



Episode 1,088: How to Think About Inequality, and Why We Shouldn't Fear It

Guest: Per Bylund

WOODS: Let's talk about this paper of yours. They're two topics I love very much. I'm very, very interested in the debate over inequality, and I'm interested in entrepreneurship, so you've got a perfect paper from the point of view of this podcast. I want to know first of all how it is – we're going to lay out what your argument is, but what I'd like to know is is there a distinctly Austrian angle to this argument. Are you seeing things that other people don't see because they don't have an Austrian understanding of entrepreneurship. And maybe we should start with: how does the Austrian view the entrepreneur as opposed to how mainstream economics views the entrepreneur?

BYLUND: Well, that's sort of an easy question. I think we can ask how do Austrians view the entrepreneur compared to mainstream entrepreneurship scholars. I mean, for mainstream economists it's pretty easy, because they don't.

WOODS: But that's – you know, I've heard so many Austrians say that and that sounds so implausible to the average person. They think you must be exaggerating.

BYLUND: Yeah, I wish I was, but I'm not. I mean, they do study entrepreneurship in a sense, but they study it as the number of small firms in an industry or the number of new firms recently started, and they see that as simply an argument for the dynamism of an industry and a potential for economic growth and employment, really. They're really helping politicians to formulate reform and policies. That's what they do.

WOODS: Okay, then in that case, given that the Austrians are in a way the only game in town, what are they saying about the entrepreneur? I remember, by the way, one of the first things I heard in the history of economic thought that really stayed with me was the idea that, even the classical economist didn't really have a place for the entrepreneur. Richard Cantillon had a place for the entrepreneur. So what are the Austrians saying? What is the role of the entrepreneur? And by the way, we should also distinguish it from, let's say, the colloquial understanding of what an entrepreneur is.

BYLUND: Right, I think the colloquial understanding is pretty close to how mainstream economists use the term. It's just whoever owns his own business. So you would be one. I would not be one. And I mean, anyone who has a little store would be an entrepreneur, right? That's not what we mean in Austrian economics. In Austrian economics, Mises called it the driving force of the market. It's the source of change or the change agent. But it's sort of a little tricky question to answer too, because there are several different Austrian theories of entrepreneurship as well.

WOODS: Right. And I don't know where you come down on that, and I think maybe it might get us too far afield to jump into that. The ones that I know of are the broad categories of Kirzner viewing entrepreneurship as a discovery process, while Mises, it looks like, when you read Mises, he's not really using that language. He's thinking in terms instead of somebody who – an owner of capital who acts under uncertainty, under the uncertainty of the future, he does his own forecasting and appraisal to decide what the proper arrangement of resources is in the expectation and hope of a profit in the future. But regardless of which one of these we accept, the entrepreneur, nevertheless I think all the Austrians would think of him as somebody who is engaged in some kind of process of adjustment where he believes there to be some kind of a discrepancy between factor prices today and expected profits in the future if he arranges those factor prices a certain way. Is that roughly okay?

BYLUND: I think so, but it's an adaptation or an adjustment to what I as an entrepreneur imagine will be the case –

WOODS: Right.

BYLUND: – which of course is very open in scope. We all have different imaginations on what will happen. I mean, Krugman would imagine that a fiscal stimulus package would save the economy, for instance. I wouldn't imagine that.

WOODS: Right, of course, of course. All right, so let's put this on the back burner for now and let's try and go through your paper one point at a time. First of all, you talk about inequality and later one we get to whether we should worry about inequality at all. But you start off by saying that when we look at inequality, we should be concerned first and foremost with individual well-being and not with income statistics. Now, what do you mean by that and why?

BYLUND: Well, I think that is a very Austrian point, in a sense, basically where you started out, that looking at are people satisfied or not. I mean, economic growth, yeah, we can measure it or try to in terms of gross domestic product and so forth, but what really matters is are people able to satisfy their needs and their wants. And to the greater extent that we are, the better off we are. So one way of looking at the standard of living basically in a society is how well off do we perceive ourselves to be, how many of our wants can we satisfy rather easily or have we already satisfied. I mean, that's one way. That would be the well-being part of it. But that's very hard to measure, of course, so what scholars usually do is look at what number of dollars to people get every month from their employer. That's the income bit instead.

I mean, the difference is pretty obvious if we look at, say, the technology sector with all these gadgets and devices and everything that people are buying. I mean, they're queueing up in line for a new mini-computer to put in their pockets every year, things like that. With a fixed income, you can get more and more of those devices, so even if you have a very different income in number of dollars, you can potentially buy the same, very high-quality and very powerful computing device. So there is no difference, really. One person might have a little more money in the bank, but in terms of consumption of that gadget, they are the same because both have access to it, both have enough funds to actually buy that and enjoy it.

WOODS: This is one of the reasons that I think, when people say we were doing better, let's say, in the early 1970s or the '60s and they'll say, look, you could have one person working and the household could be maintained, I don't think they really believe that, because if you told them, "Here's a time machine. Knock yourself out. Get in that time machine. Move back to 1971, where almost everything on which your livelihood today depends doesn't exist. The creature comforts don't exist." Things that — and not just — people disparage creature comforts. They think that you're just soft and pathetic and weak and stupid if all you care about is creature comforts, but I want to be comfortable in my life, and a lot of the comforts that I expect don't exist. There isn't air conditioning in my car, much less the Internet in those days. And you can't measure all that in just looking at income, because the question is what can you buy with that income, and not just how far does your paycheck stretch, but into what kinds of categories of goods can that paycheck stretch. It can't stretch into goods that don't even exist. So I don't buy this. I don't believe that people really think they'd be better off in 1953. I think that's ridiculous.

BYLUND: No, exactly. There are more opportunities to satisfy whatever wants you have today, since there are so many more and better products to buy. I mean, it's through consumption that we satisfy our wants. There's no other way. So of course the more products and the cheaper products, the better products that are available, the greater chances we have to satisfy our wants. I mean, it's also a matter of how much do you have to work to get sufficiently satisfied so that you can spend the rest of your time just doing whatever you like, just staying on the couch watching television or whatever it is. I mean, can you afford that? And I guess that's part of what they mean with going back to the '50s, that you could have a family survive and have a good standard of living, for the time anyway, on one salary, whereas it's much harder today. I mean, if you look at a country like my home country, Sweden, you can't have a family and survive with only one income. Both parents have to work.

WOODS: All right, but what I always use as my metric, one of the most popular television shows in the 1950s, *The Honeymooners*, because there we could see the real standard of living of these people you would expect are reflecting the experiences of actual individuals who lived in the '50s. And granting that Ralph Kramden is a cheapskate, even his friend Ed Norton, who is more generous in buying labor-saving devices, for example, for his wife, still ekes out an existence that most of us would consider intolerable in terms of the living space per capita. And it was at least conceivable, given that Ralph, they did not have a telephone, they didn't have a refrigerator — they had an icebox, which meant that a guy had to regularly bring a giant ice cube to their home — they had a one-bedroom apartment with a small living room and old furniture. They really had nothing at all.

And so I would suggest that if you want to live at that standard of living, you could do that on one income. The point is that capitalism has built in these expectations of an ever-increasing standard of living, so nobody wants that anymore. But you could have that. You could live in that 1950s splendor that everyone talks about I think with relatively little effort. It's that no one wants that level of creature comfort.

Well, I want to get to the heart of your paper here. Let's talk about entrepreneurship, and we'll get to in a minute how that relates to this. You say that entrepreneurship is the driving force behind inequality and the mitigation of inequality. Now, you're not in this paper going through the data and discussing whether inequality has grown or the extent to which it exists.

You're just saying that, as a phenomenon, it is influenced very much one way or the other by entrepreneurship. Now, what do you mean by that? In what way?

BYLUND: Well, yes, this is a theory paper, so my coauthor and I are not going through the data. We're just assuming that the data are correct, and I mean, there are questions about that too, of course. I mean, what we're saying is that in any market economy, there's a lot of change going on all the time. And of course entrepreneurship as the driving force of the market and the agency of change has to have something to say about this inequality that increases or decreases over time. And it does in different sectors, as well. And no one seems to have address this issue, at least not in the academic literature.

So what we did was simply look at, okay, what effects to entrepreneurs have in the economy, their industry, on people around them, on supply chains, and so forth. And it's pretty obvious when you think about it that a disruptive entrepreneur, short of a Schumpeterian, in a sense, who has a disruptive innovation suddenly makes a lot of money – say the new iPhone or something like that ten years ago – that completely changes people's behavior and people line up to buy it, that entrepreneur is going to be filthy rich unless he's a complete moron, because he's going to earn a lot of money. And at the same time, those companies selling flip-phones, say, back then, they're going to lose a lot of their revenue. So you are going to see a bifurcation in the allocation of riches, in a sense, because this guy is going to become very rich and others are going to lose some of their income. So the difference between them is going to be much, much greater after this innovation.

And of course, after that, what happens? Well, all these other entrepreneurs out there are going to say, wait a minute, this guy is making a load of money doing this new thing. We want to do that too. And we can take part of his profits and do the same thing or do something a little bit better and so forth and just compete with him. And that's just a normal market process. Someone invents something and it's very valuable, and then others imitate that innovation and catch up with or surpass that guy. And during this process, we see first that this one entrepreneur becomes really rich and probably his or her employees and suppliers and so forth, they get a lot of extra revenue, whereas others do not. And then in the next phase when others start imitating, those profits start to go down. And I mean, in a standard economic model, they would go down to zero, but that's not going to happen, of course. And at that point, we're going to see this inequality being mitigated and decrease quite drastically.

All right, now I guess the question that occurs to me – and I'm pretty sure you answer it in the paper – would be, if people are saying there's more inequality than ever or inequality is on the rise, and you're saying that entrepreneurship is partly able to account for this, that would have to mean there's somehow more entrepreneurship today if there's more inequality today. How do you sort that out?

BYLUND: Right, then we go into that in the paper a little bit and talk about why is it that it seems to be so much more extreme today than before, at least according to the data. I mean, one reason is that entrepreneurship the way it is today is usually global. It's not regional or national, but it's global. And you have these innovators and entrepreneurs, like Mark Zuckerberg with Facebook with a couple of billion users and things like that, and they're causing enormous change, of course, in the market. Mark Zuckerberg, I think you could argue that he's fairly rich, and he wasn't rich before, not to the extent that he is today. And others trying to do the same thing in social media and so forth. But this global market allows for

much greater successes, in a sense, and this of course is going to increase to increase the difference between the rich and the poor, especially on a global level. So that's part of the reason we see this. And technological development is going to be part of it, as well. Of course Facebook would be both. They're working on a global scale and using technology.

WOODS: You say at one point that more entrepreneurial societies would see more of this effect than less entrepreneurial societies. Now, you're not saying more entrepreneurial societies will have more inequality, let's say, than less entrepreneurial societies; it's that it would have more of this effect of entrepreneurship affecting inequality. Because there are highly un-entrepreneurial societies where there's plenty of inequality because you have a regime that's very rich and all its hangers-on are very rich, and the average person is extremely poor, so there's plenty of inequality there. But what do you mean by more or less entrepreneurial societies? How does a society become more or less entrepreneurial than another one?

BYLUND: Well, that's a very good question, and if we knew, then all countries would be rich and entrepreneurial, I think. I mean, it's partly an institutional issue, and I would say it probably comes down to private property and property protections, that if people have and own property in a real way and if they can invest that property to benefit themselves through entrepreneurship, then you're going to see a lot more of it. And if you have a very regulated society and probably undermined property rights and things like that, as we see in most poor countries, then you wouldn't see much change at all. So then you would stifle or suffocate entrepreneurship and the entrepreneurial spirit.

WOODS: There's definitely an institutional angle, and a lot of scholars have talked about that, and there's also, as others have talked about, a cultural angle, and that's a little bit more intractable. You can change institutions if you want, but if people – for example, people who lived under communism for a long time began to get the idea that anybody who does well must be crooked in some way, because that was true. If you were doing well, you were probably politically connected. But then that carries over. After communism falls, people become still suspicious of people who were successful. So there are these cultural things that probably only the passage of time can fully dispense with. What's the distinction you're making in the paper between disequilibrating and equilibrating entrepreneurship?

BYLUND: Well, we're really pitching in a sense Kirzner and Schumpeter against each other, and I would personally place Mises pretty close to Schumpeter here, where disruptive innovation is disequilibrating the market, basically destroying previous standards in production by having this innovation that suddenly just breaks with all standards and what everybody's doing before and forcing everybody to reevaluate what they're doing. So you have this leader who's imagining this new way of doing things, creating a whole lot of value, using resources in a different way or different combinations of resources, as Schumpeter said. And then you have the imitators coming afterwards, which would be the sort of Kirznerian entrepreneurs who are alert to opportunity. What they see is a big error, in a sense, the adjustment that can be made for profit between the new and the old, buying resources from producers, using them in the old way and then putting them to work in the new way that the Schumpeterian entrepreneur has shown is possible.

I mean, the first one is really deviating from what seems to be equilibrium before the innovation is made and introduced to the market. Of course, that innovation is going to break up everything and move equilibrium to a completely different point somewhere in the

future where you have a greater standard of living and greater productivity. And then you have the equilibrating process really readjusting the market to this new equilibrium point. Of course, as an Austrian, I would claim that we would never actually get to an equilibrium point, whereas Schumpeter's starting point was that we are at equilibrium and then that equilibrium is completely disrupted.

WOODS: So how is the distinction between these two ideas relevant to the question of inequality?

BYLUND: Well, in our argument, the disruptive, the disequilibrating one is really what causes or increases inequality in the marketplace, because you have this leader, this innovating entrepreneur making all this money, whereas other entrepreneurs are failing as a consequence, and then you have increasing inequality. Whereas in the following phase where the market is sort of catching up and you have this imitating Kirznerian entrepreneurs trying to copy what has been done already, then that process itself mitigates inequality, because in a sense it's taking profits from the first guy and it's distributing those profits and making available all these new types of goods and services that this innovator made available to a select few in the beginning, simply by pushing down costs and prices. So it's more affordable. More people can buy these products and benefit from them.

WOODS: So entrepreneurship benefits society at large. What are ways then that government intervention inhibits entrepreneurship?

BYLUND: Well, there are many, many ways. One would be what we talked about before about property rights, how if entrepreneurs don't actually own their property, then they're not going to be as incentivized to actually go through with their innovations and try their luck, in a sense. So people are not going to want to be entrepreneurs as much if they can't benefit from it. There's also licensing schemes and these things. They inhibit the possibility to start new businesses.

In a sense, the government is of course all over the place, but it has, I guess through the work of mainstream economists, realized that entrepreneurship has something to do with growth and it has probably something to do with innovations, yet they're also anti-inequality. So what they're doing is in a sense subsidizing innovations or businesses to get started and grow while at the same time making sure that they can't benefit from it. And of course then you don't get this process at all. What we argue in the paper is that, from an entrepreneurship point of view, you need to have both the disequilibrating and the equilibrating processes work at the same time. That's the only way you can get to rather constant growth and a higher standard of living.

WOODS: All right, so let's go on toward the end of the paper where you start talking about whether we really should be concerned about inequality at all. Let's talk about that. You give some reasons that, if anything, we may actually want to have inequality, and one of the points you make is you say, "[G]rowth-producing innovations may require inequality." Can you elaborate on that?

BYLUND: Sure. What we argue is really along the lines of Hayek and others who have claimed that we need capital accumulation in order to make these investments in novel ideas and innovations. And it's pretty hard to get people who have exactly the same savings rate to chip in a little bit in your new venture, whereas generally what we see, at least empirically, is

that you have an innovator who gets funding from one or a couple of sources — today, it's very often the government, unfortunately — and starts a venture around that and offers the product. And technology is a good example of that. When you have a new product, like with the first DVD player or Blu-Ray player or whatever, the first generation is usually a pretty crappy product. It's not very enhanced. It's not very good. It's expensive. And those who are buying those products are usually those with higher incomes, because they want to be a little more fancy, in a sense. So they spend a little more money on this flashy stuff. What that means is really that this produces a profit for the first entrepreneur. It incentivizes other entrepreneurs to follow him and imitate what he does, which forces down prices and increases innovation on that product, which really refines the product and then makes it available to a greater part of the population.

WOODS: All right, you also have sections on whether inequality is inherently bad. I have several episodes of this show and at least one of the *Contra Krugman* podcast where we've gone into this, but everybody brings some new insights to the table. So how would you answer, "Is inequality inherently bad?" — which, by the way, is just assumed. It's the subtext of every discussion on it. It's taken for granted. Of course it's bad. We don't even need to elaborate on why it's bad; we just have to think about how we can try to minimize it.

BYLUND: Right, and that's why we have it in the paper to discuss from a specifically entrepreneurial point of view. Is it actually bad? I mean, when we have talked about the process of economic growth, how we increase the standard of living through first expanding or increasing the inequality and then decreasing it through letting entrepreneurship continue in the way entrepreneurship does, then obviously it can't be inherently bad because it really facilitates this process. And entrepreneurs, we argue in the paper, can't really start these innovative businesses without someone funding them, which means we need some sort of at least income inequality to begin with, and we need this market segment of rich people who want to buy the latest thing that is not very good but expensive so that they can in a sense subsidize the further development of this good. So you need some inequality in order to actually get the development of these goods that will benefit everybody.

And this really goes back to a point that Schumpeter made in the '40s when he argued that any system that is always maximized will always be worse than a system that is never maximized. And what he meant was simply that, well, in capitalism, you always have some slack. You have idle resources and so forth. And because they are idle, they can be used when someone invents something that seems very valuable and that he or she wants to really try it out — at the risk of losing it all, of course. But without that slack, you can't actually do this, so you need some sort of inequality, people sitting on resources that they are not making available to everyone at once or all the time. But instead when they have the opportunity to invest it in something with high risk but high yield, then they make those resources available, and that's how we get this entrepreneurial process.

WOODS: I want to actually read a really terrific paragraph from your paper, but before we do that, just give me kind of a yes-or-no answer on whether inequality is inherently self-reinforcing, which is what most people think. The problem is you get some people who are wealthy. Maybe they inherit the wealth. That gives them an artificial advantage over everybody else. And then the next generation sees this perpetuated, and then there's no real way to break out of it. Is that really what we see?

BYLUND: Well, in highly regulated societies, yes, that's what we see. In entrepreneurial societies, that's the very opposite of what we see.

WOODS: Here's a paragraph I like from your paper. You say:

"If it is not a case of the rich getting richer, why then do we observe increasing income inequality? Our model explains this phenomenon to an extent not previously achieved: this effect results from cyclical trends of value facilitation and capture, and the magnitude of these wealth transfers is growing due to advances in communications, distribution, and other technologies, as well as increasing globalization, thereby increasing the scope or size of the market that can be served by entrepreneurs. Because valuable new innovations can now be marketed and delivered more quickly to more people across the globe at a lower cost, the total value capture of a successful innovation tends to be greater than in previous decades. But this same technology also shortens the lifespan of these successes, as firms' products are more frequently disrupted by competitive improvements. As a result, the top income quartile is growing increasingly volatile—and more reachable to those attempting to climb."

Wow. That is a great insight.

BYLUND: It changes the perception of inequality, doesn't it?

WOODS: Yeah, it sure does. That's a very interesting — I've for a while been thinking that surely a driving force behind at least the perception of inequality has to be globalization. If the size of your market grows to the point where it could theoretically encompass the entire world, how would that not increase inequality? The guy who is sweeping the floor in that office building that is now reaching the entire world is still just sweeping one floor, but that office building is now producing goods and services that are reaching billions more people, so that's going to have a differential effect. But yet there's nothing bad about that process. That's entirely benign.

BYLUND: Yeah, absolutely. It is. And I mean, remember with this type of globalization, you put production abroad, which means you raise salaries for poor people in poor countries while you lower prices for goods for people in the rest of the world. So I mean, in terms of income, the number of dollars, the difference might actually increase, but in terms of consumption ability, which is what we talk about in terms of well-being, we're getting more and more equal in the world.

WOODS: What's your website, by the way, so people can get a little background about you?

BYLUND: Well, it's my name .com, so PerBylund.com.

WOODS: Okay, and there you've got basically all sorts of things you work on. You teach entrepreneurship in the School of Entrepreneurship. What kind of courses — are you teaching entrepreneurship courses? Do you also teach regular economics?

BYLUND: I teach — well, not regular economics. I teach entrepreneurship and I teach Austrian economics.

WOODS: Ah, okay, well, that's what I meant by regular economics [laughing]. On this show, we have a whole different bar that we measure things by.

BYLUND: It's real economics, for sure.

WOODS: Yeah, indeed, indeed. In fact, of course, my favorite statement by Guido is, "Austrian economics is economics." And I find Guido to be so intimidating, I would never want to challenge him on that even if I were inclined to. Anyway, all right, this is great. I'm going to link to your paper at TomWoods.com/1088. It's nice to see more and more papers can be read by people easily online without paying \$500 or whatever, so we'll definitely have them take a look at it. And continued good luck to you in your work. Any chance you'll be at the Austrian Economics Research Conference this year?

BYLUND: Of course.

WOODS: Ah, all right. I'm thinking about it, because I can drive there now. I'm thinking about heading to that. It's March 23rd and 24th, 2018 for anybody interested. It is the scholarly event of the year in the Austrian tradition at the Mises Institute, so you can check that out at Mises.org/events. All right, Per, thanks so much again.

BYLUND: Thanks, Tom.