

Institutions for Economic Prosperity: An Entrepreneurial Perspective⁺

by

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I. Introduction

Economic prosperity broadly defined is a universal human aspiration. Accordingly, numerous schemes for economic prosperity have been proposed. They include: picking champions with positive external linkages to spearhead industrial development, protecting certain critical industries, cultivating industrial clusters for beneficial network effects, reforming institutions to assist, or to improve upon, the operation of the market, providing subsidies to assist the economy to migrate to higher-value added industries through R&D, creating high-paying jobs, stimulating the economy through deficit spending to avert impending depression, providing a social safety net to diffuse political oppositions from declining industries as a necessary evil to promote globalization, and even reducing inequality in income distribution in the belief that a more equal distribution is consistent not only with industrial peace but with economic growth, etc.

National competitiveness, the theme of the conference, is in a similar vein. Interpreted as a variant of industrial policy, it has been soundly criticized by economists for overlooking the fact that international trade is a positive sum game and conflating the balance of trade a national economy with the balance sheet of a business firm.¹ In a charitable reading, however, the idea of national competitiveness reflects a universal aspiration for economic prosperity, based on an understanding that how one will fare in this life depends in no insignificant measure on where one lives, just as the fortune of the people on a ship depends on the fate of the ship.² The big question is: if the ship is listing, should one jump the ship or try to right it?³ For those who believe that the ship should be righted, what can be done individually and collectively? National competitiveness reflects this type of concerns.

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¹ Krugman (1994).

² Even in this age of globalization, citizenship is like a club membership. A membership in a certain club may be more beneficial than a membership in another.

³ Hirschman.

The precondition for economic prosperity is the creation of wealth. Wealth is sum of what people value. A scheme for economic prosperity will succeed only to the extent that it leads to wealth-creation. No matter how attractive, according to the prevailing opinion of the day, a proposed scheme for economic prosperity whose main goal is redistribution will only lead to intensified competition for rent-seeking and wealth destruction; it is bound to fail, soon or later. The most fundamental criterion of judging a scheme for economic prosperity, therefore, is whether or not, and to what extent, it is conducive to wealth creation.

Fundamental to wealth creation is the process of moving resources to higher valued uses than hitherto thought possible, the process by which profit is generated. Wealth creation is necessarily driven by the entrepreneur, who discovers and exploits the profitable opportunities.⁴ Viewed in this way, any policy proposals for economic prosperity should be evaluated by the following: Will it promote or hinder the process of wealth creation? Will it promote or hinder entrepreneurship?

Unfortunately, most policy proposals for economic prosperity overlook the entrepreneur. Often, entrepreneurship is assumed to be universally given, or the role of the entrepreneur is presumed by the policy maker. That is, often the process of wealth creation is assumed to be automatic, or the policy maker presumes to have the know-how of wealth creation. By ignoring the crucial issue of entrepreneurship, the issues of incentives, process of discovery and know-how, availability of information, and the economic actor's ability to judge whether wealth creation is possible, for a later regret.

The main reason for the unfortunate practices is that the traditional economics, with its exclusive focus on the allocative efficiency of equilibrium, assuming that economic agents have effectively knows all there is to know, leaving no profitable opportunities unexploited. The traditional economics, instead, attributes all creation of value to productive inputs via the black-box of production function and any increase in wealth first to the increase in inputs and then what remains to technological change, a term left unexplained and treated as an exogenous shock.⁵

By ruling out the nitty-gritty of the market process of the discovery of profitable opportunities (from moving resources to higher valued uses) and their dissemination through

⁴ As wealth-creation process is driven by the discovery of new ways of doing things, the entrepreneur is the agent of social learning process.

⁵ Solow.

imitation as well as secondary discoveries, however, the traditional economics is strangely powerless to explain the process of economic development.⁶ Consequently, the static theoretical framework has led to many wasteful policy prescriptions, such as massive foreign aid for LDCs and shock therapy for transition economies, for example.⁷ Without a viable framework to understand the process of wealth creation, an attempt to evaluate a proposal for economic prosperity is like groping in the dark.

The aim of this paper is to attempt to fill the lacuna by suggesting an entrepreneurial perspective on wealth creation, a perspective from which institutions for economic prosperity can be explored and evaluated. The outline of the paper is as follows. First, I introduce a view on human action and decision making in the face of radical uncertainty that departs considerably from the dominant tradition in economics. This view, in contrast to Neoclassical view, allows for (1) the limited understanding of human beings reflecting unique experiences their individual circumstances, (2) the possibility of ignored opportunities to create greater value because of one's limited understanding and of their discoveries and exploitation by others with different understandings of the situation, and (3) the process of the discoveries becoming a common place as people learn from one another. This view of acting in the face of radical uncertainty is consistent with routines, dispositions, and the character of an individual, as well as conventions, norms, and institutions in organizations and society. Then, I discuss the role of entrepreneurship in wealth creation process, addressing the issue of the extent to which entrepreneurship is motivated by profit motives, as well as the issue of how institutional differences (politics, ideology, and legal framework) may impact entrepreneurship. Finally, I try to evaluate, based on the entrepreneurial perspective, some of the proposals for economic prosperity, including industrial policy, nominally free market policy resting on social insurance to compensate the losers, and programs for job creation, and so on.

II. Human Action In The Face of Radical Uncertainty

Human beings are endowed with an ability to deal with radical uncertainty. It is the power of imagination to fill large gaps the nature has created by not as thoroughly hard-wiring human

⁶ Schumpeter (1934, [1911]). Despite recent contributions by Baumol (2004), Schumpeter's criticism of the dominant tradition in economics still stands. It is because some really important insights into entrepreneurship, for example by Kirzner (1979), are still regards as marginal to the main body of economics.

⁷ Easterly (2002).

beings as lesser creatures. Life's demand for continuous action in the face of uncertainty is met by our guessing what the circumstance we are faced with and what course of action would bring the most satisfactory outcomes. The manner in which human beings go about guessing and then acting on their guesses is somewhat like the scientist's approach to his subject, hypothesize about certain phenomena in which he is interested and subjecting the hypothesis to tests.⁸ It is both experiential and experimental.

If the idea of human beings facing radical uncertainty and having to improvise every moment of their lives sounds farfetched, it is only because most of us live in a familiar setting, setting into which we have grown comfortable. In a normal course of the day, by and large we don't even have to think consciously as we manage our lives with familiar routines. Moreover, for the most part, people with whom we interact regularly act predictably, causing few surprises. We are usually so comfortable in our familiar settings that we feel that most of what we do makes eminent sense; we feel that we behave rationally and would not imagine doing things any differently. This, in part, explains why we find the economist's model of rational actor sensible.

However, to think that the traditional economic model of rational choice captures the essence of human condition is a mistake. The familiar surroundings in which we manage our affairs effortlessly have become so only through acclimatization. Just think about how uncertain we would be to act if we find ourselves in an unfamiliar setting. We would be genuinely puzzled—faced with radical uncertainty—though others who are familiar with the situation would not find it puzzling at all. Our individual system of routines, knowledge and beliefs, which affords us a relatively easy life, has been acquired piece by piece, over time, in the course of our lives. Human beings are born only with certain biological capabilities and innate drives; the rest, including how we go about satisfying the innate drives, are acquired individually over time.

Let's call what we acquire to manage our lives since our birth—concepts, beliefs, skills and dexterity, etc.—mental tools. Each piece of our mental tools, (including the knowledge of their usage), is acquired through the process of decision making in the face of radical uncertainty—the trial and error process of conjecturing the best course of action, putting it into practice, assessing the outcomes, making adjustments, trying again when the situation calls for it, etc. Only the kinds of practices that have brought satisfactory outcomes in our experiences are retained as our

⁸ A. Smith, F. Hayek. B. Loasby, YB Choi.

mental tools. Among people with whom we interact, we are known by certain favorite mental tools, by our habits and dispositions.

Mental tools we accumulate include various rules concerning our relationship with others. In following certain rules, we in turn expect others to follow the rules, as we tend to think they are appropriate. Over time, people who interact regularly will have their subjectively-observed rules adjusted sufficiently enough to have a semblance of mutually consistency in expectations about each other's behavior to maintain peace and afford a level of coordination and cooperation. Otherwise, perpetual frustration of expectations and mutual recrimination will ensue to the detriment for all. Therefore, mental tools we accumulate over our lifetime include folkways, mores, customs, norms, conventions, and belief systems.

A larger society, beyond the possibility of frequent personal interactions and containing diverse groups of people with different sets of norms and conventions, will attain a degree of normalcy only when it develops, in one way or another, a set of more formal rules whose legitimacy is not constantly challenged. The reason for this tendency to adopt laws is that having a rule is often better than having many (contending) rules or, which is the same thing, having no (common) rule (observed by anyone).

People equipped with their own idiosyncratic mental tools that are nevertheless so adjusted to enable them carry on their lives doing their parts in the social division of labor and maintaining mutually consistent expectations would produce a state of the economy, aptly called a *stationary state*. In a stationary state, people will behave in ways they deem are satisfactory and have no incentive to make any change. They are liable to think that they are doing the very best they can, given what they know. Indeed, the static equilibrium approach of the dominant tradition in economics is designed precisely to describe the stationary state.⁹

III. Wealth Creation Process and Entrepreneurship

A stationary state is timeless and changeless. It is a snapshot of changing world. In a stationary state, individuals try to do the best they can, given the mental tools that they have acquired over their lifetime and made mutually compatible to allow tolerably peaceful interactions with others. Each individual's interest in taking up his or her respective station in the social division of labor is to produce the greatest (exchangeable) value possible, in combination with the values one can

⁹ Schumpeter.

create for oneself from hobbies, leisure, and other “household production”. Since each individual is doing the best one can, day in and day out, there would be no reason to alter one’s actions. If there is any change in several individuals’ behavior and the pattern of economic activities, it must be in response to exogenous shocks. In making reactive adjustments to exogenous shocks, individuals’ mental tools (what the resources are (for), who has what resources, how they are valued, etc.) are assumed to remain the same. In a stationary state, in other words, there is no meaningful change; the only change is either proportional, or adjustment within a given structure of know-how, broadly defined.

Nearly, a century ago, Schumpeter pointed out the deficiency of the economic model of stationary state as a tool for understanding the dynamism of the market economy. Changes in the capitalist economy involve the intermittent emergence of epoch making innovations that create new industries and bring ruins to hitherto successful business practices. The agent of economic changes is the entrepreneur, the business innovator. The success of the entrepreneurial innovations invites imitation by others and soon renders the entrepreneurial innovation a common-place. In the process, mental tools of individuals in society will have corresponding changes. In Schumpeter’s view, the entrepreneur is the dynamo of capitalism.

Though Schumpeter’s theory of economic development, with its almost romantic portrayal of the entrepreneur, has made a considerable stir since its publication, the dominant tradition in economic has not changed much since. The main reason is that, despite Schumpeter’s correct identification of the entrepreneur as the driving force of capitalism, his entrepreneur is a rather distinct breed from the economic man populating the economy in a stationary state. One can see this easily from Schumpeter’s own characterization of the entrepreneur as driven by the desire to found an empire, (a rather different kind from the economic man’s mundane desire to maximize wealth). Schumpeter’s entrepreneur might as well be a random exogenous shock. Indeed, upon examining what they could possibly learn from Schumpeter, economists have tended to conclude that Schumpeter offers no good way to alter or improve the received theoretical framework of static equilibrium and that Schumpeter’s entrepreneurial innovation is largely a fancy way of talking about exogenous shocks to the economy that economists have been talking about all along.¹⁰ Indeed, from the perspective of the dominant tradition in economics, there is a real difficulty of accommodating the Schumpeterian entrepreneur in the midst of the economic man

¹⁰ Demsetz 1983, 275.

who populates the economy. How can there be profitable opportunities that the entrepreneur can grab when everyone is supposed to be doing the best they can?

The Austrian economist Kirzner allows for entrepreneurship by taking a rather different approach to economics as he views the economy in disequilibrium, constantly changing as people learn new things and adjust their action accordingly. Kirzner has no problem with the Logic of Choice, that human beings try to do their best given their understanding of the situation. But he refuses to go along with the mainstream economics that men's understanding of their situation is fixed or shared with other men. Rather, different individuals may have their own understanding of their own situations and if their actions bring unsatisfactory results they will try to revise their actions, necessarily reflecting a revision of his understanding. Even when several people act according to their understanding and they all deem the outcome satisfactory, another individual with a different understanding of the situation may see a profitable opportunity neglected by the several people and capture it. He is the entrepreneur. The capture of the profit will move the economy a step closer to equilibrium, but equilibrium will never be reached because economic actors constantly become aware of new changes through their experiences, learn new things, and try to alter their actions.

In the Neoclassical economic framework, there cannot be, as it were, a one hundred dollar bill lying on the sidewalk for someone to come by and pick it up. Why? It is because someone else would already have picked it up, leaving no trace of the one hundred dollar bill.¹¹ In the Kirznerian framework, however, it is the entrepreneur is who notices the one hundred dollar bill on the sidewalk that others somehow fail to notice. How? Everyone may be doing all they can to do further their interests but with their particular understanding of the situation and come to believe that there is no way to improve their lot. Only someone with a different understanding of the situation may see a profitable opportunity clearly visible, the proverbial one hundred dollar bill, overlooked by others. Furthermore, the "hundred dollar bill" keeps on popping up, as people may not instantly realize the profit potential of various things that they learn in their experiences, the potential that would become clearly visible for someone with a different understanding. The discovery and exploitation of profitable opportunities neglected by others is truly wealth creation that drives the economic development process.

¹¹ Arrow.

It appears that Schumpeter and Kirzner have different conceptions of entrepreneurship. Schumpeter talks about the entrepreneur as an *innovator* who creates a new industry while Kirzner talks about the entrepreneur as an *arbitrageur* who takes advantage of price differences in the market. The Schumpeterian entrepreneur drives the process of creative destruction, disturbing the economy in equilibrium; The Kirznerian entrepreneur moves the economy closer to equilibrium by closing price gaps through his arbitrage. Are they talking about two different kinds of entrepreneurship? Are there different kinds of entrepreneurship?

As there are different ways of capturing profits under different circumstances, and there are many, one is tempted to say that there are different kinds of entrepreneurship.¹² At a higher level of abstraction, however, all entrepreneurship shares one feature—the discovery and exploitation of profitable opportunities ignored by others.

Consider the Schumpeterian entrepreneur who is portrayed as disturbing the economy in equilibrium through innovation. The entrepreneur cannot create something out of nothing. All the necessary elements for his entrepreneurial success, (in terms of manpower, technology, the market for his products, etc.), must be present in bits and pieces. It is that most people are so firmly convinced of the goodness of their own mental tools (their customary way of doing business) that they don't even entertain the possibilities from connecting the dots. The Schumpeterian entrepreneur's innovation consists precisely of connecting the dots, offering a new combination (of what already exist). Apparently, the economy in so-called equilibrium in which the Schumpeterian entrepreneur introduces innovation has already unexploited profitable opportunities only to be seen and captured.

In contrast to Schumpeter, Kirzner believes that the economy is never at equilibrium to begin with and there are always profitable opportunities that an alert entrepreneur can recognize.¹³ In the market economy, profitable opportunities largely consist in arbitraging, that is, moving resources from their current lower valued uses to higher valued uses, or buying low and selling high.¹⁴ In both cases, there exist profitable opportunities overlooked by others. The apparent

¹² Drucker.

¹³ What is the evidence? There are always entrepreneurs capturing profits!

¹⁴ Kirzner abstracts from the issue of organizing a firm to realize the perceived profit opportunities and focuses on the market. But I do not believe that his view does not preclude any detailed discussion of business organizations.

difference between Schumpeter and Kirzner in their conception of entrepreneurship, therefore, is not substantial, but reflects different perspectives and style.¹⁵

There still remains an important difference between Schumpeter and Kirzner in their conceptions of the entrepreneur. The Schumpeterian entrepreneur is driven by to pursue his vision and by the ambition to found his own kingdom and for personal glory. If he becomes the captain of an industry and becomes rich, the wealth is a byproduct, not necessarily his main goal. In this manner, Schumpeter emphasizes the un-economic-man-like quality of the entrepreneur. The Kirznerian entrepreneur is driven solely by the profit motive. Is it possible that the Schumpeterian entrepreneur is immune from incentives? Is the dynamism of the market economy possible without profit incentives?

In his eagerness to set the entrepreneur apart from the economic man in the stationary state—Schumpeter needed an agent who can shake the complacent stationary state—he portrays a romantic picture of the entrepreneur, a knight in search of the Holy Grail, as it were. Certainly, innovation can occur anywhere, anytime, unpredictably. In overly emphasizing the distinctiveness of the entrepreneur from the rest, however, Schumpeter fails to clarify the reasons why the market economy, relative to other types of institutions, has a much more rapid pace of innovations. Schumpeter, at times, seems to be oblivious of the differences in the pace of innovation under feudalism, socialism and capitalism.¹⁶

Of course, in any human society, from time immemorial, there have been innovators, who are consumed by ambition to chart their own course, deviate from the established conventions and try new ways of doing things with fantastic successes. After all, all the things that we use nowadays are the products of past innovations by someone, somewhere—fire, chipped stones and fish hooks, domesticated plants and animals, irrigation, pottery, iron, writing systems, paper, printing, algebra, ocean-going ship, banking, electricity, car, airplane, vaccination, TV, computer, etc. down to online-shopping, GPS and wireless phones. But is there any reason or rhyme for innovation or entrepreneurship? Do institutions make any difference on the pace of innovation?

Historically the pace of innovations (and their adaptations) has not been uniform. Some people hardly innovate and even stubbornly refuse to adopt innovations from elsewhere. Others innovate for a while at a vigorous pace, but the process of innovation eventually peters out. Yet

¹⁵ Choi.

¹⁶ Schumpeter

others sustain and even accelerated the pace of innovation.¹⁷ Over time, societies that continually innovate and eagerly adopt innovations from elsewhere become richer and stronger. Obviously, people in entrepreneurial/ innovative societies tend to be more prosperous than people in other societies that hardly innovate and are averse to adopting innovations of others.¹⁸

IV. Institutions for Economic Prosperity

What accounts for the difference in the pace of innovation and the fervor of entrepreneurship in different societies? The first step in answering this all important question, I believe, is the Kirznerian entrepreneur, driven solely by profit. Profit, defined as the net above the next best realizable values, is possible only if the entrepreneur discovers that certain resources can be put to higher-valued uses than they are currently. The resources are put to their current low-valued uses because their owners, in their own understanding, know of no higher-valued use for them. The entrepreneur with a different understanding of the situation becomes aware that profit can be made by re-deploying the resources to higher-valued uses.

The entrepreneurial alertness to profitable opportunities is further stimulated by incentives for gain. Suppose that a maverick introduces an outstanding innovation out of sheer ambition for personal glory and nothing else. The innovation would not have the same far reaching impact on the economy if not for others, motivated solely by profit, becoming entrepreneurs themselves by imitating, modifying, and extending the innovation in a variety of areas. In other words, if not for profit-motivated entrepreneurs, many innovations may remain singular testimonies to the audacity of isolated mavericks and geniuses. With the sweet smell of profit, many more individuals with less lofty goals or idiosyncrasies would be motivated to become the entrepreneur.

Kirzner does not explicitly dwell on comparative institutions given his focus on the role of the entrepreneur in the *market process*. However, insofar as the entrepreneur is driven by profit incentives, we can examine different institutions in terms of profit incentives they provide for the entrepreneur. Institutions that provide sufficient incentive for entrepreneurship will be conducive to economic prosperity. Those societies whose institutions do not provide sufficient incentive for the entrepreneur will not be prosperous. In the remainder of the section, I consider four essential

¹⁷ Mokyř.

¹⁸ In this paper, I will focus on entrepreneurship, saving for future discussion the issues of diffusion of innovations. See Rogers.

features of institutions that impact entrepreneurship—freedom of action, channeling of actions to value-creation, protection of a fair gains thus created, and ideology that encourages experimentation and pays due respect to entrepreneurship.

Freedom of Action: The most important feature of institutions for economic prosperity is the freedom of thought and action. Wealth-creating entrepreneurship consists of discovering and exploiting profitable opportunities neglected by others, thereby creating value that would not exist otherwise. Wealth creation requires that the entrepreneur can freely experiment and seize profitable opportunities he or she discovers them.

All economic actors conduct their affairs based on their own understanding. Often many people, through repeated interactions, come to have a similar, or conventional, understanding of a situation. Actions rationalized based on conventional understanding will exhaust all *known* profit opportunity, leaving no more profit opportunity unexploited. However, there could be profitable opportunities unknown to the convention-bound; someone with a different, and superior, understanding of the situation may notice profitable opportunities ignored by others. Through his action, when successful, the entrepreneur proves the shortcomings of the conventional wisdom. For this to happen the entrepreneur should have the freedom to act, however unconventional or unorthodox his action may be. Otherwise, restrictions on the unconventional acts of the entrepreneur may greatly discourage the pace of innovation.

Who would not like to come to possession of a superior way of doing things? Who would not like to become more innovative? Alas, there is no proven method of making people more entrepreneurial than they actually are. And there is no proven method of identifying who is more likely to be an entrepreneur or when entrepreneurship is feasible. The reason for this is that entrepreneurship consists of an understanding that is superior to those of others. Anyone who proposes to teach others how to become an entrepreneur, or who is likely to become an entrepreneur, or when entrepreneurship is appropriate, presumes to possess the necessary understanding to be an entrepreneur. Isn't he like the numerologist who proposes to teach others how to pick a winning lottery number? Any human being has the potential to learn from his or her experience and discover how things can be improved, or done better. Only thing required is freedom to act on one's imagination and understanding.

Improvement in knowledge, the basis of wealth-creation through entrepreneurial discoveries, comes, as in science, from new conjectures that out-perform the previously accepted conjectures.

Other things being equal, the more freely individuals in society can explore different ideas with little inhibition and try them out in practice, however unconventional they may be, the higher the chance of improving knowledge and wealth in society. Likewise, all avenues of the discovery of profitable opportunities and their exploitation should be open. If individuals are discouraged from exploring new ideas (with a strict hierarchical ordering that severely censures any impertinence or deviance), not only will there be far fewer attempts to make discoveries, but even occasional discoveries may not be translated into wealth-creation.

The freedom of action would mean little if there are restrictions on the re-deployment of resources that the entrepreneur believes can be put to higher-valued uses than the current uses. Laws and regulations that unduly restrict voluntary transactions would restrict the freedom of entrepreneurial actions. Of course, there is room for laws and regulations to effectively deal with significant negative externalities, in addition to the protection of minimally defined rights. By undue restrictions on voluntary transactions I have in mind primarily those laws and regulations that are meant to create privileges for the interest of certain politically powerful groups, such as costly license requirements that make an entry to certain businesses difficult, if not impossible, especially for entrepreneurs with limited funding; labor and capital regulations that prohibit voluntary transactions that harm no body (other than certain privileged interest groups), and so on.

Channeling Actions to Value-Creation: From an individual's point of view a gain is a gain; he may not care whether the gain is through wealth-creation or through redistribution, at someone else's expense. The one who gains through wealth-creation is the entrepreneur. The one who gains at others' expense, by taking others' wealth without their consent, is a thief, a scammer, or a rent-seeker through various brazen or ingenious schemes of transfer using the machinery of the state.¹⁹ It should be noted that the acts of gaining at the expense of others diminish wealth not only in terms of the opportunity cost of the grabber, (the value the grabber could have created had he instead devoted his effort in wealth-creation), but in encouraging others to try to do likewise (abandoning their wealth-creating activities) and inducing those who still wish to engage in value-creating activities to devote resources to avoid being hapless victims.²⁰

¹⁹ Baumol

²⁰ Murphy, Shleifer, and Vishny.

If no distinction is made between the two types of gains, considerable talents of a society would be channeled to endeavors aimed at redistribution of wealth. If enough people come to believe that the chance of success in life is greater through theft, scams, or rent-seeking, entrepreneurship will be greatly discouraged. Entrepreneurship can never be extinguished to the extent that people sometimes cannot help noticing how current state of affairs falls far short of the potential. But many of those who are not desperately driven to cry out “The emperor is naked!” will seek an easier way of making a living, taking from others.

One clear sign of a society channeling talents to unproductive (and counter-productive) avenues is the eagerness with which people pursue government posts. The ultimate source of the prestige and attractiveness of government posts is the advantages afforded by them, namely, the combination of emolument, gifts (read bribes), and opportunities for extortion and grabbing.

For example, I have been told that a not insignificant number of engineering students at Seoul National University, Korea’s most prestigious university, takes a leave of absence to prepare for the highly competitive “judicial qualifying exam”, a gateway for a career in the judiciary or in other government bureaucracy, for wealth and prestige. This most unusual (and wasteful) practice, I believe, is an evidence of all powerful government in Korea that can make or break fortunes and shower largess to favorites.²¹

Educational system in Korea shows symptoms of channeling talents to unproductive avenues, as well. Koreans invest heavily in education. The rate of university enrollment is one of the highest in the world. Korean parents do whatever they can to make sure their children get the best education possible, by moving to neighbors with good schools (read expensive neighbors), enrolling them in costly cram schools, even sending a substantial number of children of tender age to overseas. Considering the great effort expended on education, however, Korean achievement in science is relatively meager. The reason, I believe, is that a substantial portion of educational investment is devoted to relative positioning in the sorting process ultimately for the government posts—a lot of cramming to out-perform others in the relentless and competitive sorting processes for aspirants.

²¹ Korea ranks the 40th, along with Italy and Hungary, in the 2005 Transparency International Corruption Perception Index. Korea is behind Bahrain, Jordan and Malaysia and ahead of Tunisia, Kuwait, South Africa, Namibia, and El Salvador. Many Korean are incredulous and are prone to questioning the methodology of the survey, instead of self-examination. Korea is also ranked the 40th in the 2009 Index of Economic Freedom, just behind Czech, Uruguay, and St. Lucia, and just ahead of Trinidad and Tobago, Israel and Oman.

Protection of Entrepreneurial Profits: Entrepreneurship is stimulated by the prospect for profit. The incentive for entrepreneurship will be much diminished if gains from value-creation are insecure, being subject to arbitrary seizure. Of course, most civilized society has some protection for private property, without which freedom of action is meaningless and exchange of goods nearly impossible. But nominal property rights can be greatly attenuated through regulations, taxation, the selective enforcement of laws, and arbitrary seizure by government.

Entrepreneurial profit is especially prone for arbitrary seizure (for example through targeted legislations or by a decree). One reason, of course, is that when entrepreneurial profit is large, it is both noticeable and tempting for others to grab. Another reason is that the nature of profit is often misunderstood, rendering profit an object of social censure and envy. Recall that entrepreneurial profit is the proverbial one hundred dollar bill lying on the street that no one noticed before. It is something anyone could have gotten it, in hindsight. Unlike the rents accruing to entertainers whom people are fond of, or to inventors whose invention people can easily appreciate, the source of entrepreneurial profit is often mundane, discovering profitable opportunities others somehow overlooked. Fantastic gains of the entrepreneur without easily appreciable reasons often arouse suspicion about the legitimacy of profit.²² When the general suspicion against the entrepreneur is stoked by the resentments harbored by those whose livelihoods have been disrupted by competition, the entrepreneur can become a target for pillory and expropriation.²³ The heightened resentment, in an unrestrained democracy, can be easily translated into mob incited seizure by the power of government, significantly compromising property rights and weakening the entrepreneurial incentive. How entrepreneur's profit is protected depends greatly on how the masses understand the nature of profit. For this reason, we now turn to consider how the prevailing ideology portrays entrepreneurship.

Ideology of Wealth Creation: If entrepreneurs are demonized and their properties subject to arbitrary seizures, they may survive the treacherous environment only with great difficulties. Even in the most inhospitable political milieu, some entrepreneurs may not be deterred as they cannot resist the lure of profit and manage to secure sufficient protection for their own properties, albeit at high costs. Lesser entrepreneurs will be more easily discouraged. If the ruling ideology

²² Hayek 1989.

²³ Choi 1993.

of a society portrays the entrepreneur negatively, the machinery of the state will move against the entrepreneur. The wealth-creation process will then be much dampened.

The ideology hostile to entrepreneurship includes following: No one can profit except at the expense of another; the rich got rich at the expense of others; the poor are poor because they have been unfairly exploited by the rich; the poor are innocent victims; the rich do not deserve their wealth because they are merely lucky and it is unfair to those who have not been lucky; the economic system is rigged against the poor; the rich get richer and the poor get poorer; there is no mobility; the dominant force in the economy is greed, when the good wish for all should be the ruling principle; everyone should share equally; people should be made do what is good for all, if they do not do it on their own, and so on. It should be noted that many of these views, based on a misunderstanding of the nature of wealth-creation process through entrepreneurial discoveries, are central to Marxism, Socialism, and various forms of Welfare State.

Economic programs based on ideologies hostile to entrepreneurship are self-reinforcing. The government's attempts to redress the perceived inefficiency and/ or inequity of the value-creation processes do not succeed in creating the promised heaven on earth. Instead, they arbitrarily create winner and losers. Winners, wishing to overlook the fact that they gain without creating value, will try to justify their gains, and gain even more, by further demonizing the losers (the expropriated or disfranchised by arbitrary government programs violating their property rights), further strengthening the hostile ideologies. The losers will have reasons to believe that the government programs are illegitimate and try to do their best to avoid being hapless victims, providing welcoming evidences of illegal actions by the haves to the hostile ideologies. Repeated creation of winners and losers by the arbitrary government will greatly undermine the legitimacy of the state and the rule of law breaks down, forcing all parties involved to resort to force and guile, trampling any incentive to create value.

The ideology hospitable to entrepreneurship includes the following: One is responsible for one's life, for good or ill; from overall to overall in four generations; one should live by one's own principles; one has right to defend one's rights; it is possible to make an honest living; it is good to experiment and there is no shame in learning from anyone; people are free to do whatever they wish within their rights; if one does one's best one is likely to do well in this life; money is not everything; helping the unfortunate to get on their own feet is a moral duty of good

men as individuals, but the state has no right to force people to do good as the state defines it, and so on.

Many civilized countries have these views hospitable to entrepreneurship as parts of their cultural heritage, (otherwise, they would not have become and remain civilized), but the hospitable views are constantly put to question by hostile ideologues and are daily undermined by government programs instituted based on the hostile ideologies, (sometimes further aided by nationalism and xenophobia.)

The features of institutions discussed in this section—freedom, channeling talents to value-creating avenues, protecting the gains from value-creation, and hospitable ideologies—are criteria by which existing institutions can be assessed. Institutions with desirable properties cannot be created at will, however. To the extent that institutions are just the way people think and understand their situations, they cannot be willed by government decree, or by preaching by a group of well-wishers, just as people cannot be made to think what someone else think they should. The most one can do, I believe, is to change *one's own actions*, make alliance with others with similar beliefs, and try to persuade others how they also can benefit from changing their views.

V. Evaluating Schemes for Economic Prosperity

Nowadays few argue for the superiority of central planning as a means of economic prosperity, though its verity was an article of faith among many millions, many economists included. In this section, we will examine few schemes for economic prosperity currently popular—job creation, encouraging investment for economic growth, social insurance to support globalization, and cultivating strategic industries to enhance national competitiveness.

Job Creation: Modern politicians of all stripes promise to create (good-paying) jobs; during an economic downturn, the promise of job-creation is especially popular. But can government create jobs? If any scheme by which one is paid money wages is called a job, the answer is, of course, “yes”. But there are real jobs that create value and there are phony jobs that destroy value. Government-created jobs are largely value-destroying phony jobs.

The basis of a real job is value creation. If one knows a preferred way of creating value, one would be self-employed. A variation of this is to be an entrepreneur, founding a business, offering jobs to others, persuading them that they can create more value working for the

entrepreneur than they could manage either by working for another entrepreneur, or by becoming self-employed. When the entrepreneur realizes that the jobs he has offered fail to create anticipated values, naturally, he would withdraw the job-offers, laying-off employees. The formerly employed will now have to decide how to create value themselves, or hope that some other entrepreneurs will have a better idea of creating value. It may take some time for someone to figure out what the best way creating value would be.

When the unemployment rate is (deemed) high, when neither entrepreneurs, nor the unemployed themselves, have any idea of how to create more value, politicians, eager to deliver good tidings to people, embrace magicians offering more appealing solutions: Government should create jobs. There are basically three possible ways the government can make difference on the level of unemployment statistics—government-created jobs, government-protected jobs, and jobs induced by expansionary macroeconomic policies.

(1) Government-created jobs, that have steadily increased, include jobs in government bureaus, jobs at government sponsored enterprises, as well as jobs at private enterprises doing business exclusively with governments. Beyond what is needed for the production of minimal level of public goods, however, government-created jobs are not real jobs. They mostly destroy value. A society in which the majority of jobs are government-created would be rather poor. Otherwise, the government should create jobs paying everyone good wages and solve all economic problems, once and for all!

(2) Government may prevent the elimination of jobs at some firms, especially if they are regarded as “too big to fail” or “too politically sensitive to let it fold”, by providing a privileged exemption from competition, or subsidies, or both. That a firm is on the verge of bankruptcy is a sign of the firm destroying value. (Instead, its rivals are creating value.) By providing subsidies to struggling firms, for the sake of temporarily averting a large scale layoff and keep the rate of unemployment from rising, the government ends up prolonging the value-destruction by the “jobs” so saved. The government is in fact conscripting tax-payers and consumers into the value destruction process.

(3) Keynesians advocate expansionary government policies to reduce unemployment, observing that if an economic downturn is left unattended, it may spiral downward into another Great Depression. The advocates of expansionary policy don't seem to care whether a business downturn is a symptom of un-sustainable previous business expansions (that destroy wealth)

correcting themselves and searching for new profitable opportunities. They do not see that widespread business failures represent innumerable profitable opportunities for other entrepreneurs, or that negative externalities of business failures (and the liquidation of value-destroying activities) would be more than made up by positive externalities of new ventures found on newly emerging profitable opportunities. Nor do they realize that expansionary policies divert resources from other uses. They commit the fallacy of broken window, focusing on the stimulus of expansionary policy (the seen), ignoring what it forecloses (the unseen.)²⁴ They scare the public with the possibility of an impending catastrophe and proffer their value-destroying scheme as an elixir.²⁵

Encouraging Investment: Often, it is observed that an economic downturn is caused by insufficient investment and that lowering interest rates and/ or providing tax benefits for investors would remedy the situation. While those who stand to benefit from the measure would welcome such schemes, artificially stimulating investment leads to waste and value destruction.

Often an economic downturn is a result of previous expansionary government policies, leading to over-investment. The untenable business expansions that destroy wealth must be corrected soon or later. The resultant business contractions and increase in unemployment, often characterized as a market failure, are direct consequence of incentive-distorting (and value destroying) government policies. A general economic downturn of this type may be avoided only if the government refrained from pursuing expansionary policies as politically expedient. The short term fix of throwing money randomly at economic downturns may seem to temporarily alleviate symptoms, or at least satisfy insistent and loud political demands of interested parties.²⁶ However, short term fixes prolong the process of value-destruction and create dependency, calling for more largess in the future, just as a drug addict craves for increasing doses.

Providing Social Insurance to Promote Globalization. A popular scheme in the age of globalization is providing social insurance to ameliorate the plight of the losers in the face of global competition. Basically, the scheme is meant to realize the Kaldor-Hicks Efficiency of globalization, by actually compensating the losers, to purchase their assent to globalization.²⁷

²⁴ Bastiat.

²⁵ Consider the recent massive bail out of financial firms in the US.

²⁶ There is a general conflation between pro-business, that seeks government granted privileges, and pro-market, that seeks nothing more than the freedom of action and the equality under law.

²⁷ Rodrik.

It sounds politically savvy (and humane too), but it is a variation of the traditional Welfare State approach, which assumes that people have *de facto* rights to enjoy their customary way of making living. But to grant rights is to create obligations. Who will be obliged to bear the burden? If the value creator is forced to sustain the value destroyer, what will it do to the incentives to create values? Both for the winners and losers of globalization, incentive to make an effort to discover further profit opportunities will be greatly diminished. The greater the attempts are to ease the pain of the losers, the less desperate will they become to look for value-creating opportunities. Instead, the scheme will assist them to destroy much wealth, created by others. The burden of supporting the losers who are in no hurry to abandon their value-destruction will greatly diminish profitable opportunities. Only value-destroying government jobs to minister the losers will proliferate. The liberal scheme of compensating the losers in the face of global competition will severely cripple the process of wealth-creation.

A variation of the liberal scheme has been put to practice in the US in recent decades with some grave consequences that are only beginning to be recognized. Instead of calling for higher taxes to finance the ever-expanding social insurances, placing the burden of compensating the losers squarely on the winners, the US Federal government has learned to circumvent the resistance of the public against higher taxes by borrowing money (from government sponsored pension programs, but increasingly from foreigners) to fund much of the costs of the social insurance schemes. Initially, it looked like a win-win proposal: Increasingly generous (and expensive) social insurance programs have been introduced with applause from the interested parties; tax-payers have been spared, for the time being, from facing the true burden of the programs; investors have been made happy with easy credits; and the majority of politicians of all stripes get to sing the virtues of the free market and globalization, even as they are ever expanding the Welfare State. The happy deception has lasted much longer than expected. Recently, however, the mounting Federal debt at an alarming rate has put to question the long term viability of the American Welfare State and the future US standard of living.

The majority of Koreans seems to fully share the view that the losers from globalization should be compensated, especially when it comes to agricultural producers. When Korean agricultural producers feel that they are either not fully protected against foreign imports, or not fully compensated for losing the custom, they take to the streets, waging violent protests. The recent nation-wide protests against the importation of American beef, on the rumored mad-cow-

disease contamination, are but an example. To the extent that the agricultural producers are successful in enforcing their *de facto* rights to enjoy their customary living, with the blessing of other Koreans, much wealth will be destroyed.²⁸

Cultivating Strategic Industries (National Competitiveness): Many believe that attaining the comparative advantage in certain industries is particularly advantageous for the prosperity of a nation. They include industries deemed to be high value-adding, or have significant network effects. On the drawing board, the ideas of cultivating strategic industries, or enhancing national competitiveness, sound good. Only were they so easy! Instead, we see many more failed cases of industrial policy than seemingly successful ones.

Why? The reason is that the ideas of industrial promotion are *usually* based on the false assumption of the existence of certain profitable opportunities. The advocates of industrial promotion envision the promoted industries become profitable, soon or later. In doing so, they presume that they have discovered the profitable opportunities not exploited by others. Otherwise, if the profit opportunities are seen by entrepreneurs, they would do their best to capture the profits. In that case, why should the government enter the industry and try to preempt the entrepreneurs? But how likely is it that politicians (or their advisors) discover profitable opportunities neglected by others when so many would-be-entrepreneurs are racking their brains to find one? Would they have the alertness to opportunities (which usually come from relevant experience in the field), or the incentive?

An industrial policy sponsored by the government can have an appearance of success, in three ways. (1) There are *known* profitable opportunities that entrepreneurs are prevented from exploiting. A government sponsored industrial policy may then succeed by exploiting the known profitable opportunities, that others are *prevented* from exploiting. In this case, the industrial policy is superfluous; the success of the industrial policy could have been attained by merely *allowing* profit-seeking entrepreneurs do what they are prone to do. All it takes would be lessening restrictive regulations and allowing an easier entry.

(2) Alternatively, *only* the policy maker, not the entrepreneur in the private sector, sees (or he thinks he sees) the profitable opportunities. The supposed discovery of profitable opportunities

²⁸ Some farmers may have some legitimate grievances against the government restricting their land use and imposing unfair burden on them. If so, the farmers should fight, through the political process, for the lifting of the regulations, not on their *de facto* rights as farmers.

could be genuine or false. If it is *genuine*, then the policy maker is indeed the entrepreneur.²⁹ This may account for some of the successful cases of industrial policy. Even in this case, there will be questions about the legitimacy of the success of the industrial policy to the extent that the some of the policy maker's actions are likely to be supra-legal. Moreover, if the policy-maker converts some of the profits from the policy into his own fortune, there will be suspicion of abusing his office, again raising questions about the legitimacy. Furthermore, if the policy-maker succeeds once with an industrial policy, he is more likely to be emboldened and try again and again, soon moving into the area where he is less and less likely to have discovered profitable opportunities.

(3) If the policy maker's discovery of profitable opportunities is *false* and yet his policy seems to succeed, one should wonder about the real profitability of the policy. Just because a fabulous project is carried out and many people hired, and so on, one cannot conclude that the project is genuinely wealth-creating. The fabulous white-elephant (the seen) may be built on many trampled profitable opportunities gone neglected (the unseen).

Of course, the entrepreneur in the private sector can make mistakes as well. But if his discovery turns out to be false, he often cannot go on pursuing his dream. He either goes bankrupt, or his financial backers will pull the plug. The policy maker in charge of an industrial policy usually does not face the stern master the entrepreneur faces in the market and may end up destroying much wealth. It would have been better for the economy that such an industrial policy was never entertained.

VI. Concluding Remarks

I have tried to present an outline of a framework of examining various proposals for economic prosperity from an entrepreneurial perspective. The perspective emphasizes the entrepreneurial discovery of profitable opportunities as the process of wealth creation and the dynamo of economic development. The institutional requirements for wealth-creation are—the freedom of action, channeling talents to productive avenues, protecting property rights, and combating hostile ideologies. The outlook that emerges from the perspective is generally consistent with the

²⁹ One must wonder why he remains as the policy maker, instead of going into his own business, capturing the alluring profit for himself. There may be some barriers that prevent private entrepreneurs from capturing the profit opportunities. In that case, the government could have accomplished the same results as the successful industrial policy by concentrating on removing the barriers.

Classical Liberalism, that free market is most conducive to economic prosperity. The entrepreneurial perspective, built on the subjective nature of human *understanding* that guides human action, I believe, has the advantage of being less likely to be hijacked by the statist than the traditional economic theorizing about the market economy.

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