Entrepreneurship and Social Cooperation

We may laud the market order as an indispensable arena for large-scale social cooperation, but let's not forget that people cannot cooperate with one another if they don't know that the potential for mutually beneficial exchanges exists.

In the real world ignorance is pervasive, and we mustn't fall prey to the mainstream economists' unreal assumption that full knowledge about means, ends, and preferences is "just there" at the disposal of an economic planner. We know this is not the case in real life: First, knowledge is dispersed throughout society, not concentrated in some repository. Second, much relevant knowledge is in the nature of knowing *how*, not knowing *that*; that is, it's tacit, unarticulated, and even inarticulable. Third, much relevant knowledge is *discovered serendipitously* in the course of acting, extinguishing ignorance that a person wasn't even aware he suffered. (This kind of ignorance is distinguished from rational ignorance, where one *chooses* to remain in the dark about some matter until one decides the benefits of the information exceed the cost of obtaining it.)

If all that economics takes notice of is already *known* means, ends, and preferences, it misses the defining creative and entrepreneurial character of human action. Think about how you make real decisions, and you'll see the point.

F.A. Hayek, beginning in the 1930s, called economics to account on this matter. What's the point of thinking about an economy in equilibrium, with its assumption of complete knowledge about resources and preferences, Hayek asked, if no explanation is given of *how* an economy in theory could ever evolve to such a state. After all, we never have complete knowledge about resources and preferences. If economics as a discipline is to have any relevance for the real world, it must address the question of how a society rife with ignorance and incomplete knowledge can progress. Otherwise, economics is justly mocked in the joke about the economist who, stranded with nothing but canned food, "assumes a can opener."

Here's how Hayek indicted mainstream economics in his path-breaking essay "Economics and Knowledge" (1937):

> *The problem which we pretend to solve is how the spontaneous interaction of a number of people, each possessing only bits of knowledge, brings about a state of affairs in which prices correspond to costs, etc., and which could be brought about by deliberate direction only by somebody who possessed the combined knowledge*

> *of all those individuals. Experience shows us that something of this sort does happen, since the empirical observation that prices do tend to correspond to costs was the beginning of our science. But in our analysis, instead of showing what bits of information the different persons must possess in order to bring about that result, we fall in effect back on the assumption that everybody knows everything and so evade any real solution of the problem.*

Hayek of course went on to develop this critique in great detail, showing that sound economic theory void of unrealistic assumptions — the theory of Menger and Mises — can explain the process by which markets tend to equilibrate. (Of course, they can never reach equilibrium, because change is unceasing.) It's an explanation rooted in purposeful individual action and interaction (cooperation), that is, exchange in the market. In an imperfect world, prices contain potential clues (if interpreted correctly) to overlooked opportunities for coordination and exchanges that would leave people better off.

But how, exactly, does this come about? Enter the entrepreneur, whom Ludwig von Mises made central to our understanding of the market's operation. To fully appreciate the role of entrepreneurship, we turn to Israel Kirzner, one of Mises's doctoral students. It was Kirzner who elaborated on what the entrepreneur does to help individuals better realize their objectives, that is, to facilitate cooperation that would not have taken place otherwise for lack of the necessary knowledge. "Kirzner's contribution to market process theory provides the missing link to the neoclassical theory," Peter Boettke notes in his new book, *Living Economics*.

In chapter 6 of *Competition and Entrepreneurship*, Kirzner writes,

> *Now for an exchange transaction to be completed it is not sufficient merely that the conditions for exchange which prospectively will be mutually beneficial be present; it is necessary also that each participate be aware of his opportunity to gain through the exchange….*
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> *Where the conditions for exchange in fact exist but are not exploited owing to ignorance there now exists scope for profitable entrepreneurship. If A would be prepared to offer as much as twenty*

> *oranges for a quantity of B's apples, and B would be prepared to accept, in exchange for his apples, any number of oranges greater than ten, then (as long as A and B are each unaware of the opportunity presented by the attitude of the other) entrepreneurial profit can be secured by buying B's apples at a price (in oranges) greater than ten and then reselling them to A for a price less than twenty.*

In effect, the entrepreneur enables A and B to cooperate in a way that otherwise would have eluded them — which is to say they would have been disappointed to learn that they missed out on an opportunity to exchange apples and oranges. The entrepreneur thus facilitates cooperation by being alert to potential price discrepancies, which are the inevitable result of our ignorance and error.

To simplify, we could say that he buys low and sells high when no one else notices that such arbitrage is possible. By so doing, he brings buyers and sellers together — while profiting from the price difference. Of course, in a competitive environment he simultaneously conveys knowledge about that difference, setting in motion a process that makes the "pure entrepreneurial profit" disappear. By exploiting the profit opportunity, he assures that it will be short-lived. But people are better off because of his alertness. That's what markets enable.

We now see that the battle cry "People before profits!" is based on a misunderstanding. In a *freed*market, profit is a sign of new social cooperation. Thus, a better battle cry would be "Exploit price discrepancies, not people!"