Episode ... dy's Money, Says

Guest: Peter Klein

WOODS: I realize this is an older column than I thought it was when I sent it to you, but somebody submitted it to me and didn't mention that, so they got away with something.

KLEIN: Hey, we're older models ourselves, and there's nothing wrong with that.

WOODS: That's true. That's true. Not to mention, it's not like the kind of people who make these critiques have really changed the way they think over the past four years.

KLEIN: [laughing] That's true.

WOODS: It's pretty much the same old stuff. So I've already told folks about the column and where they can find it. But the gist of it is that we're told that we live in an era of the cult of the entrepreneur. That's what the column starts with. And by the way, I reject that too. We clearly do not. We live in the era of the disparagement of the entrepreneur, and this article is itself evidence of that.

But anyway, so she's saying that what we tend to forget when we talk about entrepreneurs is that their most common shared trait is access to financial capital. And that can come in the form of family money and inheritance or connections of some kind. And although they do have a penchant for risk, it's really this access to money that comes first, because it's the access to money that allows them to take those risks. And that is a key advantage. And the author is arguing that yes, these entrepreneurs, maybe they're willing to take on risk, they have tremendous resilience, but really what they have more than anything else is privilege. So while "yes" — this is a quote from the article — "there's certainly a lot of hard work that goes into building something, there's also a lot of privilege involved, a factor that is often underestimated."

So, obviously, the point of the column is to continue this implicit, or sometimes not so implicit, critique of the market economy, that it's not really a meritocracy and you really can't get ahead unless you already have money, and, you know, arguments like that, that we're quite familiar with. And I thought, since you have done a lot of work in the area of entrepreneurship, this might be a good opportunity for us to talk. And I thought also, later on, we might say something about the somewhat related topic of the Mises for Business thing that's gotten started over at Mises.org that you have some connection to, so we'll get to that a little bit later. So give me your impressions of this rather brief column.

KLEIN: Well, maybe we could break it down in a couple of different ways. Let's start by acknowledging what the article gets right, which is that entrepreneurship — understood the way this author has in mind as people who start new companies, especially highly visible companies in the technology sector and elsewhere, the individuals and firms that we hear about, that we read about, the Steve Jobs and Bill Gates and Elon Musk and Jeff Bezos and these types — it is true that there's a lot more interest in entrepreneurship than there used to be.

When you and I were in college, you couldn't take a lot of courses in entrepreneurship. There weren't specialized programs to train students to start and run successful companies and so forth, but now there is a lot more interest in academia and also sort of among the media and journalists and so forth. Of course, a lot of it is highly critical, as you mentioned in your introduction, and I think articles like this and Obama's famous "You Didn't Build That" speech — you remember that from a few years ago? — I mean, these are kind of a reaction to what is correctly perceived as an increase in interest among young people in doing something in the commercial space, right?

In generations past, being in "business," quote, unquote, meant being a middle manager or an executive of a large company, and to many of the brightest young people, that seemed boring and you would be restrained and constrained in that kind of atmosphere, not able to be yourself and so forth. But now, a lot more young people are interested in being the next Mark Zuckerberg or the next Jeff Bezos, and they're interested in being in commerce. They don't want to go into politics or journalism, for heaven's sake. They're much more interested in the world of commerce than they used to.

And to the opinion makers and the gatekeepers and various elites and so forth, that's quite scary, right? The idea that young people would find business attractive and alluring is something that the elites are not very happy about. That's why you see articles like this. That's why you see politicians and pundits saying, *Well, well, well, let's not make entrepreneurs out to be too heroic, and let's not make it sound like it's easy to be an entrepreneur. Really, maybe you ought to go into the media or politics, as in generations past*. So I think the fact that we're seeing many articles like this is somewhat of an encouraging sign, right? People like this author are worried that students have a positive view of business and markets and commerce rather than a negative view.

WOODS: Indeed. At the same time, of course, the political class is just relentless, *relentless* in attacking entrepreneurs in ways I just haven't seen, again, I think really in my lifetime. I think it's worse than ever.

KLEIN: Yeah, you're absolutely right. I mean, whether it's Elizabeth Warren's push to break up big tech, or the complaints from the Piketty types about the 1%, and so forth, yeah, there's a tremendous attack on wealth, especially commercial wealth. It's fine if you are a wealthy athlete or entertainer or reliably left-wing kind of heiress. That's just fine. But people who have become wealthy through commercial activity are regarded as suspect and having stolen it from you and me, and that sort of thing.

I do want to say that there is an element of truth in the point that these authors make. If we define entrepreneurship as starting a successful business venture, it is true if you look at the data that it is harder to do than it might appear. And the sorts of stories that we've all heard of people like a young Steve Jobs as a teenager starting a computer company in the garage and it growing into this super successful thing, those cases are pretty rare. The average first-time business owner typically is a middle-aged person with work experience and access to savings and so forth, not because to be an entrepreneur you have to be a child of privilege, but because it costs money to start a venture, right? It's not like you can go out and get angel investment or venture capital as an 18-year-old with no experience. Most people trying to start ventures do rely on their own experience, their own accumulated resources, their savings. They might have to run up their credit cards. It depends on sort of who they know, etc. So it is actually quite hard to start and operate a business, a successful business.

And so yeah, of course, we wouldn't expect people with no work experience, people with no savings, people with no marketable skills all of a sudden to be able to do that. But that's hardly a critique of the market or the market system. In fact, it says, well, consumers want to buy goods and services that are high quality, and to produce high quality goods and services, you've got to have some skills, right? You might need some capital. You need to know people that you can hire and partner with and so forth. So yeah, I mean, anybody in life who has access to resources and access to other people and experience is going to be more successful on average than someone who lacks any of those things. I mean, why would we expect it to be otherwise?

WOODS: Yeah, so there's a sense in which this is kind of like a dog-bites-man story. Well, yeah, okay. So, what else? But the implication, though, is that therefore because of this obvious truth, that if you have money, it's easier to start a business — okay, maybe so — that the implication is not just: *Well, isn't this commonplace bit of information kind of interesting?* It's more: *The whole thing's a sham*, right? There's no such thing as meritocracy, and all the rest of it. And that is going a little bit far. And I don't think I'm being unfair to suggest that that is the subtext of the piece. Why else would you write a piece like this?

KLEIN: Oh, no doubt, you're exactly right. If one were interested in understanding this phenomenon from a more neutral point of view, there are a number of books out there. There's a recent book by a well-known entrepreneurship scholar named Scott Shane, and it's called, I don't know, *Top Ten Myths of Entrepreneurship* or *The Myths of the Entrepreneur* or something like that. We can look that up and link to that on your site. And it's just a short book that summarizes the data on first-time entrepreneurs and successful entrepreneurs and entrepreneurs in different sectors and so forth, what kinds of characteristics do they have? And one of the myths that he attempts to critique is this notion that the typical entrepreneur is a young person with no work experience but a clever idea. That's very much not the typical entrepreneurial experience.

In fact, if you think about how a market economy works, some people mistakenly believe that, well, there's lots of money out there. I mean, there's plenty of money to go around. It's just the market lacks good ideas. Anybody with a good idea can easily get it funded, because there's a bunch of dumb rich people out there who are happy to give their money away to any idea that's halfway promising.

In fact, I would describe the truth as more like the reverse. There's a shortage of resources. Resources are scarce. There are lots of ideas. Everybody's got an idea. You and I have lots of great business ideas, and my brother-in-law has an idea. Everybody's got an idea. But there are only so many resources available to support different ideas, and it's really these investors, venture capitalists, angel investors, bank lenders and so forth, who have lots and lots of pretty good-sounding ideas to choose from, and they're the ones who have to make the decisions about how to allocate resources in society across competing ends.

That's why Mises described financial markets, the stock market in particular, as being kind of the driving force of the market economy. Because to produce goods and services, to satisfy consumer wants, it takes money, it takes capital, it takes labor and so forth. And we've got to have some way to allocate those resources across all these projects that sound good. And so thank goodness we have financial markets in a capitalist economy that have this responsibility of allocating productive resources among competing ideas.

WOODS: Of course, Mises has a somewhat different definition of the entrepreneur than the one that's used colloquially. So you can answer this question any way you like: Is there such a thing as — well, the column refers to an "entrepreneur gene." Mises has a passage somewhere where he says that entrepreneurship cannot be taught, and yet there are professors of entrepreneurship. Can you make sense of all this?

KLEIN: Yes. As one of those professors of entrepreneurship myself —

WOODS: Yeah.

KLEIN: — I better be able to make sense of it. So, first, let me say you're absolutely right. When economists like Mises use the term "entrepreneur," they're not using it in the colloquial sense of a self-employed person or someone who starts a new venture or someone in the tech sector or whatever. Mises has a much more general notion of entrepreneurship in mind. Entrepreneurship for Mises is this faculty of taking ownership or responsibility for how productive resources are used under conditions of uncertainty. So bearing uncertainty, being responsible for an investment and production under uncertainty, that's what Mises characterizes as the entrepreneurial role. So it could be manifest in a technology startup, or maybe not. It could be manifest in a large, mature venture, as well as a newer, sort of a startup venture.

So when people use "entrepreneur" in the colloquial sense of sort of a new venture of founder, it's true that for a long time, it was thought, well, there's just some inborn personality trait that makes some people either willing to try to start a company or able to start a company. And I think it's correct that there really isn't some kind of magical entrepreneur trait, some people are born with a certain gene or just a certain proclivity or a certain personality type. There probably is no such thing as an entrepreneurial personality.

However, if you think of entrepreneurship in the broad sense, the sense that Mises describes it, it is kind of — let's put it this way: entrepreneurial success, being successful at taking productive resources and combining them in certain ways and using them to produce goods and services that consumers will actually want, we don't really know why some people are more successful rather than others. It isn't that they have a different kind of formal education or that they were born in a particular country, or that they have particular parents. Mises is right, that this faculty of being able to perceive the uncertain future, to be good at recognizing what future market conditions will look like, that is — I don't want to call it a mystery, but if you'll forgive the kind of statistics metaphor, it's like a residual.

In other words, after we've explained, yeah, we look at people's education and we look at their gender and we look at where they were born and we look at all kinds of observable characteristics of people, there's still something that we can't really put our finger on that makes some people more successful than others at being able to bear these uncertainties. That's what Mises means when he says entrepreneurship cannot be taught. He describes it in a characteristically Misesian phrase. Mises describes entrepreneurial ability as a specific anticipative understanding of the uncertain future. So certain people are better than others at having this hard-to-articulate, kind of tacit and intuitive understanding of the future. That's the thing, according to Mises, that can be neither learned nor taught.

Mises says the entrepreneur sees the past and the present as other people do, but he sees the future or he judges the future in a different way. So I mean, if the entrepreneur sees the past and the present as other people do but the future in a different way, then sort of by definition, the rest of us can't perceive the future in the same way, right? Because we have the same notion of the past and the present as the entrepreneur, but for some reason the entrepreneur has a different view of the future. So that suggests that the ability to anticipate future market conditions can't be reduced to a set of equations that can't be formally modeled. You can't predict it using some kind of statistical analysis. It's intuition or instinct or understanding, as the Germans would say. And that is something that really is not ultimately teachable.

WOODS: I was debating with myself whether I want to bring up this topic, but doggone it, let's bring it up, because I bet it hasn't come up in 1,533 episodes. So 1,534, here it comes. There's a member of the Austrian school whom I haven't mentioned that much, although I have quoted him in at least one of my talks, and that's Israel Kirzner.

And he's written on a whole bunch of Austrian topics, obviously, but in particular, he's written on entrepreneurship. And you have written some things, and in your typical Peter Klein style, they're very polite and gentlemanly and scholarly disagreements. You're not saying he's an idiot who doesn't understand the first thing about anything, but you do have — you versus Kirzner, or perhaps we might say Mises versus Kirzner, if we want to be a little controversial — differing ways of assessing what the entrepreneur really is and what his function really is. And in the Kirznerian formulation, the key word that you hear said over and over again is "alertness," that the entrepreneur is alert to certain opportunities. He's the guy who sees the $100 bill on the ground and picks it up, whereas other people miss it. Now, there's something, according to you and Joe Salerno and other critics, that that conception of the entrepreneur is just flat-out getting wrong and missing. What is that?

KLEIN: Well, I appreciate you describing me as having a polite style. I really aspire to a more combative Tom Woods kind of a style —

WOODS: I was going to say, compared to me has a polite style, so I wanted to point that out.

KLEIN: [laughing] Yeah. So you described this situation exactly right. I greatly admire Kirzner's thoughtful analysis of the market, but I do have a different view, and I think Mises has a different view than Kirzner in this particular case. You articulated the alertness metaphor or the discovery metaphor I think quite well with the idea of the $100 bills.

So in Kirzner's interpretation, the market, we're not presently in a kind of neoclassical equilibrium where all profits have been arbitraged away, but in reality, we're in a kind of a disequilibrium where there are some gaps in the market, there are some errors. In other words, if you think of just arbitrage, if apples are going for $1 in New York City, and they're going for $1.50 in New Jersey, then that represents a disequilibrium state, assuming it doesn't cost much to get them across the river. If you ignore the transportation costs in a case like that, if apples are a buck in Manhattan and $1.50 over in Jersey City, then you would expect someone to start buying up apples in Manhattan at $1 apiece, and then drive them across the bridge or through the tunnel over to the Jersey side, and then start selling them, and you can undercut, you can make some money in the deal. You could pay a little bit more than a dollar and buy as many as you want. You could go in and sell them for a little bit under $1.50, and you could sell as many as you want, and you'd earn a lot of money in the bargain.

And if you think about it, as you're buying up apples in Manhattan, you're sort of increasing the demand. That would tend to drive up the price of apples. And as you're unloading all these apples on the market in New Jersey, that's going to drive the price there down. And eventually, you would expect arbitrage of this form to kind of even out that price difference. So once the apples are $1.25 in each place, then there's no longer any incentive or opportunity, Kirzner would say, to make profit by exploiting that disequilibrium, this difference between the two prices.

Here's the problem. Most entrepreneurial activity is not of that nature. And here's why. Kirzner's model is one in which there is no uncertainty or risk of any kind. It's simply that people who make money perceive an opportunity to earn money that other folks have missed. But once you perceive it, you've got it. It's done. You don't have to do anything else to actually make the money. The act of perception is sufficient to guarantee that income to you.

So the money that Apple made from selling iPhones and the money that General Motors earned from selling cars — and getting government bailouts — is money that anybody else could have had if they had just noticed the opportunity earlier. But in fact, Apple and GM and other companies that have profits, individuals that make profits, they were just the first to notice that you could do something. If they hadn't noticed it, someone else eventually would have noticed it.

The way I think Mises would critique this metaphor and the way I've critiqued it, is if you go back to the idea of the money on the sidewalk, what if instead, you're walking down the street and on the ground, you see a little hint of green paper. Right, it's just sticking out from underneath a rock. Well, it might be $100 bill, but it might just be a candy wrapper. It might be trash. You really can't tell for sure just by looking at it. So if you want to try to find out if it's money, you've got to go get some equipment. Maybe you have to hire somebody with a special digging machine to remove this heavy rock. And maybe it cost you $50 to rent the equipment or to hire somebody to help you remove this heavy rock so you can see if in fact it's $100 bill.

Well, if you pay that 50 bucks, you remove the rock, and lo and behold, there's $100 bill under the rock, well, you've just earned a profit of $50. However, you pay the $50, you remove the rock, and it's just a candy wrapper, or it's trash, it's like the cover of a Bob Murphy book, then you've earned a loss of 50. You $50 is gone.

So in reality, a better metaphor for entrepreneurship is people see things in the environment that might be profit opportunities and might not. And they have to make some investment, they have to bear some uncertainty to find out if in fact, the thing that results is more valuable than the means that have to be employed in order to bring about that result.

So I think a better way to think about entrepreneurship is entrepreneurs, they're investing in the present, they're acquiring capital, they're hiring workers, they're spending money on producing and distributing goods and services today, in anticipation of, hoping for financial receipts in the future. And they hope that those receipts will be more than what they had to pay, but they don't know for sure. Sometimes, your receipts are lower than you expect, and you earn a loss.

In Kirzner's model, if entrepreneurship is about alertness, then the worst thing that can happen to you is you're not sufficiently alert and you will walk right by a profit that you could have grabbed if you had been more alert. But you can never lose, right? There's no way to lose money in the Kirznerian system, because you don't make any upfront investment. There's no spending. Just as soon as you see a profit opportunity, boom, you grab it. The worst thing that can happen to you is you fail to grab something you could have grabbed.

WOODS: And that's why the $100 bill counterexample, which I think Rothbard used to good effect, really works because if there's $100 bill on the ground and I don't see it, I haven't lost a thing.

KLEIN: Exactly, exactly. You can't really explain loss from an alertness or discovery point of view. And of course, we know practically speaking that many new ventures are not successful, as Mises outlined in his great little 1951 essay, "Profit and Loss." We always tell students it's wrong to say capitalism is a profit system. That's half right. It's a system of profit and loss. In fact, if you look Mises' short essay "Profit and Loss," you get a pretty well-articulated theory of the entrepreneur that has nothing to do with alertness or discovery. It's all about uncertainty and judgment and the willingness to invest resources in the present in anticipation of uncertain but hoped-for returns in the future. I think that's a more practical way to think about the entrepreneur from a purely Austrian perspective.

WOODS: Let's shift gears now to talk a bit about a project that you are a part of, along with Hunter Hastings, over on the Mises.org website. And that's something called Mises for Business. What can you tell us about that?

KLEIN: Yeah, well, just following up our discussion of the entrepreneur, while Austrian economics, certainly it's a very powerful and sometimes seemingly abstract set of scientific propositions, it's also very practical. And I've been teaching not only university students, but also business executives in these areas for many years. And I've found that practical people respond very well to Austrian ideas about entrepreneurship and management and finance and other aspects of business.

So Hunter Hastings has been leading an initiative in partnership with the Mises Institute to take some of the ideas of Austrian economics and package them in a way to make them more useful to professional managers, to entrepreneurs or aspiring entrepreneurs, investors, and so forth. So we have a series of videos. There's a set of podcast interviews that Hunter has done. We're in the process of putting together a more elaborate website that has articles, and there will be online courses that you can take. These will be ways to make Austrian economics useful and attractive even to people who are not especially interested in libertarianism or in economic theory, per se, but just want to understand business better. We feel like we can leverage some of the great insights of the Austrian tradition to put together some practical materials in everyday business decision making.

WOODS: How do people find this? Do they just go to Mises.org? Is there a place to click?

KLEIN: Yes, so you can find a link from Mises.org. There will be a separate URL, but it's not quite in play at the moment. But you can find it on Mises.org, or you can just Google search "Mises for Business" and it'll come right up.

WOODS: Okay, so we'll do that. So Mises.org, people should check that out. All right, we're going to leave it there. As always, I'll link to the column that we were talking about at TomWoods.com/1534, and if there's any Peter Klein stuff you want me to link to, I'll gladly do it.

KLEIN: Well, I will send you some information. There's so much good Peter Klein stuff out there, you wouldn't believe it. But the easiest way to find me and my stuff is just to use my Twitter ID, @Peter Klein. That has links to my university website and some of my more popular writings, and I'll send some links to you as well, Tom.

WOODS: Okay, excellent. I appreciate that. All right, well, thanks, Peter. We appreciate your service.

KLEIN: Oh, thank you.