cf. Holcombe, "The Origins of Entrepreneurial Opportunities", 2003, pp. 29 et seqq.

opportunities will be available for others. Entrepreneurship leads to more entrepreneurship.<sup>105</sup>

Holcombe distinguishes entrepreneurship from research and development. Research and development (R & D) does not produce an environment for profit opportunities *per se*. Nevertheless, according to Holcombe, entrepreneurial opportunities are more likely to exist in such an environment because R&D discovers new knowledge that is one factor for increased alertness. Thus to contribute to economic progress, R & D has to focus on discovering new entrepreneurial opportunities and these opportunities should also be exploitable. Entrepreneurship itself cannot be “produced” but an environment in which entrepreneurial opportunities can be discovered and exploited can be created.

Turning back to Kirzner’s investigation into entrepreneurship within the market, he separates the components of entrepreneurial and economizing aspects of human action. This is an artificial model because all human action is endowed with an entrepreneurial element since human action is a response to the uncertainty of the future. For the sake of analyzing human decisions, he uses this expedient assumption to separate human action into two entirely different components: the *passive economizer* and the *pure entrepreneur*. The economizers are passive price-takers optimizing against the background of assumed data. The activity of the pure entrepreneur is the source for all changes in prices, qualities and quantities of input and output.<sup>106</sup>

This distinction is also valid for the function of the *producer*. In his producer-function he contributes his coordinating work as a factor to the production of goods. In his economizing-function, he is a mere *price-taker*. What is commonly recognized as theory of production, according to Kirzner, has nothing to do with entrepreneurship. As economizer the producer is a mere resource-owner and his action does not contain entrepreneurial aspects. If the revenue and cost-function are known, producing is merely a matter of calculation and the solution is already embedded in the data about revenues and costs.

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<sup>105</sup> Holcombe, “The Origins of Entrepreneurial Opportunities”, 2003, p. 41

<sup>106</sup> cf. Kirzner, *Competition & Entrepreneurship*, 1973, pp. 37 et seqq.

The pure entrepreneur as producer acts mainly *between* resource and product markets. Imperfect transactions between these two markets are likely to contain many unnoticed opportunities for more efficient uses of resources. This lack of coordination is reflected in price differences and opens up opportunities for pure entrepreneurial activity. “This activity will consist exclusively in buying resources and selling products.”<sup>107</sup> The producer as a pure entrepreneur does not contribute any resources whatsoever and is neither hiring a working team nor buying all needed resources for carrying out the transaction.

### ***Profits***

For Kirzner, to distinguish between purely entrepreneurial profit and other forms of profit, the *decision* to act entrepreneurial is crucial. Entrepreneurial profit is generated by the following process: discovering an hitherto unnoticed difference in buying and selling prices, deciding to exploit this opportunity, and buying a good in order to sell it for a higher price at a later time. In this process no assets and resources other than the alertness for the opportunity are involved. Kirzner concludes: “The discovery of a profit opportunity *means the discovery of something obtainable for nothing at all.*”<sup>108</sup>

There might be profit opportunities involving time-consuming activity which can also be considered as a resource. Also, the high selling price might not yet be available when the buying price has to be paid. In order to gain pure entrepreneurial profit the expected selling price has to be big enough to surpass an interest rate that is attractive enough to persuade someone to lend the money to the entrepreneur. The money lender can of course be the entrepreneur himself. Hence, he would be entrepreneur and capitalist united in one person. But still, there is a particular difference between pure profit and pure interest and the role of the pure entrepreneur does not overlap with the role of the capitalist.

Kirzner also discusses the problem of the particular point of time when a good is sold that has been purchased previously for a lower price. This could also be considered as a mere economizing act, searching for the highest price possible on the market. This is

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<sup>107</sup> Kirzner, *Competition & Entrepreneurship*, 1973, p. 44 [italics in original]

<sup>108</sup> Kirzner, *Competition & Entrepreneurship*, 1973, p. 48 [italics in original]

not the case because the “surplus of selling price over buying price is indeed pure profit *if it is related back to the original entrepreneurial decision*”<sup>109</sup>. Profit always has to be related back to the original decision. He gains no profit if the selling transaction is carried out independently from his original buying transaction. Obviously it is not easy to determine when exactly the decision for a particular transaction was made. Kirzner’s believes that *at the same time* a receipt can be viewed as pure entrepreneurial profit *and* also something other than profit. The character of a particular receipt depends on the character of the decision made.

Kirzner’s concept of profits is challenged by Murray Rothbard in a book review. He praises Kirzner’s elaboration of the Mises-Hayekian approach to entrepreneurship but criticizes him on one of the core assumptions of his theory: the non-owning, almost ethereal being of the entrepreneur which Rothbard considers as being neoclassical and for sure not Austrian. “This is an unfortunate departure from the basic Austrian insight that the entrepreneur and the capitalist are one and the same, and that therefore the capitalist-entrepreneur always tries to maximize, not the *amount* of his profit, but the rate of *return* on his capital.”<sup>110</sup> According to Rothbard his assumption leads to the incorrect understanding that profit is only a competitive return and has negative implications for the theory of monopoly.

### ***Knowledge***

Kirzner also rejects the concept of entrepreneurship that supposes superior command over information. In this concept, the entrepreneur is a person who just knows more about resources, prices and products. Profits are due to this superior knowledge. Again, this knowledge could be hired and is therefore a special kind of a productive factor and not the essence of entrepreneurship. Therefore, alertness is not the possession of special knowledge about the market but “the ‘knowledge’ of where to find market data”<sup>111</sup>. The entrepreneur who is alert then hires people with superior knowledge.

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<sup>109</sup> Kirzner, *Competition & Entrepreneurship*, 1973, p. 50 [italics in original]

<sup>110</sup> Murray Rothbard, “Competition and Entrepreneurship. By Israel M. Kirzner”, in *Journal of Economic Literature* 1974, p. 903

<sup>111</sup> Kirzner, *Competition & Entrepreneurship*, 1973, p. 67

Since knowledge of substantive market data can be hired, this might also be possible for alertness. But someone who hires an employee with alertness has shown himself of even greater alertness. Kirzner identifies a particular order of knowledge - entrepreneurial knowledge has the highest order. Not even hiring a factor of production is an essential entrepreneurial decision because an entrepreneur can also hire someone with the talent of making wise hiring decisions. Only the ultimate hiring decision is essential for the entrepreneur.

In his later works, Kirzner also introduces the term of *surprise* as an essential element for the discovery of opportunity for profits.

What distinguishes *discovery* (relevant to hitherto unknown profit opportunities) from *successful search* (relevant to the deliberate production of information which one knew one had lacked) is that the former (unlike the latter) involves that *surprise* which accompanies the realization that one had overlooked something in fact readily available.<sup>112</sup>

This surprise has nothing to do with happy accidents but is a succession of natural alertness to unexploited profit opportunities. This notion of discovery is situated in the midway between deliberately produced information and sheer windfall gain generated by pure chance.

### ***Equilibrating Process***

One important insight Kirzner emphasizes is the understanding of the market rather as a process than as equilibrium. The market is constantly in a situation of disequilibrium and ignorance is widespread. Many profit opportunities are count up because the market participants are not aware of them. The mechanical Robbinsian theory lacks an explanation how the economizing man can overcome this situation. There is no theory how yesterday's plans are replaced by new ones. Kirzner points out that men can learn from their experience. Expectations can change. Entrepreneurs can learn from mistakes of market participants in the past that produced less-than-optimal results of their actions. This also creates corresponding alteration in plans.<sup>113</sup>

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<sup>112</sup> Kirzner, "Entrepreneurial Discovery and the Competitive Market Process: An Austrian Approach", 1997, p. 72

<sup>113</sup> cf. Kirzner, *Competition & Entrepreneurship*, 1973, p. 71

Ludwig Lachmann criticizes this notion of the equilibrating process and published a paper called *From Mises to Shackle: An Essay on the Austrian Economics and the Kaleidic Society*. In this paper he attempts to apply the theories of Professor Shackle's *Epistemics and Economics* to the Austrian School of Economics. The article was written to attack the common assumption of neoclassical economics, particularly the general equilibrium theory. Lachmann wants to find a common outlook of Shackle and Mises by examining the Austrian position with regard to Shackle's *kaleidic society*, a society of unpredicted changes, "interspersing its moments or intervals of order, assurance and beauty with sudden disintegration and a cascade into a new pattern"<sup>114</sup>.

In neoclassical theory, as Lachmann points out, there is no difference between data and knowledge. But in fact we can distinguish these two concepts in the following way: data must be measurable, knowledge is not. All assumptions of knowledge connected with the general equilibrium theory are therefore to some extent problematic. According to Lachmann, the Austrian school of economics has a different approach. Hayek's dispersion of knowledge serves as a basis for the further developed theory about the creation of new knowledge. This new knowledge is created either exogenously by technical progress and discovery of new resources by alert minds or endogenously within the market by the same alert minds exploiting profit opportunities from changes in the pattern of relative prices. Mises coins the term praxeology derived from Max Weber's writings. Praxeology focuses the science of economics on human action. For Mises, Human action is by definition rational but there is no constancy in human action. "Only in one respect can acting be constant: in preferring the more valuable to the less valuable. If the valuations change, acting must change also."<sup>115</sup>

Lachmann, by following Mises, puts an emphasis on the concept of time in economics. Mises criticizes that the mechanical measurement of time is only measuring the past and that philosophical concepts of time only consider the past and the future. The presence is usually just the point that separates the two. By referring to Bergson, Mises puts an emphasis on the present in which action takes place and reality is embodied. Mises and

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<sup>114</sup> G. L. S. Shackle, *Epistemics and Economic: A Critique of Economic Doctrines*, Cambridge 1972, p. 76

<sup>115</sup> von Mises, *Human Action*, 1996, p. 113

Shackle also share the opinion that it is not an appropriate to use probabilities in order to deal with uncertainty in human action. As discussed earlier, Mises distinguishes two concepts of probability: (1) Case probability, which is not open to numerical evaluation, and (2) class probability.

Lachmann points out that Shackle differs from Mises and Hayek in three main points:<sup>116</sup> (1) he has applied subjectivism not only to tastes but also to expectations, (2) he puts a challenge on the assumption that the market has a coordinating function for expectations and (3) especially in stock markets there is no tendency at all towards a long-run equilibrium. The subjectivity of expectations is at the core of these three assumptions. Expectations are the anticipation of future knowledge. But there is no ordering process of expectations in the market that substitutes old knowledge with superior knowledge. Superior expectations do not exist because expectations never turn into reality. In the stock market where the volatility is much higher than in product markets this is particularly true. These asset markets are inherently restless. While in the product market the achievement of equilibrium is possible to some extent, according to Lachmann, this is totally different in asset markets. Since titles on permanent income streams are traded there, there are no dates that could move nearer and cause more certainty about the future prices and thus yields the price development towards equilibrium.

Lachmann rejects the existence of a direction of the market process towards a state of equilibrium for product markets to some extent but especially for asset markets. The reality of Shackle's kaleidic society is an ultimate application of the subjectivity principle to economics. Since the future is uncertain, unexpected changes in knowledge and expectations can always occur. The kaleidic society, as Lachmann points out, is attractive to be considered as part of an Austrian approach to economics. It applies consistently of the core principles of the Austrian school of economics.

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<sup>116</sup> cf. Ludwig M. Lachmann, "From Mises to Shackle: An Essay on Austrian Economics and the Kaleidic Society", in *Journal of Economic Literature* 1976, pp. 59 et seq.

## *Uncertainty*

Israel Kirzner has put more emphasis on the phenomenon of uncertainty in his later works. While in *Competition & Entrepreneurship* he leaves almost no role of uncertainty for entrepreneurship, he considers this element later particularly in responses to various critiques. By introducing time as an important factor in his theory he broadens his concept of alertness. He adds the aspect of the response to an uncertain future. This is not a mere passive response but an active vision of the future that also motivates man to act according to this vision. “We call this motivated propensity of man to formulate an image of the future man’s *alertness*.”<sup>117</sup> This broader alertness now includes ways in which human agents can create the future by imaginative, bold leaps of faith and determination. Kirzner sticks to his principles when he outlines that the entrepreneurial element in human action has two aspects: (1) a function to perform, to create a vision (2) that is always motivated by profit opportunities switching on alertness.

Introducing time implies that human action not only considered as a single-period case (alertness only discover hitherto unnoticed opportunities) but also as a multi-period case (active creation of a vision of the future is possible). “In particular the futurity that entrepreneurship must confront introduces the possibility that the entrepreneur may, by his own creative actions, in fact *construct* the future as *he* wishes it to be.”<sup>118</sup>

Though this creative element is important for entrepreneurship, the entrepreneur is still motivated by profits and he has in fact a coordinative role in the economy reducing gaps of different prices on the factor and the product market. The entrepreneur is not solely an uncertainty-bearer but he rather pushes aside the swirling fogs of uncertainty. In 1997, Kirzner uses not uncertainty but the term “sheer” ignorance or unknown ignorance when he discusses the phenomenon of imperfection of knowledge.

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<sup>117</sup> Israel M. Kirzner, “Uncertainty, Discovery and Human Action: A Study of the Entrepreneurial Profile in the Misesian System”, in *Method, Process, and Austrian Economics. Essays in Honor of Ludwig von Mises*. Massachusetts 1982, p. 149

<sup>118</sup> Kirzner, “Uncertainty, Discovery and Human Action”, 1982, p. 155

Jack High criticizes Kirzner for not having considered uncertainty in a proper way before his article in 1982. According to High, Kirzner was always dealing with ignorance and considering entrepreneurship as a process that is removing ignorance.<sup>119</sup> Kirzner, in his later writings, believes that uncertainty provides an additional scope for entrepreneurship but is not fundamentally changing the subject of entrepreneurship. An entrepreneur is in fact an active bearer of uncertainty (he peers through the fog) and entrepreneurial activity involves foresight and judgment. But these facts are not sufficient for alertness in the Kirznerian sense.<sup>120</sup> According to High, Kirzner wants to develop the idea of entrepreneurship according to the teachings of Mises. But in doing so, he drifts apart in significant ways from his teacher's concept of entrepreneurship. For Mises, uncertainty is an essential element of the entrepreneurial aspect in human action.

### ***Schumpeter and Knight***

Kirzner identifies similarities between his theory and Schumpeter's model: the entrepreneur does not contribute factor services of production and the profit is not compensation necessary to attract the input of the entrepreneur into the production process. Imperfect knowledge creates for both theories a scope for an additional dimension of decision-making that cannot be fitted into the Robbinsian ends-means framework.

The main difference between Schumpeter and Kirzner is the fact that the Schumpeterian entrepreneur acts disequilibrating. By initiating change, he generates new opportunities and disturbs an existing equilibrium. The entrepreneur is an exogenous force, not crucial for the market process in the status of equilibrium. He breaks away from the routine and is therefore able to create temporary gaps between price of inputs and outputs. For Kirzner, on the other hand, the entrepreneur "brings into mutual adjustment those discordant elements which resulted from prior market ignorance"<sup>121</sup>. He is not a creator ex nihilo but is alert to opportunity and exploits opportunities that already

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<sup>119</sup> cf. Jack High, "Alertness and Judgment: Comment on Kirzner", in *Method, Process, and Austrian Economics. Essays in Honor of Ludwig von Mises*. Massachusetts 1982, p. 161

<sup>120</sup> cf. High, "Alertness and Judgment: Comment on Kirzner", 1982, p. 163

<sup>121</sup> Kirzner, *Competition & Entrepreneurship*, 1973, p. 73

existed and were waiting for being noticed. The function of Kirzner's entrepreneur is not shifting curves of costs and revenues but noticing that they have already shifted.

Kirzner identifies two main similarities with Frank Knight's concept of the entrepreneur: (1) Ultimate control is intertwined with the concept of ultimate responsibility and both are essential for entrepreneurship. He relates these concepts with his own notion of ultimate knowledge, which is alertness. (2) Knight points out that in the theory of the firm profit is generated dynamically by entrepreneurial decisions due to uncertainty. This concept is related to necessity of alertness within the firm in order to generate entrepreneurial profit.<sup>122</sup>

Kirzner discovers a difference in Knight's overemphasis of uncertainty. Kirzner is missing some essential characteristics of the entrepreneur in Knight's theory. An entrepreneur does not act because the future is uncertain but because he sees an attractive profit opportunity in this uncertain future of which he believes in being able to exploit this opportunity. Hence, for Kirzner, it is rather the alertness to profit opportunities that is the essential entrepreneurial element than to bear uncertainty.

### **3.6 The Integral Entrepreneur (Salerno)**

Joseph T. Salerno is another fellow of the Austrian school of economics who develops his own theory based on Mises Hayek and Rothbard. According to Salerno, in this tradition there exist also other concepts than the Kirznerian entrepreneur who is a pure decision-maker with superior alertness but owns no resources. Salerno quotes Mises: "The function of the entrepreneur cannot be separated from the direction of the employment of the factors of production for the accomplishment of definite tasks. The entrepreneur controls the factors of production; it is this control that brings him either entrepreneurial profit or loss."<sup>123</sup>

Salerno traces the origin of the contemporary conception of the entrepreneur as propertyless and pure decision-maker who earns profits by discovering back to Kirzner.

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<sup>122</sup> cf. Kirzner, *Competition & Entrepreneurship*, 1973, pp. 82 et seqq.

<sup>123</sup> von Mises, *Human Action*, 1996, p. 302

He misinterpreted Mises' analytical approach to the various factor incomes in the market economy. Mises always emphasized that his concept of the pure entrepreneur is just an imaginary construction and that the fullness of entrepreneurial activity in the real market process is captured by the *promoter-entrepreneur*. Salerno redubs this concept with the phrase "integral entrepreneur"<sup>124</sup>. Salerno examines how this misunderstanding could have come across. The pure entrepreneur in Mises' writings is introduced to separate incomes from different functions which are purely imaginary. The laborer earns wages by disposing labor services, the landowner and capitalist earn a pure interest return by refraining from present consumption, and the entrepreneur earns profits or suffers losses by his ability in anticipating the changes of the market data. Uncertainty of the future in all of these functions causes a speculative element which implies entrepreneurial gains or losses. According to Mises, these gains and losses purely psychic and never monetary.<sup>125</sup> The concept of the pure entrepreneur was invented to isolate and analyze implication of uncertainty for the formation of catallactic incomes (monetary profits and losses).

### ***Integral Entrepreneur***

Salerno points out that the entrepreneur who is not bearing the losses of his failed venture is in fact an employee of the capitalist and the property owner is the real entrepreneur in this relationship. He is the only one who can bear the burden of uncertainty. Mises uses the term "promoter" to describe persons in the economy that are especially eager to profit from adjusting production to the expected changes in conditions. They have quicker eye than the crowd. They are the pushing and promoting pioneers of economic improvement. Since the term promoter is nowadays used for someone who arranges financing for big events the expression is misleading.

Therefore, Salerno suggests to use the phrase "'integral' entrepreneur who integrates the praxeologically indivisible roles of uncertainty bearer, capital investor, and property owner."<sup>126</sup> The concept of the integral entrepreneur is limited to certain human beings

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<sup>124</sup> Joseph T. Salerno, "The Entrepreneur: Real and Imagined", in *Quarterly Journal of Austrian Economics* 2008, p. 190

<sup>125</sup> cf. Salerno, "The Entrepreneur: Real and Imagined", 2008, p. 192 (footnote)

<sup>126</sup> Salerno, "The Entrepreneur: Real and Imagined", 2008, p. 194

with specific characteristics. They earn their livelihood in risking their property to gain entrepreneurial profits. Mises calls them pacemakers and relates the phenomenon of their existence to the general phenomenon of leadership in other branches of human activity. The monetary success of the entrepreneur is usually ranked by his ability to fulfill consumer's wants. He is eager to apply the cheapest production methods available. The integral entrepreneur promotes himself into the position of organizing and directing the factors of production. But not all property owners and capitalist-investors are integral entrepreneurs. This requires also being first in understanding the discrepancy between what is done and what could be done. For Mises the concept of the promoter is like the concept of money – it cannot be defined with praxeological rigor – only by historical judgment.

### *Pre-Miseans*

Salerno investigates the most important influences on Mises for his concept of the integral entrepreneur starting with Carl Menger. Menger enumerated four aspects of entrepreneurial activity: (1) obtaining information about the economic situation, (2) economic calculation of revenues and costs to ensure sufficiency, (3) an act of will to assign goods of higher order to a particular production process, (4) supervision of the execution to secure an economic production. The entrepreneur, who is also the owner of the firm, gives meaning and structure to a complex of capital goods and shapes it with his own personality. He is the one who gives a purpose to the enterprise. Salerno explains that Böhm-Bawerk (one of the main teachers of Mises) followed Menger in his analysis on the capitalist-entrepreneur but did not pay so much attention on the entrepreneur and rather focused on the determination of the interest rate.

According to Salerno, John Bate Clark, who was quite influential on Mises, invented the imagery construction of the pure entrepreneur in order to analyze the determination of functional income shares. He also distinguishes between a static economy (which Mises adopted in his evenly rotating economy) and a dynamic concept. In a static condition there are no profit and losses and the entrepreneur is merely the universal paymaster. But in a dynamic society the entrepreneur makes the supreme decisions

which lead to changes in the business. Salerno argues that the enabling act of Clark (that is crucial in a dynamic society) is a similar concept like Menger's the act of the will.<sup>127</sup>

Salerno states that Frank Fetter came closest to conception of his integral entrepreneur. Fetter distinguishes between the passive investor and the active capitalist. In the real world the difference is still only a matter of degree. Fetter uses the term *enterpriser* to describe the active capitalist-investor. For him, uncertainty-bearing is also directly linked with ownership. Fetter conceives the entrepreneur as pushing himself to the fore and being exposed to risk. He is an economic buffer who is the first to feel influence of changing conditions. Salerno concludes that "all four pre-Misesians characterized the entrepreneur as a capitalist and owner in addition to a restless, venturesome, promoting uncertainty-bearer."<sup>128</sup>

#### ***Ludwig v. Mises and Murray Rothbard***

Salerno examines Ludwig v. Mises' concept of the entrepreneur and points out that the integral entrepreneur embodies three separate functions: capitalist, owner and entrepreneur. "For the capitalist reaps interest for the function of postponing present consumption and investing the savings, and the entrepreneur earns profits (incurs losses) for his relative success (failure) in correctly anticipating and adjusting production to future events."<sup>129</sup> Ownership is related to choosing and supervising the investment and therefore is a peculiar form of labor and generates quasi-rents. Entrepreneurial profits and losses on the other hand depend on the ability to adjust to the most urgent wants of consumers. The fact of ownership also distinguishes the entrepreneur from the manager in Mises' theory. Mises claims that a successful corporation is never controlled by a hired manager.

Salerno thinks that Rothbard ignored Mises' work in this field because Mises used the nebulous term "quasi-rents". Rothbard turned directly to Böhm-Bawerk in adopting the term "capitalst-entrepreneur". Rothbard enumerates two functions of the business-owner: (1) entrepreneurial function of uncertainty-bearing and (2) capitalist function of

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<sup>127</sup> cf. Salerno, "The Entrepreneur: Real and Imagined", 2008, p. 194

<sup>128</sup> Salerno, "The Entrepreneur: Real and Imagined", 2008, p. 200

<sup>129</sup> Salerno, "The Entrepreneur: Real and Imagined", 2008, p. 201

employing the present funds. Rothbard mentions also the managerial function which could also be performed by employees. With this third function, the owner earns an implicit wage by contributing his labor. This decision-making function involves hiring of component managers and the choice of the production process. This function also continues in the evenly rotating economy. Since this decision-making function is a property of the owner's personality it is always specific to each firm and cannot be hired. Therefore the owner "earns a unique 'rent of decision-making ability,' which tends to equal the factor's discounted marginal revenue product"<sup>130</sup>. Salerno states that Rothbard's observed the difference between the income of the business owner as ultimate decision-maker and steward of his property from his income in performing the function of a capitalist and an uncertainty bearing entrepreneur.

Salerno concludes that "for someone to be an uncertainty-bearer in the narrow entrepreneurial sense, he must incur the incidence of losses, and so he must also be a capitalist who invests funds in purchasing factor services in advance of the sale of the product on the market"<sup>131</sup>. The ownership-function also involves some kind of supervision of the capital and leads to decisions that have to be made by the capitalist-entrepreneur. Salerno points out that this fact also has important implications on the theory of the firm since the decision-making function implies that the firm is a projection of the owner's personality.

### **3.7 Conclusion**

In assessing this debate about entrepreneurship in modern economic theory we realize that there are many metaphysical, anthropological and ethical questions involved: What is the essence of entrepreneurship? Who can be considered as an entrepreneur? Which characteristics distinguish an entrepreneur from other actors within the market? What is the end of entrepreneurship? How can we cultivate (the virtue of) entrepreneurship? All these questions do not deal with the particular classification of a certain action as entrepreneurial. They are the translation of the even bigger questions about essence, existence and being into a specific economic terminology. Translating these questions

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<sup>130</sup> Salerno, "The Entrepreneur: Real and Imagined", 2008, pp. 204 et seq.

<sup>131</sup> Salerno, "The Entrepreneur: Real and Imagined", 2008, p. 205

back in the original sources where they were inspired from, will help us to understand how we can think about them more properly. We will see that the distinction of alertness and ownership as possible essences of entrepreneurship are complementary and we can find a way in approaching alertness both as ability and action in the same way.

Carl Menger, the founder of the Austrian school of economics was heavily influenced by Aristotelian thinking. Though later fellows of the Austrian school do not emphasize very much this root of their thinking or are not aware of it, we can find it still present implicitly. Aristotle's concepts and arguments will help us to speak in a better way about entrepreneurship. His fundamental realist approach is one thing that the above mentioned economists have in common. If they speak about entrepreneurship they all speak about real products or services and they speak about real profits (whether these are psychological and/or monetary). Entrepreneurship is not an idea that can never be fully achieved in this world and entrepreneurship is also not only about ideas – invention of new products or processes that have no real world application. Entrepreneurship is all about bringing new things into existing but not for the sake of their mere existence but for the sake of serving other people. Profits are gained because other people value the new thing more than they value the input factors. Hence entrepreneurship is primarily a social activity and is therefore other-directed or altruistic. In Aristotelian terms entrepreneurship matches with two of his fundamental principles: philosophy (and especially metaphysics) has to start its investigation from actually existing things and man is *per se* a social being (*zoon politikon*). (1278b20)

Aristotle divides all actually existing things into two parts: form and matter. (1029a1-3) Referring to our discussion about entrepreneurship, alertness seems to deal somehow with the Aristotelian form and ownership seems to relate to matter. The form of an entrepreneurial act is the idea or the vision how to put together capital to bring something new into existence. With Aristotle we can argue that alertness (as the ability to perceive this vision of a hitherto unnoticed profit opportunity) is the essence of entrepreneurship because he describes in *Metaphysics*<sup>132</sup> that “the form [...], or

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<sup>132</sup> cf. Aristotle, *Metaphysics*, Sioux Falls 2009

whatever we ought to call the shape present in the sensible thing, is not produced, nor is there any production of it, nor is the essence produced; for this [Note: form/essence] is that which is made to be in something else either by art or by nature or by some faculty” (1033a5-8). Though alertness might be essential, it is not sufficient for entrepreneurship because it has only to do with the potency of an entrepreneurial act. But for Aristotle actuality is prior to potency in formula, substantiality and partially in time. (1049b10-12) Actuality means always a compounded existence – the combination of form and matter. Thus capital is also necessary for an entrepreneurial act and Kirzner’s concept of a pure entrepreneur is misleading. Still it is not the ownership or the disposal of capital that characterizes an alert person in being an entrepreneur. It is alertness that distinguishes capital owners in being an entrepreneur or not. Aristotle puts it in these words: “If then a differentia of a differentia be taken at each step, one differentia - the last - will be the form [...]” (1038a27). Hence we see that also Salerno’s emphasize on the capital-owning characteristic of entrepreneurship is not sufficient.

Aristotle also helps us to look at the causes of entrepreneurship in a broader sense. He distinguishes the (1) material cause (related to the disposal of capital), (2) the moving cause (the entrepreneur himself), (3) the formal cause (alertness), and (4) the final cause (profit). (1044a35-1044b3) Entrepreneurial theory speaks explicitly about profits as the cause for entrepreneurship but neglects other causes. Particularly the moving cause – the entrepreneur himself – is also very important. It is always the individual who moves a perceived entrepreneurial opportunity from potency into actuality. The reasons why a person decides to give up a higher degree of certainty as employee and to become an entrepreneur are manifold. The easy way to argue with utilitarian principles is of course always to contend that the amount of pleasure (monetary and non-monetary profit) has to be higher in the entrepreneurial environment than in the job situation before. Otherwise a rational acting person would not change anything. But this argument has the problem that the entrepreneurial act involves time and the preferences and the subject perception of pleasure can change over time. A perceived profit opportunity can be doubted during the implementation of the new procedure or the new product and can in the end still turn out as a real profit opportunity. From a utilitarian point of view this kind of entrepreneurship is not possible.

Hence we see that we need a broader view of the entrepreneur than a profit or pleasure maximizing individual that is only driven by the final cause of exploiting entrepreneurial opportunities. Every entrepreneur is a person that has social relations, a distinct character and a variety of reasons to become a bearer of genuine uncertainty. As Mises points out, he has to be a leader in economic life. Leadership, prestige, a higher degree of independence in organizing one's work life and many other issues play important roles in the discernment of becoming an entrepreneur.

Profit in entrepreneurial activity can be compared with Aristotle's whole that is "other" (or frequently quoted as "more") than its parts. Aristotle uses the example of the syllable – ba is not the same as b and a individually. (1041b12) This is also valid for a product and its input factors. If the appreciation in the market (price) of the product is higher than the prices the entrepreneur has purchased for the input factors, he will gain a monetary profit. But he usually doesn't know during planning and producing if he will be able to earn profit since he transforms the essence of the input factors into a whole that is other than the input.

Also, it might be revealing in some ways to look at alertness, the ability to perceive hitherto unnoticed profit opportunities, as a virtue.<sup>133</sup> According to Aristotle's *Nicomachean Ethics*<sup>134</sup> a virtue has to have a predisposition in the human being's character in order to be actualized as virtuous act. He calls this predisposition *dynamis* – the quality of this predisposition varies from individual to individual. Nevertheless everybody who has a *dynamis* for alertness has to actualize this potency by acting entrepreneurially – Aristotle calls these acts *energeia*. This is necessary to create a real disposition which Aristotle calls *hexis*. (1103a27-1103b25)

The economists discussed above observe that there are some agents in the economy that act particularly different than others. They are more willing to bear uncertainty, they

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<sup>133</sup> This cannot be understood fully in the Aristotelian concept of virtue because virtues are not part of economic life but of political life. But since the significance of work and production for a person's life and also the formation of his character has changed tremendously over time, this analogy has at least some validity.

<sup>134</sup> cf. Aristotle, *Nicomachean Ethics*, 2009

have a greater capacity to create a vision and they are more consistent to turn this vision into reality. They all have a natural predisposition of alertness that has to be trained and cultivated by entrepreneurial activity and transformed into an actual disposition. Entrepreneurs can learn how to make decisions and exploit profit opportunities in schools and all kinds of trainings but this is never real entrepreneurial activity. The ultimate teachers of entrepreneurship are the consumers; the school, where entrepreneurs develop their virtue of alertness, is the market.

The components of alertness are best described by Frank Knight: the ability to forecast the future with and without entrepreneurial intervention, the discernment of the best way to shape the future state of affairs (a combination of the best profit opportunity and the decision on the plan that is most likely to work) and the ability to turn this plan into reality. To become an uncertainty-bearer two components of alert entrepreneurial activity are necessary: self-confidence and the trust in one's luck. Entrepreneurs, even though they act in an environment of true uncertainty, they usually are highly confident that their forecast of the future is correct, that their plan will work, and that in the end fortune favors the bold.

If we try to understand the importance of uncertainty for entrepreneurship, we won't find a satisfying answer in Aristotle's writings. The reason is Aristotle's concept of time that is primarily physical. For him time is a continuum and consists of an indefinite number of atomistic points of now. The Greek philosophy could not yet consider the subjectivity of the human person and time as a phenomenon that is closely related to the human person. If we look at time from an anthropological or ontological perspective, we can see that each person has a history that shapes the decisions to respond to the uncertainty of the future. *Now* therefore is not a single point in a continuum like endless other points, but is the crossing of two ontological different spheres of time: the past and the future. Human action is always motivated by the future though it is at the same time shaped by the past. Applying this fact to the branch of human economic activity, we can argue that there are different ways in responding to the uncertainty of the future and entrepreneurship is the genuine way to bear true uncertainty within the economy. If this is the case, we can say further that entrepreneurship has an equilibrating

component. A general equilibrium is usually related to certainty about the state of affairs. Hence no matter how disequilibrating other factors are, since entrepreneurship bears, and therefore reduces, uncertainty it has an equilibrating impact in the economy.

In our assessment of the nature of entrepreneurship, we now have investigated the relationship between uncertainty and entrepreneurship. We have explored the different components of entrepreneurship and its role within the economy. Before we analyze the underlying concept of the human person we will briefly look at the different approaches on how entrepreneurship is carried out in the economy. With Aristotle's view we saw that alertness might be a predisposition but it has to be activated. The entrepreneur usually needs other people to carry out his plans. This is usually done within a firm.

## 4. Theories of the Firm

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The questions we want to investigate in this chapter are: why firms do exist? What is the most appropriate explanation for their existence? The theories of the entrepreneur take in some ways for granted that the person, who has the ability to forecast and make plans in response to an uncertain future, is also able to carry out these plans with the help of other people. We will now discuss two influential theories about the existence of corporations: Ronald Coase's rationale of the importance of transaction costs and Alchian and Demsetz's argumentation along shirking costs. We will contrast them with an entrepreneurial theory of the firm that corresponds with the main arguments we found for characterizing an entrepreneur.

### 4.1 Transaction Costs (Coase)

Ronald Coase who was a professor for Law and Economics at the University of Chicago has been awarded the Nobel Prize in economics, among other achievements, for his work in exploring the nature of the firm. In the homonymous essay he published in 1937 he develops the theory of transaction costs that are the cause for the existence and the size of firms – if there were no transaction costs, no firms would exist.

Coase starts his investigation with the common understanding of the market at his time: prices have a coordinating function to allocate scarce resources efficiently. This fact is the main argument against central economic planning for society. But Coase also observes that, as a matter of fact, economic planning in society exists. Within a firm there is no automatic process like in the market and workmen are not responding to changes in supply and demand but rather following orders. Every individual makes his own plans in response to an uncertain future. The economic planning of an entrepreneur within a firm is a different kind of economic planning which is still again different from economic planning of the whole society. This form of planning is organized in a way that Coase, by quoting Joan Robinson, describes as “islands of conscious power in this ocean of unconscious co-operation like lumps of butter coagulating in a pail of

buttermilk”<sup>135</sup>. Within the firm the complex structure of the market coordinated by the prize system is substituted by the coordinator-entrepreneur who is carrying out his plans and is directing production.

Ronald Coase assumes establishing a firm has to be more profitable compared to carrying out the plan in the market economy by the price mechanism. The main reason he introduces, why firms are more efficient is that “there is a cost of using the price mechanism”<sup>136</sup>. He points out, there are two kinds of these costs in the market that can be reduced but cannot be eliminated: (1) Discovering the relevant prices, (2) negotiating and concluding a separate contract for each exchange transaction. It is especially the costs of contracts of the factors of production with each other that makes substitution of this series of contracts with one contractor more efficient. Also, the option to sign contracts for longer periods is cheaper than signing several contracts for short periods. Coase points out that also measures like a sales tax provide incentives rather to organize production within a firm than on the market. For already existing corporations, these policies tend to increase the size of the business.

Coase rejects Frank Knight’s explanation for the existence of a firm. Contracts can be designed in a way that the coordinator-entrepreneur bears no uncertainty but has fixed prices for his service while the payment of his employees may be wholly a share in his profits. Coase also deals with the question of the size of a firm which would not be able on a Knightean understanding.<sup>137</sup> He assumes that the limit of the size of a firm is determined by the point where the costs of organizing an extra transaction are equal to the costs of carrying out the transaction in the open market. Coase defines three characteristics for a larger size of the firm: (1) the less the costs of organizing are (managerial improvements, new communication means, bringing factors of production closer together), (2) the less likely the entrepreneur makes mistakes and (3) the greater the lowering in supply price of factors of production is. To determine the size of the firm, we have to consider marketing costs (using the price mechanism) and costs of organizing of different entrepreneurs.

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<sup>135</sup> Ronald Coase, “The Nature of the Firm” in *Economia* 1937, p. 388

<sup>136</sup> Coase, “The Nature of the Firm”, 1937, p. 390

<sup>137</sup> cf. Coase, “The Nature of the Firm”, 1937, pp. 394 et seqq.

## 4.2 Shirking Costs (Alchian & Demsetz)

Ronald Coase's theory of the firm was challenged in 1972 by two economists from UCLA, Armen Alchian and Harold Demsetz, with their article *Production, Information Costs and Economic Organization*. They settle their theory of the firm on the fact that men engaged in team-production have a natural inclination to shirk and burden more of their share of the work on their cooperator's shoulders. Hence, the necessity arises to meter inputs and outputs.

They challenge specifically Coase's transaction costs argument in exploring the nature of contracts and pointing out that there is no difference between a contract within the firm and on the market. The only punishments, available for an underperforming employee, is withholding future salary or suing for the bad performance. There are exactly the same options available on the product market if the seller is doing a bad job or is delivering bad quality. In Alchian and Demsetz's view only the fact of *team production* within a firm distinguishes it from operations on the market coordinated by prices. To illustrate their view they refer to the case of two men jointly lifting a heavy cargo – we cannot determine the marginal productivity of each of them. The output is not a composition of several individual outcomes but it is a sum that cannot be achieved if the work would have been performed individually (one man would not be able to lift the heavy cargo alone).<sup>138</sup>

Alchian and Demsetz presuppose a utility-maximizing individual who is involved in team production. The utility function of this individual is stimulated by an increase in income and in leisure. Since there is a higher incentive for the individual in team production to buy more leisure and the relaxation cannot be detected by zero costs, his shirking will be borne by others in the team. This incentive exists for all individuals involved in team production. Alchian and Demsetz's theory of the firm wants to find a way how to meter especially these inputs to increase the output of team production.

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<sup>138</sup> cf. Armin Alchian/Harold Demsetz, "Production, Information Costs, and Economic Organization" in *The American Economic Review* 1962, p. 779

The market process would monitor some shirking activities but even better would be to hire a monitor. But who will monitor the monitor? The monitor could have a higher incentive in not to shirk as a monitor if his income is related to the net earnings of the team production. Monitoring includes a variety of activities – like the authority to terminate or revise contracts. Alchian and Demsetz refer to the example of a football team to distinguish the different functions within a firm. They call the coach a supervisor-manager and the team captain an inspector-steward. The main reason for the existence of firms is not the costs for establishing contracts (like Coase pointed out) but the monitoring of team members and therefore increasing productivity. “Managing or examining the ways which inputs are used in team production is a method of metering the marginal productivity of individual inputs to the team’s output.”<sup>139</sup> The entrepreneur/owner of the firm is defined by a bundle of rights: 1) to be a residual claimant; 2) to observe input behavior; 3) to be the central party common to all contracts with input; 4) to alter the membership of the team; and 5) to sell these rights.

Team production can be realized in different types of firms. Alchian and Demsetz distinguish six different types<sup>140</sup>: (1) The Profit-Sharing Firms can work efficiently with small groups of partners, (2) Socialist Firms let the employees participate in the residual to a high degree and therefore increase the incentive for shirking of the manager (because his share of the residual is limited), (3) the Corporation sells promises for future returns to those who provide financial capital, hence many risk-averse investors contribute small portions and are excluded from everyday decision making by the concept of limited liability. The effective control of corporate activity is achieved by a smaller group, the managerial board. The policing of managerial shirking is executed by market forces by external and internal labor markets and voting blocs of share holders who are blocking their decision power in order to remove shirking managing boards. (4) In Mutual and Nonprofit Firms more shirking is to be expected, (5) Partnerships will be established for production in artistic or professional intellectual skills and will occur more likely between long-term acquaintances who are not only fulfilling a utility-

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<sup>139</sup> Alchian/Demsetz, “Production, Information Costs, and Economic Organization”, 1962, p. 782

<sup>140</sup> Alchian/Demsetz, “Production, Information Costs, and Economic Organization”, 1962, pp. 785 et seqq.

function. (6) Employee Unions act as monitor for employees and meter employer performances especially in non-pecuniary benefits.

### 4.3 Uncertainty (Knight)

Knight's rationale for the existence of firms is again genuine uncertainty. The entrepreneur handles uncertainty while the consumer is only confronted by risk. If real change takes place, pure reasoning is not able to deal with it. For Knight entrepreneurial judgment cannot be sold and bought. The judgment of an entrepreneur is required to be exercised and is therefore involving liability to error. This responsibility for the correctness of his opinion becomes a condition prerequisite in order to getting others to submit to the entrepreneur's control. For Knight the functions of responsibility and control are inseparable combined in the function of the entrepreneur. Judgment and the exercise of this judgment by the entrepreneur by submitting others to his control are part of the distinct nature and origin of the firm in Frank Knight's view.

It is this confidence in his judgment, the ability to carry it out and his luck that generate the income through an enterprise for the entrepreneur. This income is characterized by Knight in two different forms:

With the specialization of function goes also a differentiation of reward. The produce of society is similarly divided into *two kinds of income*, and two only, contractual income, which is essentially *rent*, as economic theory has described incomes, and residual income or *profit*.<sup>141</sup>

For Knight, this residual income is a combination of two elements: an element of calculation and an element of luck. But the income of the entrepreneur is not determined like wages are usually determined – it is what is left after the others are determined. There are three reasons why the profit of an entrepreneur tends to be larger: (1) his special ability to forecast the future and to carry out his plan, (2) his good luck in doing so, and (3) regarding society, the scarcity of self-confidence combined with the power to make effective guarantees to employees.

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<sup>141</sup> Knight, *Risk, Uncertainty and Profit*, 2006, p. 271

#### 4.4 Alertness (Kirzner)

Kirzner assumes, the firm is not the same as the pure entrepreneur but something that emerges after the entrepreneur has made decisions, specifically the purchase of certain resources. He thinks that conventional theories of the firm which assume, decisions within the firm are made in order to maximize profits, contribute to the misunderstanding that maximization of profits is not related to entrepreneurship but to ownership.

In his assessment of the modern corporate firm, Kirzner ignores the legal façade and identifies two economic categories: (a) capitalists and (b) entrepreneurs.<sup>142</sup> He considers bondholders and stockholders<sup>143</sup> as capitalists. But entrepreneurship is related to those who have the vision and alertness to exploit hitherto unnoticed profit opportunities. To explore the entrepreneurial function within the corporate firm Kirzner uses a simple, hypothetical example of an owner of a gun (person A) who hires a hunter (person B). B employs his skills as a hunter and the revenues from his hunting surpass the costs of the gun and his wage. In this case A, who earns the pure profits because he was alert of B's hunting skills, performs the pure entrepreneurial function. If A is not alert of the hitherto unnoticed profit opportunities and puts his gun to work simply in an ordinary way, he will earn no entrepreneurial profit. If B, by behaving unethically, is exploiting the profit opportunities by himself, uses the gun from A, he will gain entrepreneurial profit. Now B is the one who is alert and therefore performs the entrepreneurial function – in both cases, no matter who owns the resources, the profit goes to the entrepreneur.<sup>144</sup>

Kirzner relates this example to the modern corporate firm – with A being the shareholders who provide the capital (gun) and B being the managers who run the business (hunting). Depending on the decision-making process within the firm, the entrepreneurial profit goes either to the shareholders if they can organize themselves and employ their alertness by controlling the managers or it goes to the managers because the shareholders stay ignorant to the unexploited profit opportunities. But this

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<sup>142</sup> cf. Kirzner, *Competition & Entrepreneurship*, 1973, p. 55

<sup>143</sup> Though the stockholder also owns part of the corporation he is mainly providing capital. The stockholder does not receive profits from his share but an implicit interest, a quasi-rent.

<sup>144</sup> cf. Kirzner, *Competition & Entrepreneurship*, 1973, pp. 57 et seqq.

observation puts the general profit-maximization of the corporate firm in trouble because it is not the decisions within the firm which have a profit-maximizing function. It is the decisions of individuals that perform this function and therefore are the residual claimant.

#### **4.5 Contemporary Entrepreneurial Theories of the Firm**

Kirzner tried to deliver a complete theory of the entrepreneur and the nature of entrepreneurial activity. He did not pay so much attention on the theory of the firm but inspired other fellows of the Austrian school of economics to develop his ideas into more detailed entrepreneurial arguments for the existence of firms. Frédéric Sautet argues that firms exist because otherwise profit opportunities could not be exploited. The Knightian approach of uncertainty is considered by Nicholas Dew, S. Ramakrishna Velamuri and Sankaran Venkataraman. New firms are established if the intersubjective agreement on profit opportunity in the market is higher than within the existing firm. An entrepreneur becomes a bearer of true Knightian uncertainty if the intersubjective agreement on the profit opportunity is low both within and outside the firm. Nicolaj Foss and Peter Klein focus on Knight's theory of judgment as essential for entrepreneurship within the firm.

##### ***Exploitability thesis***

Frédéric Sautet assesses existing theories of the firm and wants to complete their approaches with a particular entrepreneurial theory. His theory emphasizes that a firm is not only a solution to a problem of costs, but also one to the problem of true ignorance and coordination. A transaction costs explanation for the firm is sufficient for a market that is constantly in equilibrium. In this state, the emergence of new firms is only related to exogenous phenomena. The entrepreneurial theory puts the promoter and his vision how the future could look like in the center of its theory and therefore provides an endogenous explanation for the emergence of new firms. There is also a social dimension present in the entrepreneurial theory because the entrepreneur-promoter relies on entrepreneurial insights of other individuals. Oftentimes the theory of the firm is reduced to a mere cost-benefit analysis. But the entrepreneur-promoter cannot buy

what is not part of his means-ends-framework. He is the driving force in the economy – no markets exist if there are no entrepreneurs.

Sautet states that innovation always involves arbitrage. He distinguishes between entrepreneurship type I which is atemporal arbitrage and does not involve production and type II which is intertemporal and involves production (and innovation). According to Kirzner, entrepreneurship and the market process have a tendency to equilibrium. But of course there is the possibility of failure. Sautet observes three types of mistakes:<sup>145</sup> (1) *missed opportunity* – something could have been done but wasn't. If pure subjectivism is applied such a failure does not exist – only if we presuppose an objective reality this kind of mistake matters. (2) *Spurious discovery* – entrepreneur acts as if, but there was no opportunity or part of the market data was read wrongly – something can be discovered but not as much as the entrepreneur thought. This failure is systematically eliminated over time through experience. (3) *Rivalry* – someone steps in to exploit the discovered opportunity; someone realizes a profit opportunity by raising resource prices. Thus, someone had the necessary alertness for discovering the profit opportunity but not the necessary ability to exploit it.

If firms don't exist, profit opportunities cannot be exploited (*unexploitability thesis*). The planner must be able to set up long term contracts and to secure resources for the duration of the plan. Otherwise production and, hence, entrepreneurship type II cannot take place. Sautet calls this entrepreneur who supersedes the price mechanism with long term contracts to exploit discovered profit opportunities entrepreneur-promoter (following Mises' terminology). This entrepreneur-promoter uses factor inputs that will become specific over time to carry out his plan. He needs to convince resource owners of his superior foresight. This requires some kind of alertness of the resource owners as well and they also engage in an entrepreneurial gamble. Therefore, the emergence of the firm can be seen as the simultaneous exploitation of profits by different entrepreneurs – most of them are within the firm (as employees) some are outside and provide assets. Sautet gives the following definition of the firm:

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<sup>145</sup> Sautet, *An Entrepreneurial Theory of the Firm*, 2000, pp. 64 et seqq.

The firm is a non-price planned coordination over time between complementary inputs in which market errors due to the ignorance of other individuals' plans do not exist. The entrepreneur-promoter coordinates all these inputs. [...] The firm is an island of planning and it serves as the locus of exploitation of a discovered profit.<sup>146</sup>

The firm is not only a matter of profit exploitation but also one of coordination that cannot be achieved other than within a firm. Factors of production that have rendered their alertness are now following the plan of the entrepreneur-promoter. Sautet's entrepreneurial theory of the firm is distinguished from a resource-based approach in such a way that not rents are the driving force for the emergence of a firm but pure profits.

Sautet thinks that this concept of the firm also could be a solution to the lachmannian problem<sup>147</sup>: He states that in the market a certain degree of order exists – therefore ordering forces must exist in the market system. The emergence of firms is such a force – entrepreneurial alertness is aligned along one vector: that of the promoter. By committing resources to the exploitation, promoters create islands of stability and order within the market. The only cost of this process is that some opportunities will never be exploited because the resources are not available. Firms provide some answers to the Lachmannian problem but they do not move the economy to a final state of rest. Sautet links firms as an institution in which certain division and combination of knowledge takes place and which are necessary to the existence of plan coordination among individuals like money or property rights.

Sautet also tries to answer the question what the distinctive nature of the firm is. Since there are many theorists who think that there is no specific difference between the firm and the market, Sautet uses Hayek's argument that people are ends-connected within a firm whereas they are means-connected within the market – plans are dis-coordinated within the market but they are coordinated within the firm. Within the firm there is also a certain hierarchy existing as a reflection of the fact that individuals are pursuing a common purpose.

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<sup>146</sup> Sautet, *An Entrepreneurial Theory of the Firm*, 2000, p.76

<sup>147</sup> As discussed above, Lachmann employs the theory of a kaleidic society and argues that within the market there is no tendency towards equilibrium is present.

### ***Dispersed Knowledge***

An article published in 2003 by Nicholas Dew, S. Ramakrishna Velamuri and Sankaran Venkataraman explores the theory of the firm due to dispersion of knowledge over people and places which leads to uncertainty over time. They want to answer when and why new firms are chosen to exploit profit opportunities and when and why an existing firm is preferred for marketing an entrepreneurial opportunity. They do not believe that costs determine if a transaction is carried out on the market or within a firm. Contrary to other theories of the firm, they argue that the emergence of a new firm depends on whether an entrepreneur is able or not to sell his recognized opportunity on the market.

The article distinguishes between (1) Akerlofian information asymmetry as cross-sectional uncertainty which expresses the unequal distribution of existing knowledge and (2) Knightian uncertainty as longitudinal uncertainty describing knowledge relevant to future predictions that is not simply unknown but unknowable. Its core aspect is the genuine lack of predictability owing to the production of novelty. In neoclassical concepts of uncertainty the agent – according to Langlois – has perfect structural knowledge but imperfect parametric knowledge which implicitly presumes that the agent has an exhaustive list of possible actions.<sup>148</sup>

The dispersion of knowledge and Knightian uncertainty lead to a phenomenon that is called *heterogeneous expectations*. This means, different people have different expectations. The article points out four rationales why expectations are heterogeneous: (1) They are an imaginative faculty, subjectively held and therefore not observable. (2) Much of the knowledge people have is tacit and dependent on different physical and mental capabilities. (3) Costs are subjectively perceived and as opportunity costs depending on what the decision-maker sacrifices when he selects an alternative. (4) Expectations are notoriously volatile and are constantly modified as the result of past actions.<sup>149</sup>

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<sup>148</sup> cf. Nicholas Dew/S. Ramakrishna Velamurib/Sankaran Venkataraman, “Dispersed knowledge and an entrepreneurial theory of the firm” in *Journal of Business Venturing* 2004, pp.664 et seq.

<sup>149</sup> cf. Nicholas Dew, et al., “Dispersed knowledge and an entrepreneurial theory of the firm”, 2004, pp. 667 et seq.

In exploring the existing theories of the firm the article examines the transaction cost theory originated by Ronald Coase. There are two types of contracts in the market: specific and residual contracts. Knightian uncertainty cannot be covered by specific contracts. The entrepreneur is the residual contract holder and makes judgment in situations of true uncertainty which is not contractible again on the market. “The creation of a firm is [...] an entrepreneurial response to the absence of a market for the entrepreneur’s service.”<sup>150</sup>

In product markets, the degree of uncertainty is related to the likelihood that an opportunity cannot be transacted in the market. If factor markets for the entrepreneur do not exist, he has to turn to nonmarket solutions with family and friends to generate a positive outcome for the venture. If a reasonable intersubjective agreement about the profit opportunity and its value exists, the opportunity can also be sold. The entrepreneur can use patents.

The article investigates the likelihood of entrepreneurial opportunities exploited within an existing firm. This depends on the intersubjective agreement especially among the key persons within the firm. Since intersubjective agreement in this article is linked to uncertainty – the less intersubjective agreement the higher the uncertainty of an opportunity – there is a positive relation between the uncertainty of an opportunity and the likelihood of being exploited in a new firm. Opportunities with a high degree of uncertainty are called “individual-centric” because they only exist in the mind of the individual. The article distinguishes four scenarios: (1) high intersubjective agreement on the value of the opportunity both within and outside the firm: The opportunity is very obvious and has kind of an objective status – transaction cost theory plays an important role in the analysis if a certain opportunity will be exploited within the existing firm or in a new firm. (2) The intersubjective agreement is high within the firm and low outside (through an information asymmetry): The opportunity will be exploited within the existing firm. (3) If the intersubjective agreement is high outside the firm and low inside, a new firm will be established and if (4) intersubjective agreement is low both

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<sup>150</sup> Nicholas Dewa, et al., “Dispersed knowledge and an entrepreneurial theory of the firm”, 2004, p. 670

within the firm and outside we face a situation of true Knightian uncertainty. A “bootstrapping” approach (use of family and friends for resources) in this scenario is very likely.<sup>151</sup>

The article concludes that existing theories of the firm provide justification for the existence of firms, but they do not explain how firms come into existence. These theories also overlook the important role of particular individuals for the creation of firms and markets. And lastly especially in the firm as a contractual structure, due to Knightian uncertainty contracts are not only incomplete but incompletable.<sup>152</sup>

### ***Judgment***

Nicolaj Foss and Peter Klein in 2004 developed a theory of the firm that is based on the concept of entrepreneurship as judgment. The entrepreneur needs a firm because judgment cannot be purchased on the market. In their approach, the entrepreneur envisions new assets to use in order to produce final goods. These resource uses are not mere data but are created by the entrepreneur. In their assessment they address the fundamental questions how an entrepreneur is connected with an enterprise and how economic theory is describing this relationship. They believe that concepts of entrepreneurship as management, creativity, innovation, alertness, or charismatic leadership, though they crucial aspects, do not provide a sufficient rationale to understand the concept of the entrepreneur. These theories lack answers to the questions why the entrepreneur has a special function within the firm and why he needs a firm in order to be an entrepreneur.

Entrepreneurship as judgment has answers to these questions. Judgment is the formation of estimates “of future events in situations in which there is no agreement or idea at all on probabilities of occurrence.”<sup>153</sup> Judgment implies ownership because judgmental decision-making is decision-making about the employment of resources. But judgment

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<sup>151</sup> Nicholas Dewa, et al., “Dispersed knowledge and an entrepreneurial theory of the firm”, 2004, pp.672 et seqq.

<sup>152</sup> There is a debate about incomplete contracts in the line of transaction cost theory of the firm but this does not contribute any additional information at this point. We leave it therefore with this statement.

<sup>153</sup> Nicolai J. Foss/Peter G. Klein, *Entrepreneurship and the Economic Theory of the Firm: Any Gains from Trade?* DRUID Working Paper No 04-12, p. 8

also implies some sort of control of the resources. This is especially linked to contract theories of the firm and the theories of incomplete contracts from organizational economics. The contracts between the entrepreneur and his employees are incomplete due to the uncertainty of the future.

The necessity of ownership of assets for an entrepreneur is linked to the perception of attributes. If we consider the heterogeneity of capital we can observe that almost all assets have multiple attributes. Attributes also may vary over time in a world of “true” uncertainty and so the entrepreneur cannot know all attributes of the assets employed when he makes the decisions for production. These future attributes of assets cannot be forecasted with certainty.

The combination of uncertainty, incomplete contracts and the employment of assets is the basis for Klein’s and Foss’ entrepreneurial theory of the firm. Entrepreneurship is not only the initial invention, the new combination. It is also not only the alertness about unnoticed profit opportunities. The entrepreneur, by carrying out his judgment through the employment of capital and by hiring employees, discovers continuously new attributes of the assets he has employed. He creates by envisioning new ways of using his assets to produce goods and provide services. He is able to do so because he is the owner of these assets (or has at least the rights that are usually related to ownership) and because contracts with his employees are incomplete and he has the right to control their work in such a way that he is able to employ their working force in different ways of carrying out his new plans.

## 4.6 Conclusion

We want to apply again some basic principles of Aristotelian philosophy in order to get a better understanding of the arguments that were used in this discussion on the nature of the firm. In *Politics*<sup>154</sup> Aristotle describes man as *zoon politikon*, as political being that is driven into community. (1278b20) While the goal of the political community is the virtuousness of its citizens we could look at the *catallaxy* – the economic community in the same way. Alertness is the virtue that is fostered by the market and

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<sup>154</sup> Aristotle, *Politics*, Mineola 2000

puts the natural leaders at the forefront. Among man there are some that have a special ability to recognize the deficiencies of other people, to envision ways to balance them and to carry out these visions. They are leaders in the economic community. Their special ability (alertness) is a necessary component for being a leader in the economic sphere, an entrepreneur, a promoter. In order to recognize an action as entrepreneurial, this action must also be turned into reality. This requires to make a judgment and to carry out this judgment.

Judgment is not a purely individualistic decision of a single person independent from his environment. Man is a social being and being in the world for him always means being in community. Carrying out of the judgment always has community as a prerequisite. He perceives the objective reality and judges in which way he wants to carry out what he observed to be useful to man. If there is some sort of intersubjective agreement on the usefulness of his observation, he will find means and ways to carry out his judgment – either within his existing firm or with support of a new firm. He is able to start a new firm because the usefulness of his observation is in some regards obvious. But if he is the only one who sees the potential of his observation and if he really believes in this observation, is courageous and has also some good luck, he can become a “real” leader in the economy.

Since entrepreneurship always involves time and the employment of resources or labor (and even if it is just the labor of the entrepreneur) we cannot agree with any idealistic concept of entrepreneurship. Two crucial facts distinguish the entrepreneur within the firm from other functions: (1) He receives the residual income and (2) he is the holder of residual contracts. This means that he is responsible not only for carrying out a judgment but also the soundness of his forecast of future demands. Since entrepreneurship takes place in time and the future is uncertain and also it is uncertain if the entrepreneur knows all attributes of the assets that he employs, it is necessary that the contracts are incomplete and he has the power to readjust the working forces he has hired. Entrepreneurship is not an initial judgmental decision and a mechanic process that is followed, but it is an ongoing creation of new visions, making of new judgments and carrying out of these judgments.

The execution of his judgment is of course part of the entrepreneurial act. This involves dealing with contract costs and also some managerial work in order to prevent tendencies of shirking among the employees. With the theory of the firm we can see that there are many issues involved regarding entrepreneurship. If entrepreneurship as a combination of alertness, judgment and execution is the virtue of appropriately forecasting and meeting future human wants, it has to be enacted through and with a firm.

After this investigation of the nature of entrepreneurship and the nature of the firm, we now turn back to our initial questions about human nature in general. We will discuss the anthropological concepts of methodological individualism and economic personalism. We will see how well they serve for developing an understanding of the human person in the economy and how they are related to the discussed topics of entrepreneurship.

## 5. Methodological Individualism

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The concept of individualism in economic theory has a long tradition and is rooted back in the emergence of the classical science of economics with Adam Smith and his contemporaries in the 18<sup>th</sup> century.<sup>155</sup> There are many different strands of individualism: political, philosophical, anthropological and many more. Hayek distinguishes two main concepts of individualism relevant for economics: true (irrational) and false (rational) individualism.<sup>156</sup> These belong mainly to the Scottish tradition of philosophers and economists on the one hand and to French philosophers on the other hand. Both schools of thoughts have an integrated concept of individualism.

Carl Menger, as the founder of the Austrian School of Economics, was the first to describe the scientific method that became a foundation for the Austrian approach to economics as theoretical science. The term *methodological individualism* that is widely known as the methodological basis was first coined by Joseph Schumpeter in his publication, *Das Wesen und der Hauptinhalt der theoretischen Nationalökonomie*. There is no authorized translation for this early work of Schumpeter and F. A. v. Hayek suggests in a preface for a translation by Michiel van Notten in 1980 that the reluctance of Schumpeter to translate and distribute, it was due to some views he expounded that he later did not believe any more. In Hayek's view Schumpeter shifted gradually away from the Austrian School of economics by turning to the teachings of Leon Walras, focusing more on macro-economics and becoming one of the co-founders of the econometric movement.<sup>157</sup> Though Joseph Schumpeter later had quite different opinions about a sound methodological approach to economics it is still worth exploring his early thoughts that clearly show the influence of his teachers Carl Menger and Eugen v.

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<sup>155</sup> There is a debate especially among fellows of the contemporary Austrian school of economics going on when the modern science of economics was established. Carl Menger was the first studying the writings of the Doctors of the famous School of Salamanca that have already extensively studied economic phenomena and developed the theory of subjective value in the 15<sup>th</sup> and 16<sup>th</sup> which has been neglected afterwards until the end of the 19<sup>th</sup> century. Joseph Schumpeter went further and traced the 'philosophic' strand in economics in *Economic Method and Doctrine* (Chap. 1) back to Plato and Aristotle.

<sup>156</sup> cf. Friedrich A. Hayek, "Individualism: True and False" in *Individualism and Economic Order*, Chicago, London 1948

<sup>157</sup> cf. Friedrich A. v. Hayek: "Preface", in Joseph Schumpeter, *Methodological Individualism*, Bruxelles 1980

Böhm-Bawerk and give a sound definition of the concept of methodological individualism.

### 5.1 Economic Processes in Close Limits (Schumpeter)

Joseph Schumpeter's writings on individualism were also influenced by Max Weber,<sup>158</sup> who contributed a theory of methodological individualism to social sciences in general. At the age of 25 years Schumpeter published his first work on economics *Das Wesen und der Hauptinhalt der theoretischen Nationalökonomie*. He dedicated chapter VI to a more profound exploration of the concept of methodological individualism. There he distinguishes political individualism strictly from individualistic science. While the "former starts from the general assumption that freedom more than anything, contributes to the development of the individual and the well-being of the society as a whole [...] the latter [...] has no specific propositions and no prerequisites."<sup>159</sup> Schumpeter wants to limit the concept to the question of whether the individual can be the basis for economic inquiry; socialists as well as political individualists can answer this question because it is purely methodological.

Schumpeter defends his assumptions mainly against modern economic theory (the German historical school). He considers three objections to his theory<sup>160</sup>: (1) the national economist and the social politician are in many cases one and the same person, hence focusing only on theoretical problems is not possible; (2) "erreure individualiste" developed from biology – the individual cannot live alone but is part of his social environment; and (3) the use of the concept of society and social value in pure theory. Schumpeter responds that the nature of economics – "what economics really is [...] is unimportant" and he proposes rather "to concentrate only on the end-result that we want to achieve, which in this particular case is the price phenomena."<sup>161</sup>

Methodological individualism makes no attempt to be philosophically speculative or to create a future ideal. The theory doesn't aim to state any fact or consider each concrete

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<sup>158</sup> cf. Stanford Encyclopedia of Philosophy: *Methodological Individualism*, <http://plato.stanford.edu/entries/methodological-individualism/>, visited March 6<sup>th</sup> 2010

<sup>159</sup> Joseph Schumpeter, *Methodological Individualism*, Bruxelles 1980, p. 3

<sup>160</sup> cf. Schumpeter, *Methodological Individualism*, 1980, p. 4

<sup>161</sup> Schumpeter, *Methodological Individualism*, 1980, p. 5

action of an individual. The theory intends to describe economic processes within very close limits and produce quick and fairly acceptable results. The alternative of a social-oriented concept in the pure theory would not give any greater advantages and is in Schumpeter's opinion therefore unnecessary. He also refers to the "Robinson"-method of classical economics<sup>162</sup> as ill-reputed because this creates an image of atomism in economics that is certainly not the underlying principle of methodological individualism. Schumpeter states, in regard to his analysis of methodological individualism, "We have not solved a problem but we have proved in fact that the problem did not need to be solved."<sup>163</sup>

Of particular interest is Schumpeter's rejection of terms such as "national income," "national wealth" and "social capital" for methodological reasons. These are collectivist interpretations (which played a major role in the German historic tradition) and are now well known and frequently used concepts in econometrics. He also explains terms such as "total demand" and "total supply" as "combinations of individual processes"<sup>164</sup>. We can observe that Schumpeter in his early writings is clearly influenced by the tradition of Austrian Economics and his teachers Menger und Böhm-Bawerk, especially in the emphasis on the individual as the origin of every economic phenomenon. These basic assumptions of methodological individualism define the scope of the theory and draw particular attention on its limits. One of the main questions that will later divide neo-classical theory (including the Chicago School of Economics and also the later Schumpeter approach) and the Austrian School will be whether mathematics and statistics provide an appropriate language to assess human behavior and whether human action is by definition rational. The Austrians negate uniformly the first question but are indifferent on the second.

## **5.2 All Actions are Performed by Individuals (Mises)**

In Schumpeter's early writings one could already read some roots of his later shift in economic theory. Ludwig v. Mises is much clearer in his argumentation in *Human*

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<sup>162</sup> By „Robinson“-method he refers to the approach of classical economic theory to explain economic problems starting with the assumption of Robinson Crusoe living together with his companion Friday on a lonely island and starting economic activity through production and voluntarily exchange.

<sup>163</sup> Schumpeter, *Methodological Individualism*, 1980, p. 6

<sup>164</sup> Schumpeter, *Methodological Individualism*, 1980, p. 8

*Action*. In Chapter II.4 he adumbrates his methodological basis. His focus shifts from the individual as such to human action and he states clearly “that all actions are performed by individuals”<sup>165</sup>. He defends methodological individualism against the attacks of various metaphysical schools. Like Schumpeter he takes an approach against the “nominalistic fallacy” argument stating that it is inappropriate to use the notions of scholasticism and apply the antagonism of nominalism and realism to economic theory.

Mises argues against the assumption that the whole (society) might be temporarily and logically prior to the part (individual) and that logically the notions of a whole and its parts are correlative. As logical concepts they are both apart from time. And even against the statement that man who thinks and acts emerges from his prehuman existence already as a social being, Mises still insists that all these processes occurred in individuals. He goes on with his argument against modern psychology and points out that whether a crowd is a gathering, a mass, an organized body or something else, depends upon the meaning the people attach to themselves. He rejects the notion that our senses make us recognize social entities – rather, it is understanding, a mental process, that enables us to do so.

Mises’ praxeology is concerned primarily with the acting ego that is beyond any doubt. He can be considered as an atomist for the following two reasons: (1) the only fact that has any meaning in his inquiry is the fact that humans act and that the economist can derive some general principles from this fact. Therefore, only human action in its categorical structure is considered – all other accidental and environmental features of human action are the task of history. (2) Human life and existence are atomistic in the sense that is the an unceasing sequence of single actions.<sup>166</sup>

But he is not only an atomist but above all a rationalist. Compared, for example, to F.A. v. Hayek, he chooses a quite different assessment of human action. Human action according to Mises is by definition rational.<sup>167</sup> There is no action that could be called irrational for one would not call this behavior action. Action always means that specific

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<sup>165</sup> Ludwig von Mises, *Human Action: A Treatise on Economics*, San Francisco 1996, p. 42

<sup>166</sup> cf. von Mises, *Human Action*, 1996, p. 45

<sup>167</sup> cf. von Mises, *Human Action*, 1996, p. 19

means are applied to achieve certain ends (only known<sup>168</sup> by the individual). So the science of economics is not concerned with ends but with the process of applying means. But in Mises' terminology the concept of rationality loses its original meaning because there is by definition no irrationality in the science of economics.

On the other hand, Mises admits that action is by no means isolated. Every action has two aspects: (1) partial action in the framework of a further-stretching action and (2) a whole in itself. For praxeology, the further reaching goal can only be achieved step by step, action by action (the procedure for building a cathedral is to lay one stone on another one).<sup>169</sup> This is the rationale why, although there exist chains of actions, the only thing that is important for economics is singular human action performed by the individual.

### **5.3 True, False and Methodological Individualism (Hayek)**

Friedrich August v. Hayek does not distinguish between individualism as a method and as a political concept. He wants to trace the method he applies for economics back to its philosophical origin. Therefore he points out that although many definitions for individualism exist, there are two main concepts of individualism in the history of ideas: (1) *True individualism*, which is related in the 17<sup>th</sup> and 18<sup>th</sup> century to John Locke, Bernard Mandeville, David Hume, Adam Ferguson, Adam Smith and, for Hayek, Edmund Burke in particular. Two of the teachers who were highly influential on Hayek's thought and who developed the ideas of true individualism further in the 18<sup>th</sup> century were Alexis de Tocqueville and Lord Acton. Hayek indicates in a footnote that the term individualism first was introduced to the English language by a translation of Tocqueville's *Democracy in America* where the great French philosopher defined it as an attitude to withdraw from society and therefore rejected it.<sup>170</sup> (2) *False individualism*

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<sup>168</sup> The individual does not consciously know his ends rather the ends just exist and the individual acts according to them. For Mises the process of choosing and changing ends and the analysis thereof belongs to psychology and is not the subject of economics. Human action is ultimately given – homo sapiens is also homo agens – and ends are always given as well. If there are no ends, there is no human action and therefore there is either no human existence or the fullest degree of human existence where no desires and ends exist anymore. The ancient Greeks called this state perfect happiness.

<sup>169</sup> cf. von Mises, *Human Action*, 1996, p. 45

<sup>170</sup> cf. Friedrich A. Hayek, "Individualism: True and False" in *Individualism and Economic Order*, Chicago, London 1948 p.5

is rooted in the teachings of Cartesian rationalism and is mainly represented by French philosophers such as Rousseau and other continental thinkers. Hayek coins the concept 'false individualism' because he is convinced that this rationalistic form of individualism always tends to develop into socialism or collectivism.

### ***False Individualism***

Hayek traces the ideas he calls false individualism back to the French tradition founded by René Descartes and developed to a peak by Rousseau. Descartes came up with the idea that perfect institutions can only be established by a wise legislator. This faith in man's ability to deliberately design social institutions serving the advancement of human civilization led to the social contract theory in the 18<sup>th</sup> century. False individualism is also related to the general idea of the French social contract tradition that man receives his natural rights through this social contract from the state and that there are no natural rights in the state of nature (different than the Scottish/British social contract theory). Hayek calls false individualism rationalistic not because it assumes that the individual behaves rational but because the philosophers claim that it is possible to design social institutions by the pure application of human intellect. It is the proper implementation of these designed institutions that guarantee freedom and the flourishing of the individual. Small groups like the family or voluntarily associations shall be dissolved into atoms and be substituted with the cohesion by coercive rules substituted by the state.

### ***True Individualism***

The main alternative today is called true individualism by Hayek and associated largely with the Scottish thinkers of Enlightenment. They have a different concept of the social contract and of community in general. In this school of thought, the individual has certain unalienable rights that are reflected in social institutions (like private property) and in order to secure these essential human rights men render some of their freedoms to the state and enter a social contract. But though there is a social contract and thus a state existing, this cannot be the object of investigation of social sciences. Hayek points out that "there is no other way toward an understanding of social phenomena but through our understanding of individual actions directed to other people and guided by

their expected behavior”<sup>171</sup>. True individualism recognizes the institutions and establishments that have emerged without human design and are now the foundations for future human achievements. It is a concept that emphasizes the limits of human reason and shows a great humility in regard to social and economic processes. These spontaneous collaborations of free men can produce outcomes that surpass their individual imagination and knowledge. It is this highly anti-rationalistic approach of English individualism that regards man as an irrational and fallible being and distinguishes it from other traditions of individualism.

Since true individualism is not established by the coercive power of the state but is given by nature it is also not opposed to natural forms of community and associations such as the family or local autonomies. Hayek mentions that therefore true individualism is less individualistic than socialism.

### ***Methodological Individualism***

Hayek outlines his arguments for methodological individualism in his essay “Scientism and the Study of Society.” There he distinguishes social sciences clearly from natural sciences. While natural sciences can discover objective facts, the data of social science always have to be interpreted with systematic subjectivism. He argues that these facts are themselves ideas or concepts. He follows his teacher Ludwig von Mises in this consistent application of subjectivism to social science. An important fact related to subjectivism is the arising epistemological problem, which is one of Hayek’s main contributions to economics.<sup>172</sup> Since knowledge is dispersed, incomplete and inconsistent, the use of quantitative analysis in social science is impossible and leads to constant errors. Hayek describes the method of natural sciences as analytic and the method of social sciences as compositive or synthetic.<sup>173</sup>

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<sup>171</sup> Hayek, “Individualism: True and False”, 1948, p.6

<sup>172</sup> cf. Friedrich A. Hayek, “The Use of Knowledge in Society”, in *The American Economic Review* 1945, pp. 519-530

<sup>173</sup> cf. Friedrich A. Hayek, “Scientism and the Study of Society”, in *Economia* 1942, p. 287

### ***Self-Love***

Hayek rejects the common assumption that it is possible to derive the idea of the economic man from methodological or true individualism especially in the philosophy of Adam Smith and his contemporaries. Hayek points out that the concept of human nature of that time was not that of a rationalist, utility-maximizing individual but rather that humans are by nature lazy, improvident and wasteful and behave economically only by the force of the circumstances. The terms self-love or selfish interest were considered as the universal moving principles in 18<sup>th</sup> century philosophy. They did not mean profit-maximization but rather expressed a moral attitude. Hayek points out that the self, as a matter of fact, includes friends and family. Even more important than this moral attitude is again the epistemological fact that the individual cannot know more than a tiny part of society and therefore it is quite impossible to judge human action as selfish. So the question is not so much whether we should allow man to be guided by selfish motives. We should rather ask if he is capable of acting guided by the knowledge of the immediate consequences of his actions or whether someone else who possesses a fuller comprehension of this knowledge is better equipped to make the decision for him. From this distinction and argumentation Hayek also derives his critique of government interference and his justification for free markets.

### **5.4 Individualism & Entrepreneurship**

Methodological individualism might be a reasonable concept for approaching economics on a macro-level. It helps to understand some of the ways how individuals act and how these actions can be classified and scientifically considered. Nevertheless, there are some problems arising especially if we turn to the micro-level of economics. As we have observed in our assessment of entrepreneurial activity, it seems that we can distinguish between different kinds of actions. In particular, actions that are performed under a condition of true uncertainty cannot be considered as being *rational* in the ordinary meaning of this concept. A response to true uncertainty requires two conditions: (1) a low inter-subjective agreement to the profit opportunity and (2) a person with a high degree of venturesomeness who has qualities of leadership in the economic sphere and becomes a bearer of uncertainty. Additionally methodological individualism is only focusing on individual actions. Earlier, we discovered that

entrepreneurship can only be identified by a series of actions that are related to each other and that those actions can be characterized as entrepreneurial only *after* they have been actually performed.

These facts reveal some of the shortcomings of the anthropological concept of methodological individualism. Additionally, the concept is not consistently used by those economists who claim that they build their theoretical framework on this assumption. The phrase is also misleading because it is frequently interpreted as a kind of atomism on the one hand and on the other hand as rationalist individualism that affirms a distinguished role of the human mind superior to the coordinative functions of sound institutions and free competition. It also connotes an understanding of human actions that gives way to the approach of econometrics – human actions that can be statistically assessed and, by creating models under simplified conditions, can enable the economists to virtually predict the future state of affairs.

Generally, we can see that these anthropological arguments of the economists we have looked at shall support some of their economic arguments. In particular the quantitative approach to economics shall be rejected by this notion. However, the term methodological individualism is misleading as already mentioned. The concept of the individual, especially in its atomistic variant, cannot prevent its misuse in an econometric approach. It does not emphasize enough the uniqueness of the individual but concedes an understanding of the individual that can be grouped in order to be quantified.

Therefore, we want to look at the anthropological concept of personalism and apply it to the economic sphere. As already outlined, personalism is rooted in philosophical anthropology and refuses any kind of a quantitative approach to the human person. Its focus on human action as the main expression of the human person in the world is a sound basis for the approach to economics and especially to entrepreneurship as outlined above.

## 6. Economic Personalism

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Though personalism did not emerge as a term until the second half of the 20<sup>th</sup> century, it is rooted in a general reaction to rationalism, pantheism and absolute idealism that occurred throughout the 19<sup>th</sup> century. There are many schools of thoughts that dedicated themselves to a personalist approach in philosophy. One of the earliest purely philosophical definitions of the person was given by Boethius: “*persona est naturae rationalis individual substantia*” (the person is an individual substance of a rational nature). This general definition is still valid for many personalists today and serves as a starting point for further exploration in the different disciplines of science.

Though there are differences between the various personalist schools, the Stanford Encyclopedia of Philosophy identifies some common principles that are more or less shared by all of them: “These include an insistence on the radical difference between persons and non-persons and on the irreducibility of the person to impersonal spiritual or material factors, an affirmation of the dignity of persons, a concern for the person’s subjectivity and self-determination, and particular emphasis on the social (relational) nature of the person.”<sup>174</sup>

The foundations for this understanding of the person have already been laid and have been outlined above in the philosophical anthropology. Even though Max Scheler, Arnold Gehlen und Helmuth Plessner did not particularly emphasize “the person” in the center of their investigation, their assessment of human nature and principles that should serve as arguments for the uniqueness of the human person have already prepared the philosophical ground for the rise of the personal understanding of human nature that specifically relates to human action.

### ***Personalist Principles***

Personalists consider only the person with his/her *subjectivity* as “somebody” ontologically different from all other objects that are merely “something.” This

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<sup>174</sup> Stanford Encyclopedia of Philosophy: *Personalism*, <http://plato.stanford.edu/entries/personalism>, visited March 3<sup>rd</sup> 2010

subjectivity of the human person is on the one hand a starting point for all philosophical and scientific investigation and on the other hand it serves as the main argument for the irreducibility of man.

This radical dichotomy of persons and non-persons is also fundamental for the concept of the *dignity of the person*. Kant expresses it in the *Groundwork for the Metaphysics of Morals* with his notion that a person shall act in such a way that humanity, whether in your own person or in the person of any other, is always treated as an end and never merely as a means to an end.<sup>175</sup> This implies for a personalist that fundamentally different standards have to be applied for persons compared to the material world and to other forms of being. This is a rejection of any kind of collectivist, materialist, idealist or utilitarian philosophy. Only a person possesses subjectivity and is therefore the only entity that has the capacity for imagination, creativity and action.

Though a person is always related with other persons and can experience his own personhood only through sympathy and empathy for other persons, this does not mean that the acting person is determined by these relations or by society as a whole. Subjectivity helps to distinguish personalism from individualism. The concept of the uniqueness and irreplaceability of the person does not allow a treatment like that of the individual who can be used as a representation of a single unit in a homogenous set.<sup>176</sup>

Another important aspect of personalism is *self-determination*. From the perception of an “I,” the human person is able to act not in a mechanically determined way but by expressing his free will. This inalienable power of self-mastery is very important for the analysis of dispersed knowledge in society that we did earlier. There is no way to substitute the act of a person for the free will of another and this fact has far reaching implications on the discussion of whether a society can be centrally planned or not. The free act of a person is essential to human nature. We can distinguish between so-called “acts of man” (*actus homini*) and “human acts” (*actus humani*). The former describes the appearing phenomena caused by the latter. To understand the acts of man one must study human acts. These human acts are not only directed towards a particular value but

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<sup>175</sup> Immanuel Kant, *Grounding for the Metaphysics of Moral*, Indianapolis 1993, p. 30

<sup>176</sup> Therefore the human person is not eligible for any sort of statistical assessment.

they also determine the actor. Due to his ability *qua* person to distinguish between good and evil, the acting person makes himself a morally good or bad human being by carrying out certain actions. The person is not only responsible for his actions but also for himself.

*Communion* and its importance is another important distinction between personalism and individualism. A person cannot exist without communion. Therefore, one can derive a natural order among the different forms of community in which a person is acting. While for individualism all forms of communion are equal and ontologically secondary to the individual, the person *qua* person is always already in community with others. He is born into the natural community of the family and joins voluntarily different forms of associations (church, corporations, neighborhood and other groups and communities). He is always part of different entities with overlapping legal and executive powers that provide a framework (usually addressed as “the state”) for the ontologically prior communities as well as interact and interfere with them.

## **6.1 History of Personalism**

The history of philosophy has brought about three main centers of personalism that are important to our investigations.<sup>177</sup> (1) French personalism was a movement started by Emmanuel Mounier in the 1930s. It was largely a reaction to the economic collapse and the political and moral disorientation of this time. (2) German personalism was closely related to phenomenology developed by Edmund Husserl and was focused on the opposition to German idealism. It wanted to overcome the Kantian dichotomy of noumena and phenomena and correct the errors of positivism and nominalism. (3) Polish personalism was centered around the Catholic University of Lublin and Karol Wojtyła, who studied Max Scheler (a student of Husserl), and created a personalist synthesis of his Aristotelian-Thomistic formation and Scheler’s phenomenology.

### ***French Personalism***

French Personalism is primarily associated with two names: Emmanuel Mounier and Gabriel Marcel. Mounier, who was a professor in philosophy, started a journal called

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<sup>177</sup> cf. Stanford Encyclopedia of Philosophy, *Personalism*, Chap. 2

*Esprit* in the 1930s. After it was suppressed during World War II, it became one of the most influential journals in France. Mounier's approach was not to give definitive solutions but rather to raise the right questions. As he wrote in 1952, shortly before his death, personalism is a "certain outlook on human problems [...] to accenture certain demands which do not always receive sufficient consideration in proposed solutions for our present crisis."<sup>178</sup>

Central to Mounier's personalism was the freedom and creativity of persons and also the impossibility to define a person. The subjectivity of an other is a mystery that is not available either to be defined with words or with numbers. Monier points out that the concept of the person was not fully appreciated in the history of philosophy. The Greek worldview, which was more concerned with the cosmos, also dominated the Roman era. With the rise of Christianity and Christian theology the focus was shifted more towards a personal perspective, though the scholastics still cared more about the non-personal being. Mounier's philosophy can also be understood as "a reaction against the excess of the philosophy of ideas and the philosophy of things"<sup>179</sup>. This reaction was especially directed towards communism and nationalism and he was an opponent of any kind of philosophy that did not recognize the human person as a core aspect in society.

Gabriel Marcel was another French philosopher of the person. His approach to philosophy is unsystematic like Mounier's and rejects the ideas of Hegel and any other kind of primarily abstract philosophy. Marcel coined the phrase "functionalization of man" meaning that man appears to himself and others only as a conglomerate of functions. The result is that we no longer speak about man the mystery but about the functions of a man as producer, parent or churchgoer. Now we can analyze man in his function while man as a mystery would fall outside the scope of human intellect.

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<sup>178</sup> Patricia Donohue-White/ Stephen J. Grabill/ Christopher Westley/ Gloria Zúñiga: *Human Nature and the Discipline of Economics: Personalist Anthropology and Economic Methodolog*, Oxford, Lanham 2002, p. 31

<sup>179</sup> Donohue-White et al. *Human Nature and the Discipline of Economics*, 2002, p. 33

In summary, in the French tradition of personalism we can clearly observe the persistent avoidance of reductionism. The philosophers were opposed to the 20<sup>th</sup>-century tendencies of narrowing human existence down to a single aspect of investigation.

### ***German Personalism***

German personalism was heavily influenced by Edmund Husserl and his phenomenology, which is more a methodological approach to philosophy than a comprehensive doctrine. This method follows the claim, “back to the thing” and was applied to personalism by two German philosophers: Max Scheler and Martin Buber.

Max Scheler developed a variant theory that can be called value-personalism – he gives concrete status to abstract values. These values are not rational formal standards like the Kantians but possessed material content that becomes immediately known to the individual through a process of intuition.<sup>180</sup>

Martin Buber focused more attention on the person and his relationship to others in community. He argued against individualism that sees man only in relationship with himself as well as collectivism, which reduces man to a part of an organic whole. His central claim is the importance of I-Thou-relationships distinguished from I-it relationships. The first can be called personal the latter functional. The totality of the I-Thou-relationships forms the solidarity of the community.

German personalism is more concerned with the relationships of persons with others and locates itself as a medium between individualism and collectivism. It had strong influence on a third European center of personalism: the Polish variant.

### ***Polish personalism***

The central thinker in Polish personalism is Karol Wojtyła, later Pope John Paul II. He wrote his dissertation on Max Scheler’s view on morality and man. Wojtyła discovered phenomenology in Scheler’s writing that helped him to develop his anthropology from his Thomist understanding of a static rational substance to that of an acting man.

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<sup>180</sup> cf. Donohue-White et al. *Human Nature and the Discipline of Economics*, 2002, p. 35

Wojtyla used personalism to inform catholic theology and was responsible, especially as Pope, for the spread of personalist ideas among Catholic theologians.

His main book on personalism is *The Acting Person*, which was written in 1969 and eventually translated into English in 1979. One of his hallmarks in this book is the Aristotelian-Thomistic approach to human action and community. He is convinced that the potential to participate in community is a part of the self. This potential has to be activated to mature. Though the self-determined human person is free to act but needs not to act, it is still necessary to act jointly with others in order to realize one's own potential and to advance to a higher level of the self. Wojtyla describes three characteristics of the acting person<sup>181</sup>: (1) self-possession means to be the seat of one's actions; (2) self-governance is the ability to make life-forming decisions regarding vocation, marriage and also in regards to religion; and (3) self-determination is the ability to determine one's own actions as an expression of the self and also as a formation of the self.

## **6.2 Economic Personalism**

After this assessment of personalism in its broad philosophical tradition we turn now to an application of these personalist principles to economics. The phrase Economic Personalism was first used in 1996 by Gregory Gronbacher, who was a fellow at the Acton Institute for the study of religion and liberty. The ideas promoted by the Acton Institute are deeply rooted in Catholic social teaching, especially in the tradition of Pope John Paul II. In economic terms, the institute is dedicated to the Austrian School of Economics. The mission of the institute is to build a synthesis of Christian moral principles applied to a specific approach to economics.

The idea of Economic Personalism was outlined in a three volume series by the Acton Institute in 2001 and was followed by a debate in the Institute's journal "Markets and Morality." The aim of this project was to initiate an interdisciplinary debate between theologians, philosophers and economists on the underlying anthropological

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<sup>181</sup> cf. Anthony J. Santelli, Jr./Jeffrey Sikkenga/Rev. Robert A. Sirico/Steven Yates/Gloria Zúñiga, *The Free Person and the Free Economy: A Personalist View of Market Economics*, Oxford 2002, p. 50 et seqq.

assumptions of modern economic theory and their philosophical and theological applications.

If we apply personalism to the discipline of economics we have to ask again: What is the human person? As we stated earlier, Boethius considered a rational nature of an individual substance as essential to the definition of person. Since economics is the science of human action we could speak about the expression of this rational human nature in human acts. We face of course some problems in defining a person by his rational acts. In a personalist approach, we do not only focus on human acts but also on the actor. An actor – a person – is constantly a person and not only in the situation of action and this implies that the potential for rational action is sufficient for defining a person in economic theory. With this distinction of potential and actual rational action we can also justify the personhood of an unborn baby and mentally ill persons. There are several other epistemic shortcomings in regard to the person, especially in the question of how to recognize someone as a person, but to advance in the topic we will now focus on the ontological examination of Economic Personalism.

We will follow in this analysis Gloria L. Zúñiga who pointed out some of the epistemic and ontological problems of personalism in her paper, *What is Economic Personalism?*, and proposed the following definition for personalism: “an ontological structure in which reality is fundamentally personal.”<sup>182</sup> This means that no mediate relations between nonperson objects and persons exist. All higher-order economic goods that might suggest the existence of such relations have been transformed by human action to this higher form of good. But the integration of personalism into economics does not produce a new economic methodology because economics is concerned with human action and human choice and therefore already personalist in nature. But personalism can correct some shortcomings in the existing theories.

Mainstream neoclassical economics have built their theoretical assumptions on the grounds of economic efficiency that are rooted in Pareto optimacy, which again is heavily influenced by Benthamian utilitarianism. The problem in regard to the person is

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<sup>182</sup> Gloria Zúñiga, “What is Economic Personalism? A Phenomenological Analysis”, in *Journal of Markets & Morality*, 2001, p. 160

that there is no moral limitation on the ends that individuals seek to achieve. According to the utilitarian principle, the greatest happiness of the greatest number is the main target of economic and social processes. The moral problems arising are obvious because this can easily lead to totalitarianism in many forms.<sup>183</sup>

Also, the Austrian school of economics has shortcomings in considering certain implications of human action since it excludes the relevance of these implications by definition. Though the Austrians, due to their non-mathematical approach to economics, did not have to adopt the utilitarian principle, they still face difficulties with moral values that could be solved with the theory of Economic Personalism.

The final question of course is what Economic Personalism really means. The formal properties are outlined by Zúñiga<sup>184</sup>: (1) Economic Personalism is a conduct that is absolute person-mindedness, (2) a conduct considered not only as action but also as thinking, judging and choosing (3) a personalist approach to things and state of affairs, (4) a conduct, thing and real state of affairs must occur in economic environment that involves a state of scarcity and gives rise to a choice that results in costs, (5) and a certain quality in person-mindedness. In conclusion, she defines Economic Personalism as “an object with three properties: a bearer, an economic content, and a unifying quality called person-mindedness [in] short we can say simply that economic personalism is economic agency or economic objects connected to human meaning and concern.”<sup>185</sup>

### **6.3 Economic Personalism & Methodological Individualism**

After this assessment of Methodological Individualism and Economic Personalism we want to answer now the question of how they are related and what personalism could contribute to economic methodology.

Economic Personalism is above all an important ally in the rejection of a phenomenon that is called economic imperialism or economism. This means the application of the

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<sup>183</sup> We do not investigate these problems in depth here.

<sup>184</sup> cf. Zúñiga, “What is Economic Personalism? A Phenomenological Analysis”, 2001, p. 169f

<sup>185</sup> Zúñiga, “What is Economic Personalism? A Phenomenological Analysis”, 2001, p. 170f

rational choice praxeology to all human behavior. Methodological individualism was invented as a concept in reaction to collectivist approaches to human action, especially during the *Methodenstreit*. It distinguishes its methodology with a primary focus on human action or behavior as the source for economic analysis; it also emphasizes that human acts are always acts of the individual person. Nevertheless, this concept is misleading and has some shortcomings as was pointed out. We can also observe that those economists who applied this anthropological concept over time moved away from their initial assumption. For example, Schumpeter applied individualism in the way that he turned to econometrics and Hayek shifted towards evolutionism.

It might therefore be more appropriate and less misleading to employ personalism as the anthropological foundation for any kind of economic thought that rejects all sorts of reductionism and economism. Personalism is by definition opposed to atomism and puts the acting person and his/her relationship to his/her environment and to society in the center of interest. Even though at the time when methodological individualism was developed there was still a different understanding of the individual and the self common, things have changed. The concept of individualism is dominated by an understanding that reaches even further than Tocqueville's. It is a very misanthropic approach to life and society that tries to avoid any contact with other persons.

Our whole discussion presupposes a natural tendency of the individual towards society and other people. In order to avoid misunderstandings and to be able to develop a thorough and comprehensive philosophical framework for economics, it is therefore more appropriate to use economic personalism as the anthropological foundation for economic theory rather than methodological individualism.

## **6.4 Economic Personalism & Entrepreneurship**

This is especially valid when it comes to the assessment of entrepreneurship. We have already observed that for the advocates of methodological individualism, true entrepreneurship is not really fitting in their theoretical framework. Mises calls true entrepreneurs “promoters” and finds no place for them in his very logical system of praxeology. There are many different motivations for promoters to actually start an

enterprise. If we only look at the single human action, we cannot understand what entrepreneurship really is. In our assessment we also have pointed out that entrepreneurial activity in the economy has a different ontological level than other activities. With Knight we understood that the entrepreneur becomes a bearer of uncertainty. This is due to the fact that time is not a physical but an anthropological phenomenon. Only man has time and only man can be aware that his future is uncertain. Unlike other living beings that react to signals of their environment, human beings do not respond instinctively but act with purpose. Purpose has its meaning only by the uncertainty of the future. Within the economy this purposeful action as entrepreneurial action is important in several ways. These ways cannot be considered if the ontological status of all human actions in the economy is the same.

Entrepreneurship as uncertainty-bearing has an equilibrating impact on the economy. Entrepreneurship requires forecast of the future and the carrying out of this plan. This involves several actions which, viewed separately, cannot be understood as entrepreneurial acts. Forecast, judgment and execution is the triple that distinguishes entrepreneurial acts from other actions. With personalism we can also understand better the social aspects of an enterprise. With the firm the entrepreneur can offer guarantees to his employees and use his self-confidence to shoulder uncertainty away. This is also contributing to the stability of a society.

With these insights we can finally conclude that the more persons within a society who carry out entrepreneurial actions, the more the economy is pushed towards equilibrium, the smaller the entrepreneurial profit will be and the more stable society will be. These are insights that can only be generated with a specific personalist approach to economy.

## 7. Conclusion

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We want to conclude briefly in this last chapter what we have discovered in this investigation of entrepreneurship and its anthropological foundations. From the philosophical assessment of the human being, we have derived the following principles: (1) action is a particular human category and essential for human nature and the concept of the person; (2) man is a deficient being and is urged to act in order to survive; and (3) man's actions transform the natural reality and create an artificial culture.

Additionally, human acts in the economy are driven particularly by uncertainty. We developed the following arguments for uncertainty about the future: (1) uncertainty motivates human action and humans act in order to reduce uneasiness, (2) knowledge is dispersed among people and is best applied by acts of the individual, (3) to bear the uncertainty of the future man has to make judgment, believe in them and carry them out.

With these preconditions of human nature we explored the nature of entrepreneurship – human acts within a market motivated by the uncertainty of the future. These acts require some sort of alertness to hitherto unnoticed profit opportunities, at least partially ownership of the employed resources and some sort managerial qualities. By forecasting the uncertain future, developing a plan, and carrying out this plan, the entrepreneur becomes a bearer of uncertainty. We discussed different arguments for the existence of profit. While the entrepreneurial income cannot really be determined by the different functions an entrepreneur performs, his function as uncertainty-bearer is the ultimate justification for receiving the residual income or suffering the residual loss. As bearer of uncertainty he acts equilibrating within the economy, reduces uneasiness and creates new opportunities for himself and other entrepreneurs. He needs the firm to exploit his opportunities and the firm is the mean through which entrepreneurship can be carried out over time.

This complex reality of actions, community and motivations provided the basis for our critique of the anthropological concept of methodological individualism - the basis for most of the economists we have discussed. It was designed in order to remove the

person from any kind of mathematical assessment. The reality of human action is too complex to be designed in macro-economic models. As we have pointed out the concept of economic personalism provides a better theoretical framework to achieve this goal because it stresses in a better way the fundamental uniqueness of the human person.

This assessment of entrepreneurship and its anthropological foundations was particularly intended to reconnect economic theory with its philosophical origin. Economists sometimes can lose sight of the big picture if they go too much into detail. The philosopher usually draws a greater picture and does not shy away from employing terms and concepts that might not have an immediate application for economic theory but help a person to understand the basic principles on which the debate is built on.

Ethics and morality are often delegated by economists to the science of business administration. Many economists believe that the only thing they have to do is to observe human actions and to derive principles from these observations. At first sight this involves no ethics. But intentions are not neutral – they have a moral quality and therefore we have to consider them. The economists of the Austrian school of economics, we have discussed above, often neglect this reality. Only if we look at the human being as a dignified, relational person rather than as an autonomous individual we can understand the implications thereof. There are human actions that do not contribute to human flourishing. Even if they are monetarily profitable, they can destroy human relationships or even human lives. Therefore, it is not sufficient to provide a framework for society that enables man to act freely; we also have to be concerned to provide a framework that promotes action towards the moral good.

One example in regard to entrepreneurship is the difference between constructive and destructive entrepreneurship. While our investigations were primarily concerned with the metaphysical and anthropological dimensions of entrepreneurship, this would be an application to ethics and political philosophy. Let's think back to the story of Thales at the beginning. Let's assume now that Thales is not the inventor of a new technology but that he has contracted the best workers for pressing olives by human labor. If someone else would invent mechanical presses this would do a huge damage to his business. So

he influences his friends in politics in order to create a new law that would prohibit the use of any technology to press olives. This can of course also be considered as some sort of an entrepreneurial act. But in this case the advancement of society and the economy has been prohibited due to this rent-seeking attitude of Thales. Destructive entrepreneurship is not only related to the question of governmental interference. Entrepreneurship might also be destructive for the human person. From a perspective of the individual who is only characterized by his actions, we cannot understand the impacts of such actions.

But if we look at the morality of the acting individual as a person, we can see that a person is a structural order of acts. A person can determine his acts, has the ability to act contrary to his drives and instincts and is always in communion. His acts have moral implications on himself and on the world around him.

Although this paper outlined the positive aspects of constructive entrepreneurship, which function entrepreneurship has in the economy, and how it contributes to human flourishing and to the advancement of society, we want to remark at the end that this is not valid for entrepreneurship *per se*. To understand the moral implications of entrepreneurship, we have to develop a thorough understanding of the human person. This would require a more thorough assessment of the morality of entrepreneurship as a whole that could be carried out in a future project.

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# Abstract

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## English

This thesis defends economic personalism as the sufficient anthropological basis for understanding entrepreneurship. It is separated into three main chapters. The first chapter explores the motivations for human action, particularly within the tradition of the philosophical anthropology. The issue of uncertainty about the future is a central aspect that is analyzed in depth. The main actor in the economy, who is acting as bearer of uncertainty, is the entrepreneur. With the next step, the different aspects of entrepreneurial activity are contrasted with each other: the alertness for hitherto unnoticed profit opportunities, the importance of ownership and the ability to forecast the future and to turn these plans into reality. These concepts are reflected along the general guideline of Aristotle's ethics and metaphysics. The investigation of the function of the entrepreneur within the enterprise completes this discussion and leads to the confrontation of the anthropological concepts of methodological individualism and economic personalism. Currently, the tradition of economic personalism is more useful to remove the individual from macroeconomic utilization of mathematical models. Furthermore, entrepreneurial activity reveals the tight limits of methodological individualism that are not able to fully recognize the broadness of the concept of the entrepreneur.

## Deutsch

Die Arbeit unterteilt sich in drei Abschnitte. Zuerst werden die Motivationen für menschliches Handeln vor allem in der philosophischen Anthropologie untersucht. Das Thema der Ungewissheit über die Zukunft stellt sich vor allem für wirtschaftliches Handeln als ein zentraler Aspekt heraus und wird daher genauer analysiert. Der Hauptakteur in der Volkswirtschaft, der als Träger dieser Ungewissheit agiert, ist der Unternehmer. Von der Aufmerksamkeit für nicht genutzte Profitmöglichkeiten über die Wichtigkeit von Eigentum und dem Einsatz dessen bis hin zur Urteilskraft und der Fähigkeit in die Zukunft voranzuplanen und diese Pläne auch zu verwirklichen werden

die unterschiedlichen Aspekte unternehmerischer Tätigkeit gegenübergestellt und anhand der generellen Leitlinie der Aristotelischen Ethik und Metaphysik reflektiert. Die Untersuchung der Funktion des Unternehmers in einem Unternehmen rundet diese Auseinandersetzung ab und leitet über zu einer Gegenüberstellung der anthropologischen Grundkonzeptionen des methodologischen Individualismus und des ökonomischen Personalismus. Es stellt sich heraus, dass sich die Tradition des ökonomischen Personalismus heute als anthropologische Grundlage besser eignet, um das Individuum einer makroökonomischen Verwertung durch mathematische Modelle zu entziehen. Gerade im Bezug auf die unternehmerische Tätigkeit werden zudem die engen anthropologischen Grenzen des methodologischen Individualismus aufgezeigt, der die Breite des Unternehmerbegriffes nicht vollständig erfassen kann.

# Curriculum Vitae

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