

ON THE ORIGINS OF ENTREPRENEURIAL ALERTNESS: DID BAUER AND YAMEY PRECEDE KIRZNER?

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After the Second World War, the entrepreneur virtually disappeared from economic analysis (Baumol 1968). This neglect followed from the emerging models of general equilibrium that formed one aspect of the core of economic theory.¹ By assumption, the Walrasian auctioneer knew the appropriate prices necessary to equate quantity supplied with quantity demanded in each market. In addition, the auctioneer knew when and by how much to adjust prices when an exogenous factor changed such as income or production technology. Trade only occurred at equilibrium prices so that markets cleared. No market participant chose or changed prices; it occurred exogenously.

Kenneth Arrow recognized the lack of real world mechanisms to determine and adjust prices in competitive markets. He identified a logical gap in the perfectly competitive model. He wrote that “there is no place for a rational decision with respect to prices as there is with respect to quantities” (Arrow 1959: 42). Prices exist independent of

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¹Keynesian macroeconomics formed another prominent aspect of economic theory. It too lacked any use for an entrepreneur as it focused on the movement of statistical aggregates with little concern about the underlying microeconomic processes.

consumer and firm behavior. A complete model would have to provide a solution to the conundrum.²

Israel Kirzner (1967, 1971, 1973) responded to Arrow's challenge. He argued for the reintroduction of the entrepreneur into economic analysis in order to explain how markets work. He offered a novel interpretation of the role of the entrepreneur in explaining how markets adjust to changes in conditions. Entrepreneurs recognized profit opportunities that no one else had. What appeared as an equilibrium price was not; it was a disequilibrium price that once recognized would yield profits. The fundamental aspect of entrepreneurship is alertness. Entrepreneurs, wrote Kirzner (1997: 72), notice "hitherto unnoticed profit opportunities" that arise from disequilibrium prices.

Kirzner did not devote many pages in his writings to discussing economic development. He focused on microeconomic processes, especially those pertaining to the mechanisms necessary to attain or approach equilibrium states. He devoted less time to understanding the role of entrepreneurship in explaining the differences in income per capita around the world. However, early in the development of his theory of entrepreneurship, he did critically examine the role of the entrepreneur in explaining comparative economic development.

In "Entrepreneurship and the Market Approach to Development," Kirzner (1971) offered a definition of the entrepreneur that predated his more well-known 1997 definition. He argued that development economics in the 1960s, outside of the Schumpeterian variety, did not include the entrepreneur and, as a result, explanations regarding the differences in income around the world were not adequate. Like general equilibrium models, models of economic development lacked an endogenous source of innovation, invention, and resource reallocation.

Kirzner's critique of development economics included a citation to P.T. Bauer and Basil Yamey's 1957 book, *The Economics of Under-Developed Countries*. He argued that their contribution missed the central feature of entrepreneurship—namely, alertness to new opportunities to make a profit. I disagree. Indeed, Bauer and Yamey (1957: 106) identified the same aspect of entrepreneurship that Kirzner would later stress—"hitherto unsuspected opportunities for profitable economic activity." Even though Kirzner (2005: 465)

²Few have followed up on Arrow's concerns. See Fisher (1983), Yates (2000), and Gintis (2007) for exceptions.

referred to the Bauer-Yamey book as a “classic” in development economics, he failed to fully recognize the pioneering contributions they made to understanding the true nature of entrepreneurship.

Kirzner’s Critique of Development Economics in the 1960s

Neoclassical economics, as characterized by Arrow-Debreu general equilibrium, does not explain how prices emerged from the trading process. Prices existed prior to exchanges. The Walrasian auctioneer knew the necessary information regarding consumers’ preferences and information as well as the cost curves facing the firms. After collecting all the information, the auctioneer identified the vector of prices necessary to clear markets. Trade only occurred after prices were announced. Arrow identified this puzzling aspect of neoclassical theory; it lacked a theory of how prices change in a competitive market: “Each individual participant in the economy is supposed to take prices as given and determine his choices as to purchases and sales accordingly; there is no one left over whose job it is to make a decision on the price” (Arrow 1959: 43). Prices existed independent of the decisions of individuals. No one within the model set or changed prices.

Interest in the entrepreneur increased in development economics in the early 1960s as alternatives to general equilibrium theorizing appeared. Irma Adelman (2001) argued that entrepreneurship became the central variable in development policy from 1958 to 1965, while McClelland (1961), Hagen (1963), Baumol (1968), and Leibenstein (1968) each offered their own attempt to include the entrepreneur. Peter Kilby (1971) identified no less than 13 aspects of entrepreneurship related to economic development. Entrepreneurship appeared on the intellectual agenda but its essential component—alertness—did not.

Kirzner (1971) developed the arguments that would later appear in *Competition and Entrepreneurship* (1973). He criticized development and growth economics for misunderstanding the role of the entrepreneur:

The literature dealing with development proper gives some attention to entrepreneurship, although little effort has been devoted to formulating a clear theoretical understanding of

the entrepreneurial role. Discussion has revolved primarily around the possibilities of an “entrepreneurial climate” emerging in hitherto primitive economies; as weak in underdeveloped countries as frequently assumed; around the feasibility of relying upon foreign entrepreneurs, and similar issues [Kirzner 1971: 194].

In a footnote following the above quote, Kirzner cites Bauer and Yamey (1957). He includes them in the group of economists who have discussed entrepreneurship but failed to address its central feature of alertness—perceiving hitherto unnoticed profit opportunities. He should not have, because Bauer and Yamey identified the central aspect of entrepreneurship that Kirzner stressed. They, too, recognized and discussed entrepreneurial alertness.

Kirzner goes on to argue that:

However valuable, these discussions appear either to lack an explicit theoretical framework within which to examine the relevant issues, or, at best, to be founded rather shakily on the theory of entrepreneurship as expounded by Schumpeter in his justly famous work. . . . Consequently, the real function of the entrepreneur in a developing market economy seems often to have been poorly understood, and the plausibility of rapid development under alternative economic systems to have been accepted uncritically [Kirzner 1971: 195].

Kirzner recognized the importance of the entrepreneur in explaining economic growth and development as did many others in the 1960s. Unlike the others, Kirzner identified an aspect of entrepreneurship they did not. In order for economies to grow, someone had to grasp “the knowledge which might otherwise remain unexploited” (Kirzner 1971: 197). But Kirzner was not the first to recognize the importance of alertness.

P.T. Bauer and Basil Yamey on Entrepreneurship

Although much of development economics in the 1950s and 1960s neglected the entrepreneur, the contributions of P. T. Bauer and Basil Yamey did not. Rather, they emphasized the importance of the entrepreneur in their earliest writings. Bauer clearly identified entrepreneurship as a vital but neglected aspect of orthodox development economics. His early studies on trade in West Africa (Bauer 1954)

provided ample evidence that entrepreneurship was omnipresent and was vital in understanding how economies evolve from low to high levels of income per capita. For example, Bauer (1954: 30) wrote that the trader-entrepreneur (as he referred to entrepreneurs) in Nigeria and the Gold Coast exhibited the following characteristics: “exceptional effort, foresight, resourcefulness, thrift and the ability to perceive economic opportunity.” Trader-entrepreneurs, at least those in Nigeria and the Gold Coast, perceived profit opportunities. They were alert. Entrepreneurs recognized the gains that emerged from changes in relative scarcities, new information, new ideas, or serendipity.

In other writings, Bauer continued to argue that the trader-entrepreneurs existed throughout the developing world. His fieldwork in sub-Saharan Africa provided plenty of evidence. According to Bauer ([1963] 1972: 347), “The prominence of foreigners in African commerce reflects technical and administrative skills, thrift, [and] the ability to perceive and take advantage of economic opportunity.” Once again, entrepreneurs perceive economic opportunity when it arises. They do not simply respond to a given set of prices, production techniques, or information. Entrepreneurs engage in more than arbitrage. They recognize profit opportunities no one else had and develop new means to attain their goals.

Bauer and Yamey (1957) offered a comprehensive discussion of the source of economic development that extended beyond conventional models at the time that stressed capital formation or the rate of savings. They stressed a number of factors including the quality of public institutions and policies, the importance of international and intranational trade, values, and attitudes. More importantly, central to their argument, they stressed entrepreneurial alertness and its perception of “hitherto unsuspected opportunities.”

Bauer and Yamey began their discussion of the entrepreneur by noting that entrepreneurship occurs quietly through small changes that raise productivity. Better knowledge of prices and costs allow the entrepreneur to make profits. Knowledge of productivity increasing techniques also represents an aspect of entrepreneurship. But they extended entrepreneurship beyond greater knowledge of existing conditions. In some cases, it leads to significant changes. In particular, “Innovation and the exercise of entrepreneurship in the sense of creating or taking advantage of *hitherto unsuspected opportunities for profitable economic activity* are often dramatic in their impact,”

wrote Bauer and Yamey (1957: 102, emphasis added). They went on to argue that “the ability of individuals to perceive new opportunities for profit and the ability and willingness to exploit them are indeed crucial in economic development” (ibid.). From these passages, it is clear that Bauer and Yamey held views similar to those of Kirzner regarding the central features of entrepreneurship.

Bauer and Yamey (1957: 102) pointed to how entrepreneurs help generate new ideas and new techniques that foster economic development:

The activities of the innovators or entrepreneurs who introduce new crops or techniques of production or open to new trading routes or areas of cultivation, and of those who appreciate the potentialities of new ideas and novel methods and adopt or adapt them for local use, raise the level of economy.

Kirzner’s contribution to the theory of entrepreneurship clearly has its antecedents in the works of Bauer and Yamey. Yet, their contribution appears to have been forgotten. There is no mention of their pioneering work on entrepreneurship in Kirzner’s seminal book, *Competition and Entrepreneurship* (1973); nor in Kirzner’s 1997 *Journal of Economic Literature* article, which is a survey of his theory of entrepreneurship. Nevertheless, in Kirzner’s (2005) contribution to a conference volume in honor of Bauer after his death, he called Bauer and Yamey’s 1957 book a “classic.”

Conclusion

Bauer and Yamey’s (1957) identification of entrepreneurship with “hitherto unsuspected opportunities for profitable economic activity” prior to Kirzner does not imply that he did not make a scientific contribution to the theory of entrepreneurship. Originality is only one aspect of scientific progress. As George Stigler (1955: 294) noted, “Scientific originality in its important role should be measured against the knowledge of a man’s contemporaries. If he opens their eyes to new ideas or to new perspectives on old ideas, he is important in the scientifically important sense.”

Even though Bauer and Yamey identified an aspect of entrepreneurship that had eluded development economists and the profession more broadly, Kirzner’s discussion opened the eyes of others. For example, Schultz (1975, 1990) developed an alternative theory of

entrepreneurship that emphasized the role of human capital partially in response to Kirzner in order to better understand the process of economic development. Moreover, Baumol (1990) differentiated between productive and unproductive entrepreneurship, and differentiated his approach from Kirzner's. Although, Bauer and Yamey emphasized the role of entrepreneurship in explaining the process of economic development, Kirzner brought a new perspective to an old idea.

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