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## ECONOMICS IN PRACTICE: FOLLOW-UP

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[*Editors' note:* In a previous issue of this journal, Dan Johansson tells of the results of a vocabulary analysis he conducted of the leading PhD economics textbooks. He shows that ideas of entrepreneurship, institutions, property rights, and freedom have almost no place in the textbooks of the core classes and industrial-organization classes. (Johansson's article is available [here](#).) We invited Professor Baumol to comment on the article. Professor Baumol's outstanding professional achievements have involved a deep immersion in issues of entrepreneurship and innovation, and their relation to economic growth. That immersion is represented by such works as *The Free-Market Innovation Machine: Analyzing the Growth Miracle of Capitalism* (Princeton University Press, 2002). More information about Professor Baumol is found at the end of his contribution. We are grateful for his participation.]

### Textbook Entrepreneurship: Comment on Johansson

WILLIAM J. BAUMOL\*

I CAN ONLY APPLAUD DAN JOHANSSON'S EXCELLENT AND highly illuminating article (Johansson 2004). I have already and repeatedly joined other voices in noting the virtual expulsion of the entrepreneur from the contemporary mainstream literature of economics. I have also joined the call for the restoration of the entrepreneurs' place in theory, given the fact that no one seems to deny their importance for the workings of the free-market economy in general and for its growth and innovation in particular. Johansson's systematic review of the postgraduate textbook literature underscores these concerns. Here I should only like to repeat my

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own explanations for the entrepreneur's exclusion and to offer a general observation on the issue.

### **WHY THE ENTREPRENEUR HAS BEEN EXILED FROM STANDARD MICRO THEORY**

There are, actually, at least two very good reasons why the entrepreneur is virtually never mentioned in modern theory of the firm and distribution. The first is that innovation is an entirely heterogeneous output. Production of whatever was an invention yesterday is mere repetition today. So that entrepreneurial activities do not incorporate the homogeneous elements that lend themselves to formal mathematical description, let alone the formal optimization analysis that is the foundation of the bulk of micro theory.

The more critical explanation of the absence of the entrepreneur is that in mainstream economics the theory is generally composed of equilibrium models in which structurally nothing is changing. Equilibrium models exclude the entrepreneur by their very nature. She is absent from such a model because she does not belong there. This has been definitively argued by Schumpeter and Kirzner who have demonstrated that sustained equilibrium is something that the entrepreneur does not tolerate, any more than she tolerates sustained disequilibrium. Here, Schumpeter's key insight is that the entrepreneur's occupation is the search for profitable opportunities to upset any equilibrium. That is exactly what any innovation, in the broadest sense, entails. But the rest of the story is told by Kirzner who recounts that the entrepreneur, with her critical ability, alertness, recognizes in any disequilibrium a profit opportunity, and by taking advantage of that opportunity she provides the pressures that move the economy toward an equilibrium condition. So the job of Schumpeter's entrepreneur is to upset all equilibria, while Kirzner's works to achieve them. The entrepreneurial mechanisms underlie continuous industrial evolution and revolution, and surely are not the stuff of which stationary models are built. Thus, it should hardly be surprising that a stationary Walrasian model, even in a more sophisticated variant, has no room for the entrepreneur.

This is particularly evident of the standard theory of the firm, which analyses the repetitious decisions of the enterprise that is already present

and fully grown. In such a scenario the entrepreneur has already completed his job and left for places where her firm-creation faculties can be exercised. Even if the creator of the firm has not departed, she has transformed her role from entrepreneur to manager, so that though she, herself, remains in place, the entrepreneur has gone.

### THE SIGNIFICANCE OF THE OMISSION

My conclusion is not that the neoclassical theory is wrong in excluding the entrepreneur, for it is dealing with subjects for which she is irrelevant. But that does not mean that no theory of entrepreneurship is needed. Here, let me be clear. I have always believed that fruitful research requires a thousand flowers to be left to bloom. It would, in my view, be as indefensible to require *all* micro writing to give pride of place to the entrepreneur as to exclude him universally. In particular, static analysis has offered many valuable insights and its body of theory is an admirable accomplishment. So the entrepreneur is legitimately not offered a place in static theory, without undermining the value of that theory.

But universal exclusion condemns us to leave out of our discussions what I consider to be the most critical issues that should be examined (though not exclusively) in microeconomic terms: the determinants of innovation and growth and the means by which they can be preserved and stimulated. Dan Johansson has helped to demonstrate that we economists are leaving to the hands of others, such as the economic and business historians, what I regard as the greatest and most important mysteries that economics faces: Why have the relatively free-market economies in the past two centuries been able to outstrip, probably by more than an order of magnitude, the performance in terms of growth and innovation, of all other forms of economic organization? The answer is not merely a matter of pandering to what Veblen called the economic researcher's idle curiosity. Rather it is the missing underpinning for growth policy in both the developed and the developing world.

WILLIAM J. BAUMOL

## REFERENCES

**Johansson, Dan.** 2004. Economics without Entrepreneurship or Institutions: A Vocabulary Analysis of Graduate Textbooks. *Econ Journal Watch* 1(3): 515-538.

## ABOUT THE AUTHOR



**William J. Baumol** is Professor of Economics and Academic Director, Berkley Center for Entrepreneurial Studies, New York University and professor emeritus, Princeton University. He is the author of numerous books and over 500 articles in professional journals. Professor Baumol has been awarded ten honorary degrees, held the presidency of the American Economic Association, the Association of Environmental and Resource Economists, the Eastern Economic Association, and the Atlantic Economic Society and is a member of the National Academy of Sciences. [Link](#) to his website.

[GO TO JOHANSSON \(2004\) ARTICLE ON GRADUATE TEXTBOOKS](#)