

Foundations of Entrepreneurship and Economic Development

David A. Harper

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In commenting on modern economics, Ronald Coase once remarked, “That in my youth it used to be sad that something was so silly it could be sung, but in modern economics it can be put in mathematics.” This silliness was no more evident than in the fields of comparative economic systems and development economics. From the mid-20th century to the 1990s, optimal planning and statistical analysis of aggregates substituted for institutional analysis in both of those fields’ models. The silliness was not only an academic exercise, it also proved damaging to the lives of millions of individuals as they languished in poverty and suffered under the yoke of totalitarian rulers and military dictatorships.

With the collapse of the Soviet Bloc in the late 1980s and 1991 in Russia, much has changed in the world and in terms of our thinking about the world. Despite what you may read in the popular press about life in the former Soviet Union, by any reasonable measure of well-being, the lives of millions of people have been made better off by the collapse of the old regime, and our thinking about the institutional preconditions for human flourishing has improved immensely. This improvement has not been limited to East and Central Europe and the former Soviet Union, but also to the Third World. Intellectual improvement is more evident as several international agencies rethink their agenda in light of new knowledge about legal, political, social, and economic institutions, and how they shape and transform societies. William Easterly in his *The Elusive Quest for Growth* has made indictments of the older approach to development policy and foreign assistance, and the scholarly literature is filled with examples of how the investment-gap theory failed and must be replaced with an institutional analysis of alternative legal and political arrangements. The institutional revolution in comparative systems and development economics is not limited to Douglass North; major figures such as Andre Shleifer and Ed Glaeser at Harvard, and Avner Greif and Barry Weingast at Stanford are transforming the fields. Studies continually flow from Massachusetts Institute of Technology by scholars such as Simon Johnson and Daron Acemoglu stressing institutions, policy, and cultural heritage as primary explanatory variables in the analysis of why some countries are rich and others poor. Times certainly are changing, and for the better intellectually and, one hopes, for the millions of people still stuck in poverty.

There are still major intellectual challenges that scholars wanting to explore the institutional foundations of economic development must confront. Existing empirical techniques are too aggregative to address the problem, and modeling still seems to crowd out the dynamic adjustments that characterize a vibrant society. If our institutional analysis of social change has indeed been enriched over the past decade, as I believe it has, we still lack an analysis of the agent of change. This agent is the entre-

preneur and he unfortunately has proven as elusive to institutional analysis as he was to static analysis. But that is more a lack of focus than a problem of model construction. In a static analysis of the problem, the agent of change is assumed away. In an institutional analysis, the entrepreneur has just tended to be ignored but he is still there. Moving the entrepreneur from the side to the center stage of analysis is the value-added of David Harper's wonderful new book, *Foundations of Entrepreneurship and Economic Development*.

Harper examines the role that entrepreneurial discovery plays in ensuring the efficient allocation of resources within a market economy, and how alternative institutional arrangements and cultural factors impinge on the psychological disposition for alertness so that individuals can realize the benefits from exchange. And he proposes ways to test his conjectures and ways to explore in an empirically meaningful way cross-cultural patterns of beliefs and institutions and their impact on economic performance.

Entrepreneurship is fundamentally a wishful conjecture—a bet so to speak. As in science, freedom is essential to advancement because it provides a background for individuals to bet on ideas. Obviously, in economic life betting on an idea is not sufficient, one must also have complementary institutions of finance (e.g., capital markets) so that those bets can be brought to life in realized projects. Again, as in science, not all conjectures prove to be correct, so we also have to have institutions of evaluation and assessment (e.g., economic calculation through profit and loss accounting) that weed out incorrect conjectures and steer us in a direction less erroneous than before.

To address the questions of economic development, Harper surveys the field and summarizes the main teachings from New Institutional Economics, Positive Political Economy, and Austrian economics. In addition to the emphasis one finds in those literatures on legal, political, economic, and social institutions, Harper adds work from cognitive and social psychology. The idea of the locus of control that an actor perceives plays a major role in Harper's analysis and is the mechanism through which cultural beliefs such as individualism or collectivism impinge on economic life. The existing psychological literature has many problems, Harper readily admits, but in surveying that literature he has made a good first step in incorporating those findings and alerting others to a field that could both add to our knowledge and benefit from interaction with economists in terms of the conceptual and analytical rigor that could be provided.

Harper rejects the idea that individualist cultures are more conducive to entrepreneurship than collectivist cultures. Instead he proposes that we look at developing countries where a more collective or group-oriented culture dominates and examine the underlying social organization and its impact on entrepreneurship. Harper's points are well taken, especially his critique of economists who believe there exists a neutral

scale for measuring entrepreneurial activity across cultures. But it is also here where my only point of radical disagreement with Harper's book lies. Just as traditional Austrian subjectivists are caught in a quandary when it comes to the issue of development, I am afraid Harper ties himself up in an intellectual straightjacket he doesn't want. Entrepreneurship is omnipresent, as Harper points out, and all societies exhibit some degree of alertness to opportunities. He claims that the cornerstone hypothesis (that individualist societies are more conducive to entrepreneurship) must be rejected. Indeed he is right because entrepreneurial alertness is evident across cultures and across time. But the way in which that alertness is directed is not and that is what matters. There may in fact be many ways for people to live, and they do, but there are very few ways for people to live prosperously. The institutions associated with Western capitalism, in their functional if not literal form, must be in place for entrepreneurial alertness to be directed toward mutually beneficial opportunities for exchange. Absent that institutional framework, what we see is entrepreneurial alertness directed toward zero-sum gains in redistributive politics rather than the positive-sum gains of market transactions. Harper's own analysis would seem to agree with my point, but he cannot bring himself to put it that bluntly. Clarifying that result through empirical analysis would have added to Harper's analysis, but instead he is content to leave the analysis at the level of prediction without testing. Both what Harper calls the cornerstone and convergence (i.e., that as societies develop they become similar) hypotheses once reinterpreted slightly are more robust than Harper gives them credit. For example, as Tyler Cowen has argued in *Creative Destruction*, as societies develop they become more similar along one dimension (use of the market, establishment of property rights and contract law, etc.) and more diverse along another (different cultural products, food, beliefs, etc.). Which dimension does Harper propose to measure along? He states that we cannot say because there is no single dimension, and he leaves it at that. But in a book on economic development the measure is more straightforward—the relationship between the institutional framework, public policy, and material well-being.

The *Economic Freedom Index* speaks plainly to us on this. Countries with institutions and policies that protect private property through the establishment of a rule of law, with low levels of taxation and regulation, with monetary policy bound more by rules than by the discretion of politicians, with fiscal responsibility instead of deficits and public debt, and with markets that are open to international trade have higher levels of income per capita than countries that do not. Countries that adopt those policies also enjoy higher rates of economic growth. More important is that these figures of per capita GDP translate into human capabilities that are viewed as essential to human flourishing—higher levels of educational attainment, better sanitation, higher life expectancy, lower infant mortality, and so forth. Harper utilizes the *Economic Freedom*

Index measurements in his analysis, but not as much as I would like to see for the questions he is tackling. As Harper states himself, “Societies which bind themselves to the principles of the rule of law, security of property rights, market coordination of resources, free trade and sound money grow faster than societies in which economic freedom is curtailed. Because many of the components of economic freedom are the result of public policy and explicit political decisions, it follows that the choice of institutional framework has immense consequences for economic prosperity and the wealth of nations” (p. 125).

Yes, and the question then becomes whether we can expect the sort of institutional framework and public policies to emerge in a society which possesses a more collectivist culture than one in which elements of individualism are promulgated in popular myth, religious interpretation, and social rituals. Obviously, the answer to this question has major importance not only intellectually but also with regard to the practical policy issues associated with reconstruction and development. The jury is still out, but the only way a verdict will emerge is through empirical investigation and preferably on-the-ground empirical work that gains access to the norms, mores, and underlying beliefs systems in operation in any society so we can develop a political economy of everyday life in these developing countries.

Despite my quibble with David Harper’s *Foundations of Entrepreneurship and Economic Development*, the book is in many ways a masterful display of synthesis, creative application of ideas from disparate disciplines, and policy wisdom.

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