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ABSTRACT

This publication provides the papers and discussions from a conference of economists, businesspersons, business historians, and politicians on entrepreneurship and public policy. "The Demographics of Entrepreneurship" (David Birch; Thomas Gray, commentator) describes research on the nature of job creation in the United States and Europe. "Entrepreneurship and American Competitiveness" (Israel Kirzner; Carol Steinbach and Katsuro Sakoh, commentators) explains that entrepreneurship is characterized by alertness to economic opportunities--competition is espoused as the key to fostering entreneurship. "Entrepreneurship and the Political Process" (Thomas DeLay) argues that the relationship between business and the political system is rarely conducive to public interest. "What Motivates the Entrepreneur?" (Robert Brockhaus) analyzes the characteristics of the entrepreneur. "The Challenge of the Information Age" (Ronald Shelp; Robert Tollison and Laurence Moss, commentators) contends that the nature of the entrepreneurial revolution has been misunderstood. It argues that the surge in small business is related to what is happening in big business, warns that protectionism may soon appear in the service sector, and calls for a national information policy. "Is Entrepreneurial Opportunity Still Alive in America?" (Albro Martin; Richard McKenzie and Robert Friedman, commentators) explains that entrepreneurship is a vital component of successful large firms. An overview highlighting conference themes (William Dennis, Stuart Butler) concludes the publication. (YLB)

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Edited By
Stuart M. Butler
William J. Dennis, Jr.

# Entrep urship

*The Key to Economic Growth*



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# Entrepreneurship
## The Key to Economic Growth

Edited by
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The Louis Lehrman Auditorium
The Heritage Foundation

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# Preface

America is witnessing a remarkable and prolonged surge in job creation. While the economies of other countries have been stagnating or merely crawling forward, this country's economy is bounding ahead. In Europe they call it "The American Miracle."

The Reagan Administration can claim some credit for this remarkable performance. Policies designed to encourage risk taking and hard work have provided an important stimulus to the process of economic expansion. But the roots of America's success go deeper than that—fortunately for all of us the country's underlying economic health does not depend primarily on who occupies the White House. Rather, the driving force has been a phenomenon that is characteristic of America—entrepreneurship. There is something about America, and Americans, that leads to inventiveness, to risk taking, and to a determination to find better ways to provide goods and services. The result is jobs and growth.

Despite the critical importance of entrepreneurship to our economic well-being, there is a surprisingly poor understanding of it among Washington lawmakers. Like apple pie, everyone agrees it is a good thing. Yet debates and decisions on Capitol Hill indicate that many politicians have only a passing understanding of the process of entrepreneurship and what is needed to stimulate it. They can be forgiven for this, at least to some degree, however, because researchers have generally not done a very good job at providing the political process with the information it needs to understand entrepreneurs, and thus develop the policies needed to encourage these complex beings to become even more active.

In an effort to rectify this deficiency, The Heritage Foundation and the National Federation of Independent Business, America's leading small business organization, decided to hold a one-day conference at which economists, businessmen, business historians, and politicians would meet together to discuss the nature of entrepreneurship, what it means to the process of economic growth, and what policies help or hinder the entrepreneur.

This publication, made possible with the generous assistance of NFIB, records that day's discussion. The papers and discussion provide the politician, the businessman, and the informed layman with a rich body of information and insights. The book is a valuable primer for those wishing to understand the nature of entrepreneurship and essential reading for those who have to make political decisions affecting the nation's entrepreneurs.

Edwin J. Feulner, Jr.
President
The Heritage Foundation

# Introduction

Why did Heritage and NFIB organize this conference on Entrepreneurship in America? Certainly conferences about entrepreneurship are not unique. In fact, they are quite the rage these days. So why this conference? Or, as an entrepreneur might say, what is the market niche? What are we doing that is different . . . or, better than anyone else is doing? The answer I think consists of two parts—the audience and the topical focus—which when rolled together with an extraordinarily knowledgeable group of speakers creates something rather special.

To date conferences on entrepreneurship have been largely directed to academic audiences. Occasionally, businessmen have been introduced to vary the pace—even a journalist or a trade association type here and there. But on the whole it has been academics. More specifically, it has been academics in business administration and related fields such as management, talking to audiences of academics in business administration and related fields. If that weren't narrow enough—in the discipline of economics, supposedly a closely related field, the entrepreneur has largely been ignored. In fact, the last time the *American Economic Review*, the journal of the American Economics Association, devoted any significant attention to the topic was 1968. And as for political science, sociology, or public choice, . . . well, let's say the term "entrepreneur," when used at all, has probably been used pejoratively as frequently as not. Thus, not only have entrepreneurship conferences in the past largely been confined to academic audiences, those conferences have almost exclusively been the purview of a small group in the department of business administration.

The audience today is different. The audience is the public policy apparatus of official and unofficial Washington. It is a key audience the entrepreneurial parade has thus far largely passed by. My calculations indicate we are nearing the end of our second decade of the current entrepreneurial outburst, though public policy is only beginning to recognize it and attempting to devise means to prolong it.

It is not as if information exchanges are unknown. Washington's public policy apparatus witnessed one White House Conference on Small Business under President Carter and will see another in 1986 under his successor. Some legislation favorable to entrepreneurs and small firms has been enacted; it required argument and information. This I grant. But the public policy apparatus, particularly the entrenched apparatus. doesn't understand the entrepreneur; it only knows that the United States has experienced severe economic problems over the past several years while possessing the nagging suspicion that by a return to our entrepreneurial roots the course may change. The result is that while entrepreneurs are no longer alien to Washington, they certainly remain strange beasts—not quite clean, not someone you would really want at the dinner table, but someone you had better not ignore.

The new audience implies discussion of topics different from those of other meetin s on entrepreneurship. The topical link today is entrepreneurship and public policy—not traditional topics such as management of entrepreneurial endeavor or direct research findings on venture capital. Yet, this public policy link is not entirely new either At least three of today's participants have authored or edited volumes tying the two in some manner. But what is topically unique about this entrepreneurship conference in contrast to others is the systematic exploration of broad subject matter which hopefully will help develop a frame of reference for people dealing with public policy issues—a frame of reference allowing them to better analyze a policy's impact on entrepreneurial endeavor.

That brings me to two themes which underlie the conference. The first is that we have chosen to address broad issues of entrepreneurship and public policy rather than narrow ones. For example, we have chosen to discuss the role of the entrepreneur in American competitiveness rather than something as specific as international conventions on intellectual property. We have chosen to discuss the existence of entrepreneurial opportunity from an historical perspective rather than the propriety and efficiency of the Small Business Administration or the Minority Business Development Agency. We have chosen to discuss the demographics of entrepreneurship and the implications of failure rather than imposition of a flat tax.

At the heart of the matter, entrepreneurial development must be a national priority. But it cannot and will not ever be the sole priority or even the paramount priority. Therefore, unless or until the broader perspective of the role played by entrepreneurs is understood and appreciated, it will be difficult to reasonably sort, categorize, prioritize, and otherwise analyze specific policy issues affecting entrepreneurs and their activities.

The second unifying theme is the focus on *small* entrepreneurs. Most of us associate entrepreneurship with ownership and operation of new or small businesses. Frequently, that is an accurate impression. However, not all small firms are entrepreneurial. Some small businesses have not changed in forty years nor will they change in the next forty. That doesn't make those businesses valueless to their owners or society, but it does not make them entrepreneurial either. Conversely, large firms or units in large firms can also demonstrate entrepreneurial characteristics. There is even a new term for such activity—"intrapreneurship"—although Arthur Lipper, publisher of *Venture Magazine*, colorfully argues that entrepreneurship in large firms can't exist unless every employee wears a ski mask. But once that disclaimer has been offered, it should be understood that entrepreneurial endeavor in new and small firms will be our target.

There are several reasons for narrowing the focus to such a theme. First, a parochial reason; we can't cover everything and NFIB's primary interest is smaller firms. In this regard, we appreciate Heritage's forbearance. Second, entrepreneurial endeavor in smaller firms not only produces economic gains, but has enormous and often visible ramifications for social mobility and national temperament. If not more prevalent in small firms, these effects can often be more visible and dramatic. And third, smaller firms are where the current public interest lies, if for no other reason than more people are trying to become entrepreneurs today than have ever tried before.

To discuss Entrepreneurship in America at this conference, we thought it important to do more than "round up the usual suspects." Instead, we have attempted and I think succeeded in bringing together a distinguished group of people who are capable of exploring many ideas in more than a routine manner. Most are not novices to Washington. Yet, they are sufficiently detached from the daily routine that constitutes our lives, so that their perspective is more attuned to appreciating the role of entrepreneurs over years rather than appreciating them from one set of unemployment numbers to the next.

John Sloan
President
The National Federation of Independent Business

# Session 1: The Demographics of Entrepreneurship

David Birch describes his research on the nature of job creation in America and Europe. He notes that the American economy is characterized by a remarkably high rate of business start-ups and turnover, and that small firms are the engine of job creation.

*Commentator:* Tom Gray

"In each country the contribution that the crop of new business firms makes to the larger job creation pattern varies considerably, and depends heavily on the climate for entrepreneurship in that nation. If it is a good climate, the small firm gains can offset many of the large firm losses. If it is not, then they cannot.... The key to future growth, particularly job growth, involves establishing an environment in which the small entrepreneurial company can flourish as quickly as possible."—David Birch

"... [S]mall businesses search for solutions more capably than large businesses. In many cases, they search better precisely because the market works and enforces a discipline in small businesses that says 'If you do not search for solutions well, you die quickly.' And dying quickly is an essential part of an efficient economy."—Tom Gray

Dr. David Birch: The U.S. and international economy is going through some very basic changes. These changes will have a significant effect on corporate demography, in terms of who is creating jobs, what kinds of jobs they are creating, where—and to a certain extent for whom. I would like to explain the causes and implications of these changes by looking at what has happened to the economy and then considering both where this entrepreneurial spirit is coming from and where it might be headed.

We, at our MIT research center, started back in the early 1970s by trying to break the economy into pieces—the individual corporations and establishments of which it is constructed. We have been doing that now through 1984, and have about a fifteen-year history of most of the corporations. My best guess is we have looked at one time or another at some 12 to 15 million individual companies.

What we discovered underneath the surface of the economy was fairly startling to us. We found a tremendous amount of turbulence and volatility, much more than we had expected. We found that the U.S. is losing about 8 to 10 percent of its companies and 8 to 10 percent of its jobs every year. So about 50 percent of the job base has to be replaced every five or six years, just to break even. This means that there is great opportunity for change. It offers a chance for the new ones to replace the old ones and to change the structure of the economy in very fundamental ways.

I should note here that the word "failure" is being thrown aro d rather loosely. In fact, what is really meant is "closing," not bankrupt About 550,000 firms close down every year, but the bankruptcy rate is only 50,000, about 10 percent of the startup rate. So in only 10 percent of the cases did the person who closed owe more money than he had. In the rest of those cases they had more than they owed, or at least nobody was aggravated enough by the closing to take them to court. So in fact, closing, in general, is financially attractive to the entrepreneur of the store or the business. In 550,000 closings, there have been 500,000 successes and only 50,000 failures. So when we say there is a massive failure rate, what we really mean is massive turbulence, a massive starting and going, and entry and exit.

Originally we thought of the changing structure as a shift from manufacturing to services, and superficially it certainly looks like that. Close to 32 million net new jobs have been added to the American economy since 1967. But not one of them is in manufacturing; there are the same number of manufacturing jobs today as back in 1967 That process has worked its way through to the degree that only about 10 percent of the labor force is directly involved in making anything, in the sense of being in a factory.

A much more accurate description of what is going on is that there has been a shift to higher and higher rates of innovation wherever they are found in the economy—not a shift from manufacturing to services. I call what is emerging a "Thoughtware Economy," simply as a way of trying to focus on the thinking content and innovation in the growth that is now taking place.

Some of the thoughtware involves the actual invention and creation of new technology, that is, the new gadgets of the so-called high technology segment. But most people are beginning to realize now that the high technology segment *per se* is actually very small: it amounts to only about 2.8 percent of the jobs in the American economy, and it is slowing down rather considerably. Its growth in the 1970s was phenomenal, but growth in the 1980s will be much more marginal. In the 1990s the growth rate probably will be slower. This segment probably will account at most for 5 percent of the new jobs America will need in this decade, and perhaps 4 or 5 percent of the jobs needed in the 1990s.

Anyone who has been following the recent history of the Massachusetts high technology community will be startled by the extent of the state's current problems. Computervision lost 25 percent of its net worth in one day on the New York Stock Exchange a couple of weeks ago. And that is just one example. There is a list of hundreds and hundreds of layoffs in the high technology segment in Massachusetts over the last six months. It will be an up and down business rather than a ramp as it was in the 1970s.

Much of the dynamism and innovation is taking place in some of the more traditional sectors of the manufacturing economy. We were very surprised to find the degree to which young entrepreneurial companies are growing and flourishing in what looked like stagnant old industries

We did a study of the so-called high technology segment of the economy. We quickly generalized that to what we call the high innovation sector—a sector where a great deal of growth is found and growing companies are doing their thing. We found very high concentrations of rapidly growing companies in steel, textiles, clothing, bicycles, retailing—very unusual sectors in which to find entrepreneurs. Unfortunately, in those segments the entrepreneurs coming up are being offset by massive losses coming down. So the net growth in industries such as steel appears to be stable or declining.

Most of the net growth is coming from the application of technology to create new services that have no hardware product. These include computer software, data base companies, finance, education, applied communications, consulting, health care, new forms of insurance, new forms of distribution, new forms of hospital management—all sorts of new activities. And these companies are no longer just "taking in each other's wash." They are exporting in a very significant way. Joan Spero, President Carter's Trade Ambassador to the U.N., has looked at the numbers. America is exporting about $60 to $70 billion worth of thoughtware, for a net positive balance on the order of $30 to $40 billion, offsetting some of the merchandise losses that are being experienced.

The final step in this trajectory will be the increasing role of telecommunications and computers, particularly the fifth generation computer. This will render obsolete many of the people now gaining jobs in the high innovation and thoughtware sector. The trend is well under way in engineering, medicine, chemistry, financial services, and the high technology segment itself. The Macintosh computer can be produced at the rate of one every 27 seconds—and only 100 people are involved in that operation. It is a highly productive, highly efficient, highly nonlabor-intensive operation. We just completed a major survey of the large insurance companies in Connecticut. These firms were large creators of jobs during the 1970s, but their employment will be stable or declining in the 1980s and 1990s as the machines come in and take over many of the clerical and management functions in the insurance industry.

These changes will have a significant effect on the structure of the corporate world. There are tremendous opportunities for innovation in corporate formation. Barriers to entry are very low in the thoughtware sector—it shows in the entry numbers. In the 1950s, America started up about 90,000 new companies. By 1965, it was around 200,000. By 1975, it was 300,000, and it is now well over 600,000 and has been since about 1981. That does not even include partnerships and the newly self-employed. My best estimate is we have about 300,000 new self-employed and another 400,000 new partnerships starting every year.

So there are perhaps well over a million new entrepreneurial activities of some sort each year. As I pointed out, this is beginning to affect job creation in the economy. In our initial study back in the 1969 to 1976 period, we found that the group of businesses employing up to 20 was creating about two-thirds of all net new jobs, the 0 to 100 employees group was creating about 80 percent, and those businesses four years old or younger were on a gross basis, creating about 80 percent of the new jobs. We have since looked at the 1977 to 1981 period and found that the group employing 0 to 100 actually dropped in terms of its share in job creation. But the Small Business Administration (SBA) looked during the 1980 to 1982 period and found that small businesses were creating over 100 percent of all new jobs. Those of over 100 employees lost about 1.7 million, while those under 100 gained 2.7 million for a net of one percent. Since 1980, 6 million jobs have been added to the U.S. economy. During this same period, the Fortune 500 companies lost 2 million. The Fortune 500 actually declined in absolut terms.

I have made a rudimentary study of the individual Fortune 500 companies over time. They are a fascinating group to watch in terms of the economic history of the United States. They are enormously volatile. About 30 percent of the Fortune 500 in 1970 did not exist as corporations in 1981. In fact, as I look at the numbers, the odds of a Fortune 500 company vanishing are only 2.5 times less than those of a young startup company.

One thing to understand about this small business phenomenon is that it is not evenly distributed in several aspects. First of all, it is not evenly distributed over time. We have begun to realize that that is largely the function of the activity of large corporations rather than the small corporations. Whereas small corporations are fairly steady job creators, the large corporations as a group are very volatile. The Fortune 500 sector goes up in the late 1970s, then drops in the 1980s. It will go up in some other period. And as the large corporations rise and fall, the small business share tends to be very volatile, going anywhere from 50 to 60 percent up to 270 percent, depending largely on how well the larger corporations are doing.

The phenomenon is also not evenly distributed over space. It is not true that small corporations are creating jobs equally in all places. In fact we tend to find that the older the place, and the more it is in transition, the larger the small business share of new jobs. In newer, younger places, such as Tampa, Denver, and Orlando, the opposite is true and the larger corporations tend to dominate.

Austin, Texas, has become particularly interesting to me. In terms of jobs created there, Austin ranks in the top 10 percent of growth areas in the United States. Yet if you rank Austin in terms of jobs created by corporations headquartered in Austin, it is in the bottom 10 percent. That is to say, practically all the jobs in Austin are being created by corporations headquartered somewhere else, whose branches are growing in Austin. Very little of it is indigenous growth from small corporations in Austin.

The phenomenon also varies a great deal across the economic sector Turning back to our high technology study we find an enormous variation in the rates of innovation across sectors. Some of the established industries have very high rates, such as steel, textiles, and clothing. There are also very high rates in some of the services, but low rates in others. Generally there is enormous variation from one part of the economy to another.

And as noted earlier, the phenomenon is not evenly distributed across companies within a sector. In fact we found that most small businesses created relatively few jobs and that in fact it is only 12 to 15 percent of the smaller corporations that emerge and grow rapidly —the Apple Computers, the Hewlitt Packards, the Control Datas, the Wangs, the Digitals, the Data Generals, the Computervisions. These few are responsible for most of the jobs created by smaller corporations.

I call this elite group of companies the "entrepreneurial" companies because their goal from the very beginning is to create a significant number of jobs. And I call the other ventures "income substitution" companies. The latter group are companies that are started for the purpose of obtaining independence, freedom, and the ability of the proprietor to provide his income and to be his own person. But these firms are not conceived for the most part as becoming ten times bigger than they were when they started. In fact, most of them stay at their original size or that achieved in the first few years.

We have just completed analyses in several other countries, starting with the business addresses of individual companies. We studied each business address in Sweden, the United Kingdom, and Canada in the last year or two to see if the United States is special or different—or just like everybody else.

I think the answer is that the U.S. is special. First of all the degree of turbulence here is much greater than it is in most other countries. The Dutch turn over 1 or 2 percent of their companies every year—the U.S. turns over 8 or 10 percent. The U.S. is also different in terms of the pattern. We looked at the United Kingdom, for instance, and found that small businesses create jobs —in fact they are the only creator of jobs in the United Kingdom, with the large corporations suffering massive losses in many cases.

France is another good example. Between 1975 and 1983 small corporations created 50,000 jobs. But large corporations lost 750,000 jobs for a net of minus 700,000. That is a typical European pattern from what we have observed in Belgium, Holland, England, and to a certain extent, Germany.

Sweden is a little different and interesting. Small businesses grow quite well in Sweden. But as soon as they show any signs of life at all, they are acquired by large business. So small establishment growth in Sweden is rather significant, while the small enterprise growth in Sweden is insignificant. Only 10 or 12 or 14 percent of the jobs are created by small enterprises in Sweden.

Canada is an interesting example with a different pattern. Small businesses create many jobs in Canada. Large corporations also create a significant number of jobs in Canada. And there is a big trough in the middle. It is apparently very hard to get from small to large in Canada. In fact, while 12 to 15 percent of American small businesses grow rapidly, only 3 or 4 percent do so in Canada. There is a trap in the middle that the Canadian companies do not seem to be able to get through, as happens in the U.S.

The formation of smaller firms is very important in all these nations, but growth varies considerably from nation to nation. In the United States the ability of young companies to grow offsets declines in the larger ones. In most of Europe the small gain does not offset the decline at all.

The bottom line is that the opportunity for small firms to form has never been greater in perhaps the last 150 years in terms of the economic climate. Most countries are experiencing significant rates of formation, while the experience of the United States is nothing short of extraordinary.

In each country the contribution that the crop of new firms makes to the larger job creation pattern varies considerably, and depends heavily on the climate for entrepreneurship in that nation. If it is a good climate, the small firm gains can offset many of the large firm losses. If it is not then they cannot. And that seems to be the pattern. The key to future growth, particularly job growth, involves establishing an environment in which the small entrepreneurial company can flourish as quickly as possible.

The Europeans are flat on their backs from a job creation point of view. They have created one million jobs from a base of 105 million in the 1970s—the U.S. has created 20 million jobs from a base of 67 million. So we created 25 times more jobs proportionately than they did. I have not looked at the recent figures, but I think Europe has lost all its 1970 gains. France alone, during 1975 to 1983, lost virtually all the jobs the entire Common Market created between 1970 and 1980.

The permanent structural unemployment rate in the Netherlands is something on the order of 25 percent, if you compute it the way we would in the United States. It is more than 30 percent in Belgium, and it is anywhere from 14 to 17 percent in Britain, depending on what period you look at and how you measure it.

The causes of these differences would involve a long and fascinating discussion. Some of my European friends would say, "If government would just change the rules, Europe would be creating jobs like mad." But when asked, "Well, why don't you change the rules?" the answer seems to be, "We like the rules the way they are." When asked, "Why do you like the rules the way they are?" they say, "Because it is the way we feel about our country." Then the reason why the rules are not changed is clear, and the reason why the marginal tax rate for most entrepreneurs in Sweden is 85 percent, and the reason why 60 to 70 percent of the economy of the Netherlands goes through the government. It is almost a complete reversal of the U.S. system. It is because the Europeans have cultural attitudes that go much deeper than the rules. In particular, they have a very different attitude toward failure. The U.S. is far more tolerant of failure than they. If you fail in Europe you are socially and economically ostracized. You just do not have a second chance. But you can fail here and do quite well. I have a banker friend who will not make a loan to anybody who has not failed once.

There is a totally different attitude toward risk taking and failure in the U.S., which places great social stature on the entrepreneur. Somebody who has tried and failed is better in U.S. eyes than somebody who has not dared to try, whereas in Europe it is just the opposite. Only 1.7 percent of the graduates of Dutch universities ever end up in a small business, but 75 percent of the graduates of the Harvard Business School end up in a small business within 10 years. There is a totally different attitude toward the role of the entrepreneur and a cultural acceptance here of the entrepreneur, which adds up to a different set of rules, based on these deeply held attitudes toward what an acceptable life is and what a career is all about.

**Dr. Thomas Gray:** It is true that the business world is characterized by change. When we look at the American economy from the small business standpoint, we see business expanding and contracting, being born and dying at rates that are much larger than most of the public realizes. If you look at federal statistics you will notice that almost all the data generated are net change data, so you never see gross births and gross deaths. What you see is net change, and net change turns out to be fairly small. But the small change hides the facts. It is like the slow-moving hands on the face of a clock. Behind the face there are wheels turning at very rapid speeds.

Two further points emerge when we look at business formation. One is that the world is characterized not only by change but by disequilibrium. Most economic policy has been based on economic analysis that focuses on equilibrium solutions. Those solutions imply that there is an optimum solution, and that if we just look hard enough we will find it. But it may be that the world is best characterized as being in continuous disequilibrium. The issue is not one of an equilibrium solution but of a continuing search for a solution. Most business people have to move fast just to stand still. Tastes change, demands shift, competition finds new techniques that lower costs, and innovators innovate. Each change forces an adjustment if a business is to survive. It is only the shortcomings of economists and policy analysts that have prevented the development of dynamic models to look at that continuous adjustment process in a more productive way. Fortunately the profession is aware of that, and it is working to help solve that problem.

The second point I want to make is that the market works. This is not a statement that is easily accepted in most of the world. Nevertheless, it is true, and small businesses search for solutions more capably than large businesses in many cases precisely because the market works and enforces a discipline in small businesses that says "If you do not search for solutions well, you die quickly." And dying quickly is an essential part of an efficient economy.

Let me develop that argument further. Small businesses are often denigrated simply because they are small. We tend to associate small in the business world with a number of things. We think of small firms as firms that use casual labor, use less specialized resources in general and less capital per worker, and are shorter-lived and less stable than larger firms. And we consider all of these things as less desirable than the conditions in large businesses. My argument is that, from the standpoint of adjustment, all of these conditions may be aids to speedier adjustment in situations where the small business is facing rapidly changing demand situations. In fact, I would hypothesize that small business is often organized specifically to be able to make rapid adjustments. Small businesses may specialize in situations where they have to make adjustments in order to survive.

There are a number of important implications for policy that follow from this. One of the economic implications is that small firms do things differently from large firms by choice, not by accident. If they do not do them well, they leave the market rapidly. As both David Birch and I can attest, the number of business deaths is 8 to 10 percent of the population in a given year.

Another point is also related to David Birch's work. It is that, in terms of net changes, there is about a 3 percent increase in the number of establishments each year. That 3 percent net growth in the number of establishments has held up over the last eight to ten years, starting with the 1969 to 1976 period that David measured and going through the work that the SBA has done from 1976 to 1982. The 3 percent growth hides the fact that 10 percent of the firms or establishments die each year and more than 10 percent are born each year. There is a tremendous dynamic change going on behind the scenes. Why are there such large numbers of births and deaths? And why is this true in good times and bad? As David mentioned the proportion of job generation due to small businesses varies over time among other things, but it is always related to a large amount of change.

Why should that be? First, there is a short-run issue: How do small businesses adjust in a world where they have a fixed plant and equipment? My argument here is that small businesses make their adjustments by organizing their existing resources in a different fashion than large businesses.

To understand the implications of this, conceive a world for a minute that is different from the one I have been talking about—a world that is a stable place in which firms face very stable demands.

What does a business person do in a situation where he faces a stable demand that he can predict over time? He tries to build an optimal size plant, where the average cost of producing a given unit of output is as low as possible. Big businesses try to do the same thing, of course. And once these large firms get that plant built, there is very little doubt that they can produce at a lower cost than small businesses. In economist's jargon, we say that these optimal-sized plants have been built to capture "scale economies" related to size.

So how do small businesses exist in an industry where the large businesses clearly have scale economies available? How can a small business systematically compete over time when a big business can underprice them?

The answer is that, while the big businesses shoot for an equilibrium position where they are manufacturing at the lowest possible average cost, in a real world setting they do not reach that goal very often because the real world is rarely in equilibrium long enough for them to be at the optimum point. In fact big businesses may often produce at a point away from that optimal point, at a much higher average cost than intended.

Now small businesses may never reduce costs as much as large firms, but they tend to organize resources in such a way as to enhance their "flexibility," their ability to shift output over wide ranges at relatively constant costs. George Stigler first noted this ability back in the 1930s.

So although big businesses theoretically can produce at lower cost, small businesses can adjust their output over a wider range of outputs at relatively constant cost. It turns out that, since big businesses do not produce at their optimum point, and small businesses can adjust over a wide range, production seems to organize itself in many industries as a mix of large and small firms. And fluctuations in output in a number of industries are accomplished by the expansion or contraction of small businesses. Big businesses tend to try for the stable part of the market and get as close to their optimal average cost as they can.

There is a second aspect of the question, which centers on a long-run phenomenon—where an industry adjusts output by exit and entry from the industry. In this case, small businesses are much more capable of entering and leaving an industry than are large businesses. One reason is that, if a big business has captured full economy of scale, then virtually by definition it has invested in specialized equipment and plant to achieve that ideal point. It must have very specialized facilities that are difficult to shift to other uses. For example, in a large steel-making plant, it is very difficult to shift to a different usage at low cost.

Small businesses, on the other hand, tend to have much less total capital and much less capital per worker. And they tend to have less specialized capital, so if a small business shuts down, it can usually sell its capital off in a functioning secondary market in used capital equipment. That equipment can then be put to other uses relatively quickly and relatively efficiently. Having little capital is not a detriment from a small business standpoint, if in effect you have to move out of a market because you are not making a profit in the market.

The same thing can be said with respect to labor. As I noted earlier, small business has often been criticized because it generally uses less specialized labor than large businesses. Again, if you are working with specialized capital equipment, normally you have specialized workers who are expert with that equipment. Small businesses use less specialized equipment and less specialized workers, and those workers generally have a wider range of opportunities available to them outside of the small business. The opportunities may not be as high paying as they are in large business, but there are more of them. Thus, if a small business shuts down, it imposes less of a social cost on its workers and on society because the workers have more flexible opportunities elsewhere. Indeed, many of the things considered detrimental about small business may well be very useful from the standpoint of easing the adjustment process. If a small firm is productive and is earning a large profit, it can expand rapidly. On the other hand, if it is a losing proposition it can shift resources out of their current use and into some other use quickly. Both of those things are happening in the economy on a regular basis. And the efficiency of the American economy is ultimately increased because small business can move resources rapidly into or out of a particular production area. That argument holds whether we are talking about manufacturing firms or about the thoughtware industry. The advantage is the same.

I hope this helps to explain some of the changes observed by David

Birch in various economies. The U.S. economy is more productive than any other because its free market capitalist institutions encourage small entrepreneurs to make adjustments rapidly. A good deal of innovation can be explained as small business adjustments to changes in a world of disequilibrium where the search for better solutions is made on a continuous basis.

# Session 2
# Entrepreneurship and American Competitiveness

Israel Kirzner explains that entrepreneurship is characterized by alertness to economic opportunities. Government cannot be expected to identify opportunities that others do not see, he notes, nor is it clear how entrepreneurial alertness can be taught. Competition is the key to fostering entrepreneurship.

*Commentators:* Carol Steinbach
Katsuro Sakoh

"The way to wake up America is not to spend costly resources on expensive alarm boxes. It is to open the shutters and permit the sunlight of opportunity to perform its own stimulation. Opening up the economy, eliminating restrictive regulation would stimulate alertness and compel existing firms to stay on their toes to forestall aggressive competition by others."—Israel Kirzner

". . . [W]hat distinguishes Europe's movement, born of economic decimation and the realization that the coal mines, steel mills, textile factories and auto assembly lines will never again support the work force they once did, was the Europeans' awareness that the jobless and the disadvantaged—those with low income, poor or outmoded skills and little prospects for employment—should be warmly included in this new drive toward entrepreneurialism. Indeed, many Europeans believe they should be a major focus of it."—Carol Steinbach

"A common but mistaken impression in the United States is that the Japanese economy is controlled by giant corporations. But almost 80 percent of today's total employed workers, and 99 percent of the total business establishments, are in the small business sector."—Katsuro Sakoh

Dr. Israel Kirzner: I was strap hanging last week in the New York subways, and I noticed an ad that was trying to stimulate interest in the New York State lottery. It was a series of little panels—steps you have to take to become a millionaire. The first panel showed two strap hangers, one of them with his eyes closed and one of them with his eyes open. And the caption said, "Step number one is, wake up." And then it proceeded to say, "As you are reading this ad already, you are ahead of the game." That intrigued me. In fact it suggested to me that the subtitle of my talk might be: How to Wake America Up.

Entrepreneurship was involved in that ad a sort of high-level entrepreneurship. It was trying to attract my attention to a particular message to alert me to an opportunity I might be interested in. The ad writer was already alert to his opportunity to wake me up to notice that particular opportunity that might interest me.

In some sense the current ferment about entrepreneurship and the need to stimulate it is a recognition that this country is not fully awake, that it is overlooking opportunities staring it in the face and that something needs to be done about it. It is often said that this country seems to have fallen behind in the competitive race with other countries who are its rivals in commerce and industry. And it is suggested that if entrepreneurship within this country somehow can be stimulated it would enhance the U.S. competitive position in the world.

Proponents of this view often go on to suggest that entrepreneurship must be stimulated by operating on two fronts. The supply of entrepreneurial talent needs to be increased, and it is thought that perhaps this can be done by teaching and encouraging young people to become entrepreneurs. The second front consists of lowering costs of engaging in entrepreneurial endeavors, such as lowering the cost of raising capital or dealing with labor.

These are well-meaning views, held by thoughtful and well-meaning persons. Yet at least in part these views are seriously in error. Not that I am against lowering the cost of doing business; not that I am against encouraging young people to be entrepreneurs. But there is a rather subtle intermingling of truth and error in these views that I would like to disentangle.

Let us go back and ask what entrepreneurship is and why it is important. To do this, it might be useful to emphasize two quite different aspects of economic activity. One important aspect, of course, is that of acting efficiently. Efficient economic action is a key aspect of economic endeavor. A second and quite different aspect of economic endeavor is the discovery of opportunities.

First, what does it mean to be efficient or inefficient? To be inefficient in a given activity is to engage in that activity in a wasteful manner. It is to use up an unnecessarily large volume of resources in achieving a given goal—or alternatively to fail to achieve the maximum output available from a given volume of resources. To act efficiently, on the other hand, is to pursue goals in a consistent manner that accurately reflects their relative importance. Someone once put it this way, "To be efficient is to tell the truth." To be efficient, in other words, is to act in a manner that faithfully reflects the announced hierarchy of importance with respect to various goals that have been set. To be inefficient is to announce interest in a certain goal and then in fact to pursue a different goal—or to refer back to the subway, it is to set out to go uptown and in fact take the downtown train. Observe that acting efficiently cannot occur without a clearly identified framework of given goals, with respect to which truthfulness can be identified.

Let us turn to the second aspect of economic activity, namely the activity of noticing opportunities. To notice opportunities means to notice new goals worthy of pursuit. It is to notice the availability of resources that had perhaps hitherto been overlooked, or that had hitherto not been available at all. Or it is to discover an earlier error in judgment in ranking the various goals. To act efficiently is one matter. To notice opportunities is a quite different matter. Both are important. Both are intertwined in actual economic activity. Once opportunities have been identified, they must of course be pursued efficiently. In the process of pursuing objectives efficiently, the tendency is certainly to remain alert to the possibility of new opportunities that hitherto had not existed or hitherto had been overlooked.

Producers must operate on these two fronts. They engage in the cost-conscious production of goods that they believe consumers will be prepared to buy. In this way they tend, of course, to faithfully execute consumers' relative evaluations of alternative products. The "truth" that efficient producers tell is the truth with respect to consumer evaluations. But at the same time producers must be alert to the possibilities of producing new goods or perhaps producing the same goods with new, less costly methods of production. This aspect of business activity is, of course, the entrepreneurial aspect. And it is this alertness that constitutes the heart of entrepreneurship.

There is a key relationship between this notion of entrepreneurship alertness— and competition. We all know that competition among producers, though painful to those producers, is highly beneficial to the consuming public. It is competition that keeps producers on their toes

But keeping producers on their toes requires more than that they and their competitive producers simply be efficient. It requires also that they and their competitors be entrepreneurially alert. What keeps producers on their toes is their awareness that others are being alert. If competitive pressure means the pressure exercised upon producers by their being aware that others may be discovering better opportunities of serving the public, then clearly competition and entrepreneurship are merely two sides of the same coin.

This notion of competition is very different from the textbook case of perfect competition identified as a state of affairs where innumerable small market participants exist. That is not what I have referred to here as competition, and it is certainly not what businesses mean by competition. And it is not the form of competition that keeps producers on their toes. That competition arises from the pressure exercised upon producers by their awareness that others are intent and alert on discovering new ways of serving the public.

Entrepreneurship is the key to change. Change *per se*, of course, need not be for the better. A new product is not necessarily a better product, or a new system of organization, necessarily a better system of organization. To the extent that change is desirable, however, entrepreneurship is required to discover it, not merely to discover the possibility of change but to discover the desirability of change and to weed out those possibilities for change that are not in the interest of the consuming public.

In this sense, entrepreneurship initiates desirable change by the mechanism of identifying pure profit possibilities, that is, profit possibilities that have not hitherto been discovered.

While entrepreneurship is thus a key factor in initiating change, it also has a primary and crucially important role in anticipating, noticing, and responding to changes that already have occurred or are about to occur in the market itself. So entrepreneurship does not merely initiate, it also responds to changed conditions, new preferences, new patterns of population location, and newly discovered technological possibilities that create opportunities for entrepreneurial endeavor.

Let me emphasize that entrepreneurial alertness is not the same thing as deliberate search. Search is important, but to search deliberately may consist of simple, efficient activity. If we know that someone has planted a $50 bill somewhere in this room, we can then engage in systematic search. That would not be entrepreneurial. To be entrepreneurially alert would be to realize that it was a $50 bill worth looking for. The discovery or realization that there are opportunities here that might usefully be searched for is entrepreneurial. The realization that there are cost/effective search possibilities is entrepreneurial. Search by itself need not be *per se* entrepreneurial.

All of this can perhaps be expressed in terms of the much maligned free lunch. In the view of many economists, free lunches simply do not exist. All lunches, they say, are to some extent costly. The least costly lunch can be efficiently pursued perhaps, but not a free lunch because there are none to be pursued. But this view is profoundly wrong. The truth is that free lunches are everywhere, available to be picked up for nothing. There are unseen opportunities that are available to be grasped. Those are the free lunches. And it is the awareness that free lunches are abundant that switches on entrepreneurial alertness, that gets those entrepreneurial juices moving.

What makes these free lunches available is the perception of something that the competition has not yet perceived. It is those two straphangers standing there, one asleep and one awake. The one awake sees an opportunity that the other has overlooked. Such opportunities would not exist if all others were fully alert. Awareness of opportunities is a part of the competitive process whereby one competitor inches ahead of the others.

If alertness to opportunities is desirable, how can we, as a society, encourage such entrepreneurial endeavor? How do we as a society encourage activity considered to be desirable? Ordinarily we do so by diverting resources from less desirable activities toward rewarding those who engage in more desirable activities. There are goals that we as a society perhaps may consider worthwhile, but less worthwhile than others that we wish to encourage and subsidize. Therefore we tax the first and subsidize the second. That is how to encourage activity. The lunch that is stimulated in this way is not a free lunch because the resources that reward the subsidized activity are taxed away in some sense from the activities that are being given up in order to encourage the activities that we wish to stimulate.

But what if the activity that we wish to stimulate is that of noticing truly free lunches, that of entrepreneurially identifying opportunities for pure net gain. This does not mean encouraging opportunities that society has already noticed or encouraging the pursuit of search possibilities identified as worthwhile. This asks a very different question. "How can we stimulate people to be alert to opportunities that neither we nor they have specifically recognized, but which we are sure are available to be identified if we could only wake up?"

This means we cannot identify specific activities for subsidy. We cannot know which new lines of business call for stimulation, since if they were known, we would not be proposing the encouragement of entrepreneurial activity. Nor surely will we succeed in stimulating entrepreneurship by lowering the cost of doing business in general, or by lowering the cost of doing business for small firms or for new firms, because we do not know where in fact the opportunities exist. There may very well be opportunities that small businesses can exploit and can discover. But we do not know what they are. We would surely wish to stimulate a discovery at all levels wherever discovery is possible. But we as a society cannot know in advance where those opportunities specifically exist because, if we did, we would already be the entrepreneurs.

How do we encourage genuine discovery? We can easily subsidize innovation and change. I understand that in the Soviet Union there is a substantial program of incentives for innovation. But that reminds me of the kinds of innovation that deans of colleges very often demand of their faculty, new courses, new programs. Sure enough they get them. But there is no guarantee whatsoever that such innovations are in the interest of the consuming public. Innovations for the sake of innovation may be worthless or worse. So subsidizing innovation and change is not at all the issue. It is the innovations that are in the public interest.

How about teaching entrepreneurship? Here I must agree with a distinguished colleague of mine who has pointed out that, if you can teach it, it ain't entrepreneurship. What is taught may be very worthwhile. But teaching how to start up and run a new business is not necessarily teaching people how to be entrepreneurial. It is possible to teach useful skills for entrepreneurs they may be worth support and encouragement and may very well be socially worthwhile. But it should not be thought that that constitutes teaching entrepreneurship, as the techniques of pure discovery simply cannot be taught.

So back to square one. How can we stimulate entrepreneurship? Perhaps the earlier observations concerning the linkage between competition on the one hand and entrepreneurship on the other may be of some help. I would suggest that the way to keep potential entrepreneurs awake and on their toes is to make sure that decision makers are subject to and that they are aware that they are subject to the keen stimulating winds of competition.

This may sound like a circular line of thinking, since competition is necessarily entrepreneurial. It sounds as if I am suggesting that the way to stimulate entrepreneurial alertness is to stimulate entrepreneurial alertness. Certainly the way to stimulate entrepreneurial alertness is to create an atmosphere in which competitors are free to be alert and each one is aware of that. There is nothing that concentrates the mind so wonderfully as the awareness that others are concentrating their minds to discover better ways of serving the customers' needs.

The way to stimulate entrepreneurship then is to ensure that free entry into each and every potentially profitable entrepreneurial activity is guaranteed. It is to withhold protective privileges from all incumbent producers. So we have almost come full circle. There is a widespread perception that the international competitiveness of American products somehow requires a revival of the entrepreneurial spirit. The point has been reached where it appears that the way to revive the entrepreneurial spirit is to foster the competitive spirit within the American economy, to refrain from discouraging entry and entrepreneurial discovery. Any blockage against entry is a signpost that says "Don't bother to be alert. You might as well be asleep here."

The way to wake up the U.S. is not to spend costly resources on expensive alarm clocks. It is to open the shutters and permit the sunlight of opportunity to perform its own stimulation. Opening up the economy and eliminating restrictive regulations would stimulate alertness and compel existing firms to stay on their toes to forestall aggressive competition by others. Strengthening international competitiveness implies encouraging a sense of openness—the sense that there is a wide open world out there full of $50 bills, full of free lunches, waiting to be discovered and the awareness that, if you do not discover them, the fellow next door will. That, I believe, should successfully wake up the U.S.

Ms. Carol Steinbach: As a journalist who has covered entrepreneurship since the 1970s, I find two elements of the phenomenon particularly exciting. First is its dynamism and the many highly creative people who are at the forefront of developing new entrepreneurial policies. This has made it an extremely rewarding subject to cover. Second, I find entrepreneurship an appealing and hopeful approach to making real inroads against poverty and creating new avenues for economic growth and job creation.

Last October, I traveled with eleven U.S. economic development practitioners to Great Britain and France to observe firsthand their emerging enterprise development movement. Europeans are trying desperately hard to become entrepreneurial. They see our net job creation performance over the last decade and they salivate. And a growing number of Europeans are convinced that economic revitalization depends to a large extent on becoming more flexible, loosening the rigidities that beset their economic system. Many believe that the keys to diversification and growth rest with small firms and new enterprises.

But transforming Europe into a hotbed of entrepreneurialism will not be easy. It involves no less than changing a traditional mindset that devalues commerce into one where people see starting their own business as a viable option. To succeed, it must confront a class system that is still rigid; a political system beset by ideology and centralism; an educational system that is simply not adapted to entrepreneurial training; a lack of broad entrepreneurial support in the economy and the society, particularly from the private sector; and governments that, no matter how supportive, are really neophytes in this arena.

Nonetheless, what distinguishes Europe's movement, born of economic decimation and the realization that the coal mines, steel mills, textile factories, and auto assembly lines will never again support the work force they once did, was the Europeans' awareness that the jobless and the disadvantaged—those with low income, poor or outmoded skills, and little prospect for employment—should be warmly included in this new drive toward entrepreneurialism. Indeed, many Europeans believe they should be a major focus of it.

In the U.S., when we talk about entrepreneurs, the image is of a white male engineer going to a venture capitalist to get money to develop his brilliant high-tech idea into a product that will make them both rich—and quick But, by contrast, in Great Britain, the movement toward entrepreneurialism comes from the poorer, distressed areas. It gets lip service from the central government and the private sector, but very few resources. In France, the central government has created a cabinet level department to promote what they called the *Economie Sociale*, and that is their big effort at entrepreneurialism. But again, it is really a very bottom-to-top movement, based on distressed areas and unemployed people left out of the mainstream. And that is understandable. Structural unemployment has hit so hard there that they are hoping that, if they can create a mindset that values entrepreneurialism in such conditions, it will spread to the rest of society. The private sector, moreover, is hardly involved in any of this in Europe.

We did not visit a city where we were not told by envious Europeans how much more entrepreneurial is the American psyche than the European. And of course in the large context this is correct. But in another sense, we found the Europeans were a bit ahead of us. In the United States, there has been no widespread systematic effort to encourage self-employment among those whom the economy has left behind. And in the isolated examples where the attempt has been made, only rarely are these efforts accompanied by the necessary support systems and by the nurturing faith that these entrepreneurs, too, really can succeed.

Here are some of the most interesting lessons we found in the European programs:

*Lesson One.* European income support systems are being transferred into more than just a safety net against poverty. By redirecting their focus and resources toward enterprise development and self-employment, the Europeans are trying to create a ladder for motivated recipients to climb out of poverty.

As in the U.S., European countries, confront high welfare costs, a shortage of jobs, and disincentives and barriers to work built into their transfer system. Their response has been to launch a broad-scale socioeconomic experiment. The British and French programs are being run by a conservative and a socialist government, respectively. What they do is to permit their unemployed citizens to use welfare and jobless benefits to start their own enterprises. In the U.K., the "entrepreneurs" receive a weekly government allowance for one year while their fledgling businesses are getting off the ground. The French approach is to offer laid-off workers the option of taking their benefits in a six-month lump sum to use as seed capital for business. Similar programs exist in other European countries.

As of last August, the more than 43,000 Britons in the scheme were operating a variety of enterprises. Most popular were building trades, domestic services, toy manufacturing, computer services, and not surprisingly—consultants. So far, the results have been impressive. More than 70 percent of the British firms were still in business 18 months after start up. An early survey suggests that each new enterprise is creating an average of one and a half jobs.

As of March 1984, 135,000 French had opted for the scheme. Enterprises there span the range of high technology manufacturing to janitorial services. The bulk are in the service industries, and a government evaluation suggests that between 60 and 80 percent of the enterprises started under the French scheme have survived for three years.

I would say that, in the U.S., programs of this type should be undertaken mainly by state and local governments. The federal government's best role is to remove some of the prohibitions that bar demonstration programs. Indeed, some initiatives of this kind are already in preliminary stages. Federal legislation in October 1984 expanded the states' authority in experimenting with Aid to Families with Dependent Children. Although the federal legislation did not specify the encouragement of the entrepreneurship alternative, it appears that all the states would need to implement such schemes would be a waiver from the Department of Health and Human Services. They would not need any new federal legislation to try this. So the State of Minnesota is preparing to apply for waivers to adopt the British style program for some of the Aid to Families with Dependent Children recipients. The intent is to pay them a weekly or biweekly allowance—the format is not set— and then help them in starting the new enterprise.

*Lesson Two:* Large, private firms can help rebuild the economy in communities where they must close plants or fire workers. Enterprise and job-creating strategies, as a centerpiece of such efforts, can have a positive impact on even the hardest hit areas.

We heard the term redundancy frequently during our visit to Europe. It is a catchall phrase to describe the factories and the workers whose products and skills can no longer be justified on economic grounds. We were all familiar with the scenario but we found some significant differences in the ways this nation and its employers respond. The best U.S. firms tend to offer severance pay, relocation assistance, retraining, and job counseling for the workers they have to dislocate. In Europe, on the other hand, we found an exciting lesson in the emerging attempts by European corporations to go beyond these traditional types of assistance and stimulate job creation and new business growth in the wake of plant closings.

The program begun nine years ago by British Steel is Europe's showcase example. In the later 1970s, the corporation embarked on a massive industrial restructuring plan which, by 1983, was to slash 150,000 employees from its work force and to write off billions of dollars of outmoded plant and equipment. To cushion the blow, British Steel in 1975 spun off a wholly owned subsidiary, BSC Industry, Ltd. This subsidiary had a single mandate: create jobs in steel closure areas.

At first BSC Industry focused principally on providing cash incentives to recruit other large firms to the distressed steel areas, but this approach proved to be expensive and not very fruitful. So the company decided to undertake a more comprehensive effort to provide a broad range of assistance to small firms and would-be entrepreneurs. During the past three years, BSC Industry's program has been expanded to 18 steel closure areas in England, Scotland, and Wales. The subsidiary became independent of British Steel in 1984.

BSC Industry directs its efforts in four ways. First, it markets heavily a new image for distressed steel communities. It refers to them as "opportunity areas," not distressed areas. And it tries to provide the psychological climate for indigenous development and, where possible, to attract employers from elsewhere.

Second, it provides comprehensive business assistance, including loans and seed financing, to foster the development of new businesses and to help assure that the existing firms survive and grow. It also has spurred the formation of independent public/private partnerships to bring together a wide variety of resources in a united effort to regenerate distressed steel communities.

Finally, and most interesting, BSC is converting many of its redundant facilities into incubators for entrepreneurs. Its nine entrepreneurial workshops now house about 400 businesses that employ around 1,500. Through the seed financing program, it has made about 800 loans to collateral-poor entrepreneurs. Ninety percent have been for less than 25,000 pounds. Overall, as of March 1984, the company had assisted 1,500 firms in creating about 20,000 jobs to replace the 150,000 that had to end. It estimates that the total will reach about 36,000 new jobs as of next year.

*Lesson Three.* Small seed finance programs are a necessary component of successful entrepreneurship and enterprise development initiatives Studies of new enterprise formation in the U.S. consistently have found that the lion's share of new businesses perhaps as high as 90 percent is started with capital drawn from the owner's personal savings and the famous "FFA Network"— friends, family, and associates. For high-tech startups with good growth potential, the burgeoning venture capital industry can be a source of financing. These informal networks work just fine for entrepreneurs in well-off communities, but they are not much help to the less privileged. The U.S. suffers from real seed capital gaps, especially in poorer communities.

To compensate for a lack of seed capital, the British and the French have launched a hodge-podge of innovative, small seed-financing schemes. Some are run by the government; some are run by the private sector. Similar kinds of programs in the U.S. could help expand access to startup business capital for U.S. entrepreneurs. One of the most intriguing models we found was the informal investment clubs that are dotted throughout France. One club, called Feminotre, has copied a model from Africa known as the Tontine. Thirteen women pooled their savings, and then they spun off one of their members to start a business.

The Europeans probably do more for seed capital than Americans do The U.S. fares better at expansion capital and some of the second round financing. France has created some government programs that provide money from the tax base to small businesses that create jobs. There also are efforts underway there to encourage private banks to provide some of these small seed capital infusions. These banks are very different f. .m U.S. banks. They are centralized, and there are almost no local banks. Great Britain is trying tax incentives. They have a program where private investors who make equity investments in small firms can write off the investment pound-for-pound against their income.

*Lesson Four:* Entrepreneurial training programs are successful. In their quest to be more entrepreneurial, Great Britain and France are relying heavily on a variety of new initiatives to train their citizens to make their own jobs. We were struck by the sheer magnitude of programs. Achieving the lofty goals set forth for these programs will be a formidable task, particularly in the communities hardest hit by industrial decline, where generations of children followed their fathers and mothers into the mills, mines, and assembly lines. It may be that the old adage is true: that entrepreneurs are born, not made, and that Europe's high hopes for entrepreneurial training will come up short.

We found elements in these programs that could be especially useful in the U.S. It was not so much the type of training or curricula—what we offer does not differ greatly in kind. The lessons stemmed from the magnitude and variety of enterprise training efforts, particularly the willingness to experiment with financial mechanisms and policy support by government, and from the attempts to integrate training with other economic development programs. Finally, and most important, we could learn from European efforts to target entrepreneurial training to the unemployed and to distressed areas.

*Lesson Five.* Small enterprise workshops are a useful tool. The U.S. is no stranger to business incubators. In recent years, a number have sprouted up in urban, suburban, and rural communities. Briefly, these are the workshops that re individualized space to entrepreneurs to run their businesses within a complex where many other small businesses are also operating. They share common facilities and services, and they generally have on-site managers and other professionals who can offer either free or low-cost business assistance and psychological support.

The extensive experience with workshops in Europe—particularly in Great Britain where the concept is highly refined—could be transferable to the U.S. Europe not only has more workshops, but the Europeans have developed some sophisticated models. They are also experimenting with many new concepts.

Several features of the European workshops were especially impressive. First was the establishment of workshops in redundant industrial communities, distressed areas, and public housing projects. The second was the desire to use existing buildings and facilities for workshop complexes. The third, and most interesting, feature was the willingness to allow work spaces to be used for pre-business product development. Some workshops now include spaces for freelancers, for people who want to work on a project-by-project basis, and even for people who are trying to develop their hobby into a profit-making enterprise. Finally, ' re is clearly a belief in Europe that work spaces can be more than ply attractive supportive places to work. In what is a relatively new d p-ment in the workshop concept, some communities are trying to create complexes that offer a broad range of amenities—both for tenants and to attract community residents and tourists. Some, for instance, have space for retail outlets, restaurants, common exhibition areas, a library, a park, and a museum. This is all in the workshop/work space.

*Lesson Six.* Some of the European efforts to regenerate closing businesses have been successful. Not ll businesses fail because the marketplace no longer demands their goods or services. Poor management, temporary capital shortage, retirement, or voluntary closure by the owner all account for a significant percentage of the companies that annually cease operations. A variety of efforts is underway in Europe to regenerate still solvent business of all sizes. France, for instance, has developed programs to regenerate closing businesses by converting them to co-ops. One program dispatches a "relay manager" to an ailing industry, and the mission is to turn the firm into a co-op within six months and then leave behind a team of workers to manage it. A second program seeks to mak co-ops from healthy enterprises where the owner is retiring or dies with . heir to take over. This is a particularly important problem in Europe. France, Great Britain, and the other nations experienced a rash of business startups immediately following World War II, and now France estimates that as many as 60 percent of the companies, small and mid-size businesses, will confront the owner retirement question in the next five years.

These then were some of the most intriguing programs we saw. We came to believe that many would be transferable to the U.S. and could help to stimulate enterprise development within our own entrepreneurial culture. Some may be especially helpful in extending the benefits of entrepreneurialism to those who traditionally have been left out of . .e U.S. economic m..instream or who were left behind by economic and demographic shifts.

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Dr. Kaisuro Sakoh: Japan is not very popular these days, especially in the U.S. Congress. Once viewed as a nation of purposeful, innovative, hard-working people, Japan is now seen as something of an economic pariah. The main reason for this change in attitude, it seems, is that Japan has been too successful economically and too competitive in the world market. It is important to remember, however, why Japan's economy and its industries are successful and competitive today. It is in large part because of the actions of the U.S. government following World War II.

Under the U.S. occupation, Japan's traditional feudal society collapsed, the old leaders were purged, and old economic orders, such as Zaibatsu cartels, were dissolved. In short, the Japanese gained unprecedented individual freedom. And for the first time, practically any Japanese citizen, regardless of age, class, or family background, could venture into business and succeed. Not only did established businesses prosper under fresher and younger management within this freer environment, but thousands of new enterprises, such as Honda, Yamaha, Sony, and Suzuki were born.

Even though thousands of new companies were born in this new environment, many of them did not survive. A few survived and today are huge, internationally known corporations.

A common but widely held misconception about Japan is that its economy is controlled by giant corporations. But, in fact, almost 75 percent of all employees work in small companies that make up 99.5 percent of Japan's total business establishment. Small businesses are defined as those with fewer than 300 workers in the case of manufacturing, fewer than 150 in the case of wholesale trade, and fewer than 50 employees in services and retail. These numbers indicate that Japan is very much a small business-oriented country and that these small businesses are the main source of jobs and economic vitality.

In the last ten years, roughly seven million new workers entered Japan's labor force, and nearly 90 percent of them are employ , small businesses. Moreover, most of today's large and successful companies in Japan were started through garage entrepreneurship. Those entrepreneurs, or innovative young managers, made the Japanese economy extremely dynamic and competitive after World War II. Whether or not Japan will be able to maintain high growth depends on whether or not small and new companies will be able to play an important role in its economic future.

Through deregulation, privatization, and incentive policy, the Japanese government is trying to create an economic environment favorable to the establishment of small businesses. After all, it was the growth of small businesses after World War II that set the stage for Japan's rapid economic development.

# Session 3: Entrepreneurship and the Political Process

Congressman Thomas DeLay draws from his experience in both the business and political worlds to argue that the relationship between business and the political system is rarely conducive to the public interest. Businessmen, he notes, are not slow to use government to restrict competition, the lifeblood of the entrepreneurial process.

"It is a fact that entrepreneurship produces competition and nobody in business likes competition. Barbers and doctors and taxi drivers do not want competition. That is why we have licenses—to keep people from competing with them. Industry does not want competition. That is why Japanese motor bikes carry a 45 percent import tariff. Unions do not want competition. That is why trucking has not been completely deregulated...."—Congressman Tom DeLay

Congressman Thomas D. DeLay: In his fantastic new book, *The Spirit of Enterprise*, George Gilder tells the story of many of America's greatest entrepreneurs—men like J.R. Simplock, who invented the frozen french fry and has been supplying the bulk of McDonald's needs for twenty years. Simplock did not have tariffs protecting his business. He did not have incentives coming from the federal government to entice him to get into business. But he also did not—until probably the 1950s or 1960s—have abusive taxes sucking away his capital. All he had was a spirit for winning and a spirit for making money—and that wonderful thing that seems to be lost around here, the profit motive. He had that profit motive and he was a wonderful human being. And just recently he has put a $23 million investment into the computer business—at the age, I think, of 72. An American success story, and there are thousands and thousands of these success stories.

I do not claim that my own story is a success story. I do claim to be a businessman—a small businessman. I am in the pest control business—I checked the books last weekend, and I am still in the pest control business. I graduated from the University of Houston with an education in biology and chemistry. My father said I was to be a doctor. After graduating, I decided that I would not be a doctor, but a bachelor's degree in biology and chemistry is not very useful.

So I went to work for a pesticide formulation plant. We supplied agricultural chemicals and fertilizers for the pest control industry in a five state area. Within two years, I was running Redwood Chemical in Houston, about a $3 million business. But my boss would not pay me what I thought I was worth, so I bought a truck and went into the pest control business.

The business turned out well, but I realized that as I was getting into the business, government regulation and government taxation were holding me back from developing my business And then, in 1977, the Environmental Protection Agency mandated that all pest control operators be licensed. But licenses restrict competition. We fought that; we lost.

That made me angry, so I decided to get involved in politics. I ran for state representative in 1978 and was the first Republican ever elected in that county.

During that time I fought with my own industry. The industry that fought licensing of pest control operators realized that licensing was a great way to keep others from getting into the business. We went from just having to take a simple licensing test to where the industry demanded five years' experience before an applicant could even take the test. That would keep the service technicians working for them for at least five years before they went into business and became competition.

After that I ran for Congress. And here I am in Washington. It has been quite an experience, but I think my story tells you why I did all this. Why did I get into business? To make a profit, to feed my family and create jobs and all those things that entrepreneurship brings. Was it because of government encouragement? No. Nobody came over and asked me if I wanted to get in the pest control business. Was it because of government protection? No. In fact, it was probably just the opposite. At that time, the pest control industry was not regulated by government. Or was it because of government bailouts? No.

In my estimation, government—especially the government we have had for the last 30 or 40 years—has been more responsible than anything for stifling growth in America for inhibiting entrepreneurship. Licensing and protection has been particularly harmful. It is a fact that entrepreneurship produces competition and nobody in business likes competition. Barbers and doctors and taxi drivers do not want competition, and that is why we have licenses to keep people from competing with them. Industry does not want competition and that is why Japanese motor bikes carry a 45 percent import tariff. Unions do not want competition, and that is why trucking has not been completely deregulated and why the Davis-Bacon Act has been preserved.

We all know that legislation and policy making on any government level takes a very short time, while entrepreneurship takes a very long time. Silicon Valley and Route 128 did not begin five or six years ago, when they became famous. It took decades. And it also took World War II, which gave an enormous shot in the arm to both of those areas. It takes a great deal of time to build the resources and connections for banking and sales channels and other commercial infrastructure. Unfortunately, the world of making legislation and policy runs on a short timetable—there must be quick results. This severely inhibits entrepreneurship. Government is always behind the times, and it is always disruptive.

More successes in entrepreneurship inevitably mean more failures. When there are more successes, it is because there are more people trying and a number of them are going to fail. But some failure must be tolerated. Sometimes it shocks people, but bailouts are not the answer, because bailouts do nothing but put unfair competition on those industries that are doing a good job. The U.S. must recognize the freedom to fail as well as the freedom to succeed. And through failure, people succeed.

What I urge you to do is to support those of us who truly believe in entrepreneurship and the free market system. There is a deficit problem that everybody is focusing on, and some people will be pushed off the fence on the side of cutting the deficit. There are going to be some really tough decisions—some affecting small businessmen. The Small Business Administration is one of them.

But while the deficit is a problem, it is also an opportunity to change the direction of the government. It is an opportunity to establish what the true functions of the federal government are and to get rid of or reform those functions that are not. If that is not done, America will never have as many J.R. Simplocks as it potentially could have.

# Session 4: What Motivates the Entrepreneur?

Robert Brockhaus analyzes the characteristics of the entrepreneur, noting that they tend to have a problem-solving style that concentrates on the short term, and that most are not high risk-takers. Moreover, he notes, people tend to be pushed into entrepreneurship by dissatisfaction with their existing situation, not drawn into it.

"For the most part, people do not start a business because they have invented the perfect mousetrap . . . Rather they have been pushed into it by some other factors. Indeed studies show fairly consistently that about 60 percent of the people who start businesses make the decision to start a business before they make a decision about what the product or service will be."—Robert Brockhaus

Dr. Robert Brockhaus: This morning, as I was flying up from Orlando, the plane flew along the Florida coast. I could look right down along the beach where the waves break—but could not see waves breaking. There was apparently nothing dynamic about it. The foam was there, but from the airplane, 34,000 feet in the air, I could not see the movement of waves. The ocean looked static.

This reminded me that maybe some of us are too far removed from the entrepreneurial process. We look at it in macroeconomic terms. We think of entrepreneurship as a large encompassing area, and we talk about the economic good it does the country and the culture. But sometimes we forget that if we get really close we see entrepreneurs coming in and going out, just as we see waves along the beach—individual wave in, individual wave out, individual entrepreneur in, individual entrepreneur out. We need to keep in our minds that the entrepreneur is indeed an individual. Entrepreneurship is not a mass. It is made of collective numbers of individual entrepreneurs.

We have heard about the failure rates of entrepreneurs and small businesses, but it is important in this regard to realize what entrepreneurs risk in their endeavors. Should the venture fail, the entrepreneur will almost certainly suffer severe financial losses—in most cases he will have personally guaranteed loans to the business, so that financial loss will be borne by the individual entrepreneur. This can be devastating to his future standard of living and have major emotional consequences. In addition, the entrepreneur probably spent five to ten years of his life in the business of being an entrepreneur and now has to go back into the workforce five or ten years behind his colleagues who stayed there. That certainly is not an attractive position to be in.

Let us take a further look at what happens when a business fails. During the period preceding the final death throes of the venture, the entrepreneur probably spends almost all of his time, energy, and finances trying to save the faltering business. As a result, his family suffers from both financial sacrifices and emotional strain. The stress associated with the actual failure could lead to such family trauma as divorce. At the very least, he and his family are forced to adjust to a new and probably unpleasant situation as they work to repay some of the debts that they have incurred.

Given these risks, the potential entrepreneur probably will not enter into a new venture unless he believes that the effort will succeed. As a result, he devotes himself totally to making that business a success. And when the business fails, it is not just the business that fails in the mind of the entrepreneur—it is the entrepreneur who has failed. This means a loss of self-confidence that can be a tremendous blow if there is not some way for that individual to reestablish his self-esteem. So it is something to be concerned about. Not all fail, of course. But it certainly happens to more than a few.

Let us now take a look at some of the characteristics of entrepreneurs found by researchers. First, David McClelland at Harvard has developed a concept called "need for achievement," of which he maintains that entrepreneurs have a high level. He further states that people who have a high level of need for achievement also tend to be moderate risk takers. If we asked the typical person on the street whether entrepreneurs are high risk takers, low risk takers, or moderate risk takers, we would find that most of them think that entrepreneurs are high risk takers. That is the general public's image. But McClelland found them to be moderate risk takers. They do not want to take the big risk because that is foolish and they know it is very likely to fail. Yet they do not take the low risk option either because it is not challenging enough.

About ten years ago, I did some work, which has since been followed up and replicated by others, in which we used an objective instrument to measure the general risk-taking propensity of entrepreneurs. Using this instrument, we found that the general risk-taking propensity of entrepreneurs is identical to that of the range from the mean score minus the general population. Statistically, the one standard deviation to the mean score plus one standard deviation contains approximately two-thirds of the population. Thus most studies have found that two-thirds of the entrepreneurs fit in that range and concluded they are moderate risk takers. But, maybe, they did not recognize that one out of six of the entrepreneurs is at the high end, and one out of six is at the low end. They tend to ignore these groups because they are the odd ones. The majority were in the middle. I am not stating that those who have said that most entrepreneurs are moderate risk takers are wrong, only that they neglected to look at the ends of that continuum and realize that both high and low risk takers are there as well as the more moderate ones.

One of the real difficulties involved in such analysis is determining the risk-taking propensity of an individual in a specific case. For instance, I once owned a restaurant. When I started the restaurant, I did not know what the failure rates were for restaurants. I was naive. Those of you who are far wiser than I was back then would say, "Restaurants are very high risk businesses. So he must be a high risk taker to do that." But I simply did not know it was a high risk. But even if I had known, I would have gone ahead because I knew that where I was starting my restaurant was right across the street from a brand new university that had 10,000 students, 1,000 faculty, and no cafeteria. I was locating it in the nearest commercial building, and there was only one other restaurant nearby. Even if I had known of the overall risk of starting restaurants, I would have gone ahead because I had special information.

Therefore, when we try to determine the risk-taking propensity of an entrepreneur in a specific venture, it becomes difficult because we do not have a true understanding of the amount of information that the entrepreneur has to assist him in his decision. It is very difficult to measure risk taking on an individual venture basis.

The other aspect of risk taking that is very difficult to measure is the potential downside—in other words, what is at risk. What happens if everything goes sour? When I started my restaurant, for instance, I was single, and I had some inheritance money that I felt I could afford to lose. I had a very good job with Ralston Purina, but I knew I could go back to it without any consequences. Thus, I had a relatively low loss potential. Today, I am a full tenured professor with other sources of income that would cease to exist if I spent a couple of years attempting to establish a restaurant again. I would be risking a lot more if it did not succeed. So we need to look at the potential loss to the individual. It will vary individual by individual in otherwise identical enterprises.

Another key aspect of entrepreneurship is a concept termed "locus of control." Entrepreneurs tend to have an "internal" locus of control. They believe that they can affect the outcomes of events in their lives. If they did not hold this belief, they probably would never take risks. Why would I open a restaurant if I felt that, if people come in, they come in, and if they do not, there is not much I can do about it. That is what persons with an external locus of control would think. They would believe that there was very little they could do to affect the outcome of events in their lives. Entrepreneurs are more internal than the general population, and that has been consistently shown. Managers also tend to be internal. An individual does not become a successful manager if he thinks that he cannot control the outcome of the sales or the cost of production. Both entrepreneurs and managers are internal compared to the general population.

Entrepreneurs also tend to have a problem-solving style that is short term. They want to deal with the here and now, with the concrete not the abstract. It is their way of going about things. They normally have not thought about the consequences three, four, five years down the road.

Even more important for entrepreneurs than these characteristics is something referred to as "pushes." For the most part, people do not start a business because they have invented the perfect mousetrap and they are going to exploit it and make millions. Rather they have been pushed into it by some other factors. Indeed, studies show fairly consistently that about 60 percent of the people who start businesses make the decision to start a business before they make a decision as to what the product or service will be. That was true in my case. I knew I was going to start my own business. I did not know what it would be. I just knew I was going to do it.

Dissatisfaction with a previous job is a primary "push" factor. Dissatisfaction can be broken down into five major components. the work itself, the pay, promotion opportunities, relationships with superiors, and relationships with coworkers. Of those five, studies show fairly consistently that the factor that they are most satisfied with in their existing job—in fact more satisfied than the general population—is pay. The ones that they are dissatisfied with include. the work, coworkers, supervisors, and especially promotion opportunities. Often, a person makes a decision to quit because he has been passed over for a promotion.

Another factor is displacement. We read about the Cubans and Vietnamese who have come to the United States and how entrepreneurial they are. In other countries there also are sects that are particularly entrepreneurial. In almost every case, there is some type of displacement. We have displacements occurring in this country when General Motors lays off people. A worker who has been employed for 20 years and suddenly finds himself laid off through no fault of his own is determined that it will not happen again. The only way he knows that he will not have to worry about being laid off again is to start his own business. In the data that came out of the recent recession period, we saw a record number of people starting businesses. They were being pushed into it by being laid off.

Another aspect that enters into it is "role models." An individual looks at a former co-worker and says, "If he can start a successful business, so can I. He is not that bright, and does not work as hard as I do." And even if the business fails, it is assumed to be because the former co-worker was not willing to work hard, or he did not know how to get the right store location, or he did not price correctly.

Family role models also are important. If parents were entrepreneurs, the children are more likely to try it. Even if the parents were unsuccessful, the children will consider it. Consider how many doctors have sons who are doctors and how many carpenters have sons who are carpenters. With any type of profession or work, the older person serves as a role model, and relatives go into the same field.

A couple of other personal characteristics are important. Education is significant. Individuals who start high-tech companies probably have a masters in science degree. But individuals opening a little shop tend to have a lower than average education level. Poor education also can be a push factor. Some people get frustrated. They work for General Motors, and they find out that without a college degree they can only go so far. Promotion opportunities are not there. So they leave and start out on their own.

A lot of studies show that entrepreneurs are in their late 30s or early 40s. But again, the distribution of ages of entrepreneurs at the time that they start their enterprises is very similar to that of the total workforce.

There have been some recent studies on women entrepreneurs. For the most part, the women entrepreneurs are almost identical to the males. Perhaps they are better educated, and they may be from a slightly higher social class, usually because they can get away from taking care of the children, or their husband has enough income that they can afford to take the risk of a business. But other than that they are similar to the men.

In 1975, I studied all businesses that had started in the previous three months in St. Louis County, Missouri. I invited them in to talk about small business and to fill out some questionnaires. I went back three years after they had started their businesses to see whether they were still in business. If they were, I called them successful. If they had closed, I called them unsuccessful. Using these two rather primitive definitions of successful and unsuccessful, I found that those who were still in business had tended to be internal in their locus of control beliefs when they filled out the questionnaire three years earlier. They believed that they could and would make the business succeed. They also had tended to be more dissatisfied with their previous position than those who were no longer in business. Thus, they were more committed to avoid returning to the role of employee.

One of the things that did not show up in that study three years later was risk taking. I had thought that those who tended to be high risk takers would have failed because they were doing some foolish things that could not possibly succeed, while those who were low risk takers would be so uncomfortable with it, once they found out how risky business was, that they would give up. But I could not find anything that seemed to suggest that.

In my job, I do a lot of work with small businesses. I am responsible for the overall policy direction of the Small Business Development Centers in Missouri. We both encourage and discourage people from starting businesses. We look for those who seem to be sincerely committed and help them do their homework. We do not do it for them, but we help them learn to do it on their own.

If we try to point out that their concept does not look like a very good idea, they normally do not believe us. They are going to start anyway.

There is very little we can do to encourage others not originally inclined to start businesses. Those people who do not want to go into business will probably not do it, regardless of various assistance programs or government policy.

There may be something that government can do to help. The easier it is to get funding, the more rapidly businesses can grow. There is a point at which the money the entrepreneur's back pocket runs out as the business begins to grow. If it is not big enough for venture capital or not in the dynamic industries that people are interested in funding, there can be a real problem. That is where tax programs can help small businesses make investments by sophisticated investors more attractive. I do think that the growth rate is affected by this type of government policy. Therefore government can affect the success rate, because often the input of outside capital occurs at a very crucial point. If they do not get funding at that point, they will never grow large enough to get the interest of venture capitalists and will ultimately fail.

These are some of the aspects of entrepreneurship that should be kept in mind in considering ways that the government can assist small business formation and growth.

# Session 5: The Challenge of the Information Age

Ronald Shelp contends that the nature of the entrepreneurial revolution has been misunderstood. To a significant extent, he says, the surge in small business is related to what is happening in big business, and cites growth in business services as evidence. He warns that protectionism may soon appear in the service sector, and calls for a national information policy.

*Commentators:* Robert Tollison
Laurence Moss

"As a general proposition I am very skeptical of the efficacy of the tax system in stimulating economic endeavors. As long as a tax system is not confiscatory--and in the United States system it is not--then tax considerations do not drive investment decisions."—Ronald Shelp

"There is another breed of entrepreneur in the world which we might loosely call a 'political entrepreneur.' I offer you the following definition of a political entrepreneur. a political entrepreneur is someone who takes resources from highly valued uses and puts them to lower valued uses." Robert Tollison

"For the small business person, a trade secret often meant what we are calling circumstantially-relevant business information such as information about how a product is shipped."—Laurence Moss

Mr. Ronald Shelp: To a young person of the 1980s, the entrepreneur is what the public servant was to my generation, the young person in the 1960s. We were inspired by a young president, John Kennedy, who made us want to go into government. Today's generation is inspired by an older president, who assures them they can accomplish more outside of government—in business—than in government. To my generation the heroes were people like Sargent Shriver, the first director of the Peace Corps. Today the heroes are young business dynamos like Stephen Jobs, the founder of Apple Computers.

Entrepreneurial fever is sweeping this country. The *Wall Street Journal* recently ran a story entitled, "On Campuses Making Dean's List Comes Second to Making A Profit." Peter Drucker predicts that we are at one of those historical turning points that come once in a hundred years. He says that, just as the century of *laissez-faire* began with the publication of Adam Smith's *The Wealth of Nations* in 1776, and a hundred years later the panic of 1873 gave us the century of the modern welfare state, we are now at the beginning of a new century, an epoch he terms the "Entrepreneurial Society."

President Reagan made the phenomenon official a few weeks ago in New York when he talked about this being the "Age of the Entrepreneur." But before we get washed away with a flood of enthusiasm proclaiming this new entrepreneurial spirit to be the source of our economic resurgence, and the solution to all our problems, we should make sure that it reflects the noble values that shaped the greatness of this country.

One way to look at it is to see it as a reflection of a national mood—a mood that bespeaks an overwhelming concern with wealth and getting rich quickly. For example, the type of television show pioneered by Norman Lear some years ago, such as *All In The Family*, emphasizing working-class, family-oriented values, stands no chance today. It has been replaced by a string of hits—*Dallas*, *Dynasty*, and *Falcon Crest*—centered on big business, great wealth, and the power they bring.

I must admit I found it a little disconcerting to read a survey in the *Wall Street Journal* a few weeks ago about the children of successful executives and to find that they love all the things their Dad's money buys. They want to make even more than he made—but they do not want to work so hard for it. If these are the values of the Age of the Entrepreneur, then the apprehension of some about encouraging this tendency is warranted.

There is no doubt that getting rich is one of the reasons people want to start their own business. But my experience suggests that making money is not the primary motivation. Higher on the list is the desire to be independent, to be creative, and to find the work satisfaction often lacking in the large corporation. This was confirmed by the late Professor Albert Shapero of Ohio State University, who found that entrepreneurs would not become corporate managers even if they were paid five to one hundred times their current earnings. If this is true, and money is not the overriding consideration, it suggests something about the policies necessary to encourage the entrepreneur. Before discussing these policies, however, let's briefly examine the kind of economy in which entrepreneurship is flourishing—one that has been called the information economy.

The U.S. economic miracle over the last few years has not been lost on anyone. It is the envy of every nation. Europe and the rest of the world are scrambling to determine the reason for the U.S. success so they can imitate it in their own countries. This miracle is seen not so much in the vigorous economic growth, which hit almost 7 percent last year, but rather in the spectacular job creation that has accompanied it.

Approximately six million new jobs have already been created in this decade. And few have missed who created them. During the last recession Fortune 500 industrial companies lost three million jobs while businesses less than ten years old added more than [illegible] million new employees. In other words, most jobs are being created by small business. And small business is perceived as being entrepreneurial. Thus the logical conclusion is that, if small entrepreneurial business is responsible for the current boom, then what we need is the right mix of policies to assure more of the same.

This part of the equation is generally recognized, but I wonder if the formula is as simple as it sounds. Is there more to this economic revolution spearheaded by small business than meets the eye? There are several crucial questions that need to be answered.

The first is. Why did this suddenly happen in the last four years? Was it supply-side economics, deregulation, technological change? The answer is that the job boom spurred by small business has not simply erupted in the last four years. It is the extension of a trend that began at least fifteen years ago. As David Birch has shown, 82 percent of all jobs created between 1969 and 1976 were in small firms.

The second question is. What kind of businesses are these small firms involved in? Are they, as the news stories might lead us to believe, the modernday replacement of the old manufacturing firm—the small high-tech microelectronic company making silicon chips? The answer is no. Considerably less than one-third of the new small businesses are in high tech. The great majority of those six million new jobs were created in service firms. And the same thing happened in the 1970s. Nineteen million new jobs were created. Seventeen million, or 89 percent, were created in service industries. So a more accurate description of the economic revolution that has changed the economy might be that for nearly two decades small service businesses have driven the economy, providing ever increasing shares of employment and production.

The third and final question is: Does this small business revolution really represent a spontaneous development independent of those "stagnant" giant corporations that have dominated the economy since the end of World War II? The answer is no. The large corporation has generated the need for these businesses. Often it has encouraged their creation, supported and nurtured them. This has occurred for three reasons.

First, what some have called the "industrialization" of the service function has been a factor. Both service ar ' ~ .ufacturing businesses have realized that the greatest productivity improvement and cost reductions can be made in the area they have so long neglected—the service function. For service businesses this is true L .use that is their business. For manufacturing businesses it is true because the service function provides larger and larger percentages of their work force. Thus, both have made investments in the new technologies that allow improving service functions.

Steven Roach of Morgan Stanley has noted that, in 1982, $145 billion was invested by service firms in these new technologies, which was a 145 percent increase over 1981. T' 's has spawned new, small, independent service firms servicing such big companies as computer software firms.

The second reason big corporations have spurred small businesses is because they have learned that contracting outside for services is often more efficient. Obtaining accounting, financial management, legal, purchasing, and management services from outside instead of supplying them from inside has led to a multitude of new small service businesses.

A third reason is because of the "intrapreneurial" thrust of big business. We all read about this popular new idea to revitalize creativity in the big corporati . But the focus has tended to be on what is done within the company. Examples abound in Gifford Pinchot's books, such as Chuck House of Hewlett Packard and Art Fry of Tandy Corporation. But we hear less about an equally compelling phenomenon spinning off the new enterprise altogether. For example, two weeks ago the Boston papers reported on the Boston insurance company that had spun off its public relations department. This new independent firm was contracting with its former employer for a substantially lower price than it had cost the company before. In the process a new company was born. This in essence is extending the profit center component to its logical conclusion. The profit center concept is given total independence.

The recognition of this relationship between small and large firms forces reexamination of the assumptions about the small business revolution. True, it has occurred. True, it is at the heart of the economic boom and the center of entrepreneurial activity. But it is closely linked to what is happening in big business. In fact as the research of Brookings Institution analysts Catherine Armington and Marjorie Odle has shown, a significant portion of the small businesses that have been created in the last fifteen years are branches or subsidiaries of big firms.

These developments taking place in the economy allow us to draw some general conclusions about the nature of what many term the "new" economy.

First, given the spectacular job creation in services, it is no surprise that it is a service economy Seventy-four percent of the work force is in service industries. But that invites us to jump to the wrong conclusion. A service economy is bad enough, but a small business service economy is worse. It suggests Mom and Pop stores. It has led to a long litany of distinguished Americans making comments akin to that of Lee Iacocca, who recently said that "within a few years our economic arsenal is going to consist of little more than drive-in banks, hamburger joints, and video game arcades."

Some have seized on the "information" economy as a slightly more palatable description. John Naisbitt helped popularize this notion in *Megatrends*. He noted that, since 195̣, white collar workers have outnumbered blue collar workers. He also said for the first time most of us work with information rather than produce goods. Thus, he proclaimed, Daniel Bell's postindustrial society was no longer an apt description. It should be called the information society.

The so-called Atari Democrats, who stressed high technology in last year's presidential election, clearly are more comfortable with information industry than service industry. A new technology/information-based economy associated with glamorous industries such as microprocessors and laser beams is certainly more reassuring than talking about services, but only marginally so. It is discomfiting to think of most of our work force spending their time processing information.

Neither "information" or "service" is satisfactory. There is an alarming tendency to try to understand the most complex economy ever by simplifying it. A service economy is not one producing mainly low-skilled consumer services. Over half the jobs are found in upper level service occupations at the professional, technical, and administrative level. And the dominant services are business services.

More important, the service economy is actually a major manufactur ing producer. Both industrial production and the percentage of GNP contributed by manufacturing is at an all-time high. Nor does an information economy concern itself mainly with producing information. Information is used for what it has always been used for—to supply goods, commodities, and services. New technologies and international economic integration make information a much more valuable ingredient, enabling us to produce more, better, and new goods, commodities, and services.

In a nutshell, then, the American economy is a complex, diversified blend of various categories of economic activity. Service production more and more resembles the manufacturing assembly line. Manufacturing production more and more involves service functions. Manufacturing, service, and commodity businesses all involve elements of the other to the extent that distinguishing among them is futile.

Complicating this change is the fact the U.S. economy has become closely linked to the international economy. This may seem a cliché, but the cliché has been ignored when it comes to making policy, especially about services in international trade.

Consider some examples. The Administration has made considerable progress in including service trade in international trade negotiations For the first time we may start negotiating next year some new trade rules that would cover the $700 billion annual services trade the only trading activity still outside of the General Agreement on Tariffs and Trade (GATT). But it will take years and years to achieve. Meanwhile, most of our bilateral trade agreements do not cover services at all, or they do so only partially.

Second, the Trade and Tariff Act of 1984 and its predecessor bills in the past decade go a long way toward bringing services into the mainstream of trade policy. Yet anti-dumping and countervailing duty legislation does not apply to services. So a domestic service producer does not have adequate remedies to deal with foreign service suppliers who dump or are subsidized.

Third, the trade promotion policies of government are finally oriented to helping service exporters. Yet the recently passed Foreign Service Corporation export tax incentive maintains the inequity that offers this incentive to all industries but denies it to all but two service industries

Fourth, in our rush to deregulate we are mainly deregulating service industries, such as aviation, trucking, and financial industries, because they are the ones most regulated. But we forget the international implications. For instance, take our deregulated trucking industry. The U.S deregulated, but trading partners to the north and south did not. As a result, there has been a flood of Canadian and Mexican truckers into the

United States. And because they have not deregulated, our truckers do not have equal access to their markets.

As a result of all this, what is happening is foreign service trade barriers run amok. The U.S. Trade Representative's Office has a computerized list, several hundred pages long, with some 1,200 barriers on it. Little wonder that the service surplus in our trade has dropped 57 percent in just three years.

It is only a matter of time before a "New Protectionism" is going to appear in the service sector, the very sector which up to now has been the one that pushed to stop protectionism. And it is not going to come because of the barriers abroad, or because of intense foreign competition. It will come because of the issue that caused protectionism in the smokestack industries—the "export" of jobs. The new technologies combining telecommunications and computers allow firms to move service production around the world the same way they can move manufacturing production—only more easily. So Citibank not only can move its service production for credit card processing from New York City to South Dakota, it can move it to Taiwan, Korea, Argentina, or France.

If we fail to address these serious trade issues, we are heading down the road to disaster.

The second area of policy concerns information. It is remarkable that the world's greatest information economy does not have an information policy Actually it has an anti-information policy. Recently, there were signs of this when the Office of Management and Budget proposed cutbacks in data collection. It is not the time to be cutting back when the information is 50 years out of date to begin with. Take the standard industrial classification code. Classifications of the major groups in the code were developed in the 1930s, and there have been no significant revisions in the classification since. Thus leather making and tobacco are classified as major industries. And there is no separate classification for digital computers and microprocessors - they are part of "electrical machinery."

Or look at other favorite indices, the Federal Reserve Board's industrial production and capacity utilization findings. They are based on a composite relative index of importance to total production of 215 industries. But the index was established in 1967. So declining industries, like steel, are overstated while growth industries, such as microelectronics, are understated.

Data collection is one function that cannot be left entirely to the private sector. Private firms do not have the capacity to do it alone. In order to compete, business wants all the information it can get on the domestic and international economy, and data collection is one function that even the most conservative businessman wants government engaged in.

It is time to develop a national information policy which would have the simple goal of developing, maintaining, and completely updating the most advanced data base on the U.S. and the world economies. The president should call a White House National Information Conference to assess the needs and give a sense of urgency. I urge foundations and the business community to fund studies on updating the data base of the economy This process should focus on the economic indicators. They need to be updated. In particular, the undue emphasis on an industrial economy needs to be corrected.

The third critical policy area is tax policy. Fiscal policy is the single instrument of public policy most often embraced as essential for encouraging entrepreneurial activity. A central thrust of the current national debate over tax reform is concern over how to use tax policies to direct resources into desired economic activities. When former Treasury Secretary Donald Regan first introduced the original Administration tax reform proposal, he argued that a bias exists in the tax system that favors industrial activity over service work. The Administration's solution. adopt a tax reform plan that lowers tax rates and removes industry-specific incentives. Thereby the marketplace—not the tax mechanism would decide where investment should be made.

I agree that the tax system is slanted toward manufacturing, a bias aggravated by the 1981 tax bill—which strengthened the accelerated cost recovery system (ACRS) and the investment tax credit. Thus the Administration proposal is appealing. But it is not the only way to go. There are at least two other approaches. One is to provide equity in the tax code to nonmanufacturing sectors. For example, the research and development tax credit is available only to manufacturing industries This means a computer hardware manufacturer can obtain an R&D credit for innovation, but the software designer cannot. Granting service businesses the R&D tax credit already available to manufacturers would be a giant step toward putting equity into the system.

Another way to introduce equity for services would be to grant tax incentives for investment in human resources, the economic factor that is to services what capital goods are to manufacturing. One way to do this would be to adopt another Bradley/Gephardt idea, one lost in the rash of attention their flat-rate tax reform proposal has received. This incentive would grant employers a Social Security tax credit for adding new employees to their payroll.

Another alternative to broad-based tax reform is to provide incentives targeted to specific service sectors. For example, financial industries, such as insurance firms in the business of risk taking, could be granted a tax exemption if they set aside catastrophe reserves. This provision is in effect in most countries—but not in the United States. It would encourage insurers to take risks in areas where catastrophes might occur.

While the Administration's tax reform plan intended to provide an "even playing field" is seductive, it must be considered in light of international developments. Much of manufacturing is clearly in trouble. And one reason is because of tax and other incentives provided to manufacturing in other nations. So before removing the traditional tax benefits given manufacturing, the U.S. should first make sure other nations are willing to do the same. In the meantime, addressing the needs of the service sector means a goal of seeking tax instruments that give service firms equal treatment.

What about the other tax reform notions, such as the proposal to eliminate capital gains treatment from the tax code? This notion has raised a national brouhaha. Those in favor of retaining capital gains treatment argue it would discourage new investments, while those who favor the change argue that other tax incentives provided in the reform proposal would compensate for this lost incentive.

As a general proposition, I am very skeptical of the efficacy of the tax system in stimulating economic endeavors. As long as a tax system is not confiscatory—and the United States system is not—then tax considerations do not drive investment decisions. Perhaps the one exception to this general proposition is the financial paper shuffling involved in the acquisition fever that dominates the business news. Tax considerations unquestionably play a role in this destructive addiction. But taxes play at best a minor role in most risk-taking decisions. We certainly do not allow it to affect our decisions in my company—although the tax lawyers say we should. We make decisions on the merits and then, and only then, do we turn to the tax specialists to minimize the tax consequences.

If taxes do not drive decision making in going concerns, neither do they dissuade those wanting to start a new business. Entrepreneurs do not hesitate to act because their profits, if they make any, will not receive capital gains benefits. Perhaps the venture capitalist who funds startup ventures may take fewer chances if he loses capital gains treatment, but it will not cause him to stop being a venture capitalist.

There are many good reasons for keeping the capital gains treatment provisions in our tax law. But the argument that removing them will kill entrepreneurial activity is not one. Creative mechanisms that stimulate capital formation for new business, such as those contained in Congressman Charles Schumer's (D-NY) National Entrepreneurship Act, will do more than tax incentives to encourage business creation.

If tax policy is not a panacea to encourage risk taking, what are the appropriate policy tools? For one thing, we tend to focus too much attention at the national level. Most industrial promotion activities—some thirty thousand organizations altogether—are found at state and local levels. Traditionally, these agencies have had a manufacturing focus. More recently they have had a high-tech focus. Every local organization wants to repeat the Silicon Valley experience. In doing so, they may attract some small firms, but that is not their intent. Jobs are the name of the game—so they are after giant firms.

The time has come for local and state industrial development programs to aim at the small firm, especially the small service firm. They should consider offering small companies the same incentives given to big corporations. Why not establish a "service industrial park" like the traditional manufacturing industrial park. Such a facility could offer service firms low-cost space, telecommunications, and other business services essential to their activities.

A final policy area needing urgent attention concerns adjustment. The United States does not have a national adjustment policy today, and it never has. This luxury is no longer affordable. Workers must be trained for the jobs that will dominate a service/information economy. Admittedly, such a policy is easier to advocate than to define. But there are some indications as to the path we should take. To begin with, it will require the best educated populace ever. Second, future career patterns probably will mean constant retraining and frequent career changes. Given these assumptions, it is time for government at all levels, as well as the private sector and foundation community, to begin to assess what future job needs are likely to be and how to prepare workers for them. I doubt this will be very successful, as the capacity to predict change, given the speed at which it is occurring, is simply not up to the task.

My intuition tells me that it is the basic skills of a literate man that will be needed most. So the "return to basics" movement now energizing educational institutions throughout the country is particularly encouraging. But it is dismaying that this new devotion to education is accompanied by substantial federal cutbacks in aid to education. The cutbacks now being proposed for federal aid to students are especially alarming. If human resources are the key to the future, investments in them must be increased, not reduced.

A second and more difficult part of the adjustment process is dealing with the displaced or redundant worker. There were five million such casualties in the last recession. It is true, of course, there are probably no more than in past periods of service economic change. And perhaps the personal pain and suffering caused by these dislocations will be less because many of those affected are fifty-five or older and have adequate retirement benefits. But it is still a serious problem, especially since there is such a high concentration of dislocation in one sector, manufacturing, and in one region, the "rustbowl." Forty-nine percent of the five million dislocatees worked in manufacturing. Over half of these have not been reemployed. And those who have been almost always have gone back to work in the same industry. Only 480,000 shifted to a new industry. This suggests the adjustment process is not working.

But the idea that government should help people make the transition to a new job has never taken hold in this country. The only time there has been any support for adjustment policy was in the 1960s, when the Trade Adjustment Assistance legislation was enacted to help workers, firms, and communities adjust to displacement from import competition. The national debate that accompanied adoption of this program raised the legitimate question. Why help those dislocated because of trade, but not those dislocated due to technological change or other factors? Congress finally adopted this trade adjustment assistance program because it would help the U.S. maintain its commitment to free trade. But the Reagan Administration has basically gutted this program.

Determining whether today's job displacement is trade or technologically induced is virtually impossible. It is probably a little of both. This offers an excuse to do as in the past and once again fail to develop a national adjustment policy. This would be acceptable if today's economic disruption were a one-time occurrence that is not likely to be repeated very often.

But it is not. With the current pace of technological change and the expanded involvement of the United States in the international economy, it will occur more – not less – frequently. In a short time, technology and trade will cause displacement in the current growth sector – services. Peter Drucker predicts that new technologies such as interactive computer shopping and word processors will eliminate fifteen million service jobs by 1995. This means the time has come to establish a national adjustment policy. There are many elements such a policy should contain. Let me suggest two.

First, the Trade Adjustment Assistance program should be overhauled and restored. Second, serious consideration should be given to adopting the Individual Training Account proposed by Pat Choate, whereby employers and employees would pay into a fund, much like the Social

Security fund, which a displaced worker could draw upon for retraining. This is an appealing approach that gives the initiative to the employee and keeps government out of making decisions. Finally, much can be done outside of government, and this should be encouraged. The retraining programs that are part of certain union-management pacts are a good example.

I stated earlier that the drive for money was not the primary motivation spurring an entrepreneur. This suggests that there are limits to what public policy can do to encourage it. More important than tax policy or other inducements is the climate in which the entrepreneur operates. In that respect the United States is and has always been unique. This is especially true today.

The entrepreneur is respected. He has become a cult figure. Intellectuals want to spend their time with him. Gloria Steinem calls the entrepreneur the artist of business. The media features businessmen such as Steven Jobs and Donald Burr in the same way they used to focus on anti-establishment figures.

So we have stamped the entrepreneur with a seal of approval and put a premium on his value to society. This is the right environment. It is better than any legislative incentives that could be devised. As long as this atmosphere prevails, risk taking will flourish.

Dr. Robert Tollison: My remarks will take off on a tangent from Mr. Shelp's and return, at the end, to reflect on some of his policy recommendations.

Israel Kirzner defines the entrepreneur and the entrepreneurial process as taking resources from lower value uses and putting them to higher value uses. But those entrepreneurs are not the only entrepreneurs in the world. There is another breed of entrepreneur whom we might loosely call a "political entrepreneur." I offer you the following definition of a political entrepreneur. A political entrepreneur is someone who takes resources from highly valued uses and puts them to lower valued uses. Many smart and creative people, who are political entrepreneurs, choose to work in this town of Washington, rather than to work in the private sector. I maintain that we should try to deflect these people into the private sector, where their activities have a chance to increase GNP, rather than into the public sector, where their creativity often leads to reductions in the nation's welfare.

To understand how to deal with the political entrepreneur, let us examine the political process at the state, local, and national level in this country and consider what changes can we made in that environment to ensure that gifted people are not attracted into this sector rather than the private sector. And let us consider how to ensure that the people in the public sector are creative and productive. How can we change the political order to achieve such results from political entrepreneurs?

I do not have any easy answers to those questions. What I say will be controversial, and I am merely putting these ideas on the table to address the issue. How do we get people in politics to be productive rather than unproductive? And how do we keep really creative people from going into politics in the first place?

One thing we could do is make the political choices that they have to make more obvious and difficult. We could set up systems in which it is not easy for politicians to evade responsibility for the choices they must make. For example, let us have a balanced budget amendment, and let us have a fixed size of government in the national economy. Then, year by year, under one of the modified plans that have been proposed, politicians would no longer be able to walk away from taking responsibilities for their expenditure decisions. If life is more difficult in the political arena, surviving in that arena will consist of doing what the constituents want. It becomes less fun to be a politician if the work is harder and there is less discretion. That will make politics less attractive as a power trip to smart lawyers who seem to gravitate to the political sector.

My second proposal is that we should reintroduce *laissez-faire* into campaign finance. The campaign finance system we currently have at the state and federal level is pure and simply "incumbent protection," designed to prevent entry into politics. Normally entry and turnover seem a good thing. In markets we consider entry and turnover as matching supply more closely to the preferences of the people and what they want in the marketplace.

The same principle works in politics. It is not a question of rich people getting elected and poor people being barred from it. It is a question of opening up the marketplace. Let us force whoever occupies a political office to be on his toes and efficient and to respond to serious challenges by people who can raise money and run against him. So I would say one way to discourage political entrepreneurship is to deregulate campaign finance.

Now let me go into the far reaches of political science fiction. We have in this country a vibrant, basically free economy that is encumbered with a political system designed in the 1780s and 1790s and subsequently amended. We have a bicameral legislature. We have an independent judiciary. We have an independent executive branch. We have two-year terms in Congress. We have two four-year terms for the President and so forth. Those features rarely change. But that is not to say that they cannot be changed or that we might not want to think about restructuring the system of representation and political choice appropriately for a modern economy rather than a developing economy.

I do not have any really good ideas about how to do this. There is nothing to prevent having another house in the legislature—elected at large, for example. It is not written in concrete that we could not deny former government officials from working for firms that they regulated or contracted with until after five years. And there is nothing to stop us from having a larger House of Representatives--making it a little less easy for special interests to prevail.

I know that this sounds like a radical departure. But some attention ought to be given to the nature of the political process that we have grafted onto a very mature, vibrant economy. It is not often we do that.

Turning now to some of the things that Mr. Shelp talked about. I think we could have a useful debate about data collection. I am probably the wrong person to be standing here, because my major accomplishment in almost two years at the Federal Trade Commission was to kill the business data collection program. I killed it for a simple reason--after looking very hard at the costs and benefits of the program, I concluded that the costs were astronomical and the benefits were astonishingly small. And that is the problem with Mr. Shelp's suggestion. It is not a question of this government walking away from all data collection. It is a question of where is it cost effective to collect data? And what is the data used for?

More often than not, in any meeting of the relevant parties for a national information policy, there would be some good results and some bad. Much useful data collection would be modernized, as Mr. Shelp wants. But the bureaucracies would be using the funding to collect much that is not needed. So it is a question of how much, not a question of whether.

I believe that the general answer about how much data this government should collect is they should collect less. A careful look at the end uses of much of what the federal data machine cranks out would lead most serious, cost-effective managers of government to that same conclusion.

We should note that Mr. Shelp extended adjustment assistance not just to international dislocation but to dislocation because of shifts in demand and supply curves in the domestic economy at least I think that is what he meant when he said that a technological revolution is going to create unemployment among service workers. So we are talking about millions of workers in retraining programs Every time I have seen studies of the effectiveness of these adjustment assistance programs, I am led to conclude that government ought to avoid them. That may sound harsh. But I would just as soon see workers get onto the next job by themselves without any government-imposed stumbling blocks, such as government programs that supposedly are going to retrain them.

Mr. Shelp's remarks about education were right on the money. We throw a lot of money into education. But the question this administration has been raising from the start is a most basic one: Where on earth is it going? I used to live in the state of South Carolina. South Carolina is noted in the statistics of education for two things. Students do the poorest in educational measurements, and its administration expenses ratio is the highest across the 50 states. So the principals and school administrators are getting fat, and the kids are not getting an education.

It seems to me that this is similar to any government program where we throw money at a root cause to solve a problem. Often it is political entrepreneurs who stand between the money and the job actually getting done.

Dr. Laurence Moss: I also would like to start with some comments on Mr. Shelp's proposal for a national data policy. I see great danger in this, especially in terms of its negative impact on entrepreneurial activity.

Mr. Shelp is quite correct that the majority of economists, conservative, liberal, and otherwise, have continuously emphasized the importance of government data collection. Even Carl Menger, the founder of the free market Austrian School, writing at the turn of this century, advocated government involvement in collecting and disseminating business statistics. Menger thought that this would improve the efficiency of the market. In addition, "institutionalist" economists such as Wesley Mitchell, who helped found the National Bureau of Economic Research during the 1920s, emphasized government data collection and management as a way of smoothing out the business cycle. At least that is what they hoped would happen. They believed that, if business people could have equal access to timely business barometers, they would be able to adjust their inventories in time and not get caught in recessionary spirals.

Having placed Mr. Shelp's proposal among those of a large number of prominent economists who support government subsidization and management of business data collection, let me speak against this proposal. I think that an essential element in entrepreneurship is the ability of entrepreneurs to discover and act upon very particular and, to some extent, peculiar types of business information. This information has not received enough recognition, either in academic or government circles. There is no easy way of describing this type of information, so my colleagues at

Babson College and I have had to coin the phrase, "circumstantially-relevant business information." The closest we have come to a real discussion of this sort of business information and a clear recognition of its importance is in Friedrich Hayek's works, especially in several articles he wrote during the 1940s. Hayek noted that one of the great virtues and features of a market economy is that, by decentralizing decisions and allowing people to accept responsibility and benefit from their decisions, individuals are encouraged to focus their attention on these circumstantially-relevant pieces of business information that would never catch the attention of central planners. Furthermore, the prospect of profits lures these same individuals to mobilize the information at least within their own plans and designs. A market economy utilizes circumstantially-relevant business information to better advantage than any other economic system known to man.

In our time, it has become one of the marks of the educated man to look down upon specialists and purveyors of circumstantially-relevant information. You may remember the famous story about Aristotle who concluded that women must have fewer teeth in their mouths than men. Apparently, neither Aristotle nor any other of the philosophers thought it necessary to look into a woman's mouth and count the teeth because that would be to approximate the menial labor of the slave. Western philosophers did not get involved in such extensive experimentation until it became fashionable to do this sometime in the seventeenth century. Instead, they went after abstract knowledge, knowledge of the general laws of science. Specific empirical details were just that—details. This prejudice is carried over by certain academic writers who discredit or trivialize the creative work of entrepreneurs. I think this attitude is both unprofessional and uninformed.

Those of you who are familiar with modern, neoclassical economics will appreciate that its theory of production rests almost exclusively on a distinction between a "choice of techniques" and a "change in technology." This distinction is a rather dramatic one, and a mastery of the subtleties is required of all economic majors in American universities. At any moment in time, a firm is said to have a "given" production function and a complete menu of choices of techniques. The firm will switch from one technique to another when relative prices vary. Over time, technology is supposed to change, and when it changes, it does so in rather sudden and unexpected ways. In textbooks on economics, the detailed description of the processes by which new ideas become diffused is mainly overlooked. The task is left to the business professors whose interest in the market process is not as thoroughgoing as this subject requires.

My colleagues and I became aware of the importance of circumstantially-relevant business information when we investigated the Freedom of Information Act. When we interviewed entrepreneurs, they complained that the government reporting requirements were betraying their trade secrets. When we interviewed Freedom of Information officers in the executive agencies of our government, they said, "Nonsense. We don't give out business secrets. We have an exemption under the Freedom of Information Act that, when anybody requests another company's trade secret, we will flatly deny the request."

So how could we reconcile the perceptions of the entrepreneurs with the sincere views of the government officials? The solution had to do with a basic misunderstanding about what was meant by trade secret. For the FOIA officers, the notion of "trade secret" embodied mostly technological and scientific information and not marketing or related information. For the business person, "trade secret" was broader than technological information and meant what we are calling circumstantially-relevant business information such as information about how a product is to be shipped and carried.

An example from the experience of a large corporation will serve to illustrate that distinction. Procter & Gamble once shipped Pampers diapers to Japan by Boeing 747 airplanes. That information was reported as the law requires on a shipper's export declaration filed with the Commerce Department. One of Procter & Gamble's competitors used its rights under the Freedom of Information Act to request that information, and the government FOIA officer could see no reason to deny the request. After all, knowledge of how Pampers diapers are shipped is certainly not equivalent to some secret production formula. What harm could there be in giving out such a mundane piece of business information? But Procter & Gamble was rely , on the confidentiality of that piece of information in order to pursue a profitable marketing program. If the competitors found out they were using a 747 rather than a ship, they would realize what a wonderfully lucrative market existed for paper diapers in Japan. Apparently, nobody believed that the Japanese would throw away paper since one of their customary habits was to conserve paper. So it was assumed that there would never be a large market for disposable diapers in Japan. Procter & Gamble was the first to discover that there was. So here was a piece of information which government officials, acting in good conscience, disclosed. They never thought they were disclosing anything of value and yet they were. Procter & Gamble lost profits as a result of this government disclosur

The inability of government to protect business information is one aspect of centralized government data collection that threatens entrepreneurial activity in our country. This type of disclosure jeopardizes the entrepreneurial process by reducing the incentive to discover and utilize decentralized information. To the extent that this happens, a distinctive feature of the market economy is undermined.

Having questioned the sensitivity of both the legislative and executive branches of government to the proprietary nature of the entrepreneurial process, I wish to say a few words about the judicial branch and to give the judicial branch of government high marks for being quite sensitive to this information problem. At least two court cases are germane. The first case was the famous *Kewanee* case, decided in 1973. In that case, the defendant argued that his business should be allowed to use the alleged trade secret information that the plaintiff's former employees had taken with them when they joined the defendant's firm. Their argument was that this practice should not be discouraged by law since the one who had originally discovered the information had had ample opportunity to seek a patent and probably would have qualified. Because the plaintiff did not pursue his patent options, his information was fair game, and employees could bolt off and start their own business with this information. The inventor plaintiff, having had his bite at the patent apple, should not be given the protection of state law in shutting down his competitor and having these disloyal employees thrown out of work.

The Supreme Court did not buy the defendant's argument and decided the following. State trade-secrecy law that protects producers of information from the misappropriation of that information by a competitor is still good law. In other words, the existence of a federal patent system does not prevent the state courts from enforcing traditional trade secrecy law. Most important, the Supreme Court did not restrict its holding to technological information. Indeed, all types of circumstantially-relevant business information may be protected against misappropriation.

The other decision that contributes to understanding of the judiciary's attitude toward the entrepreneurial process is the *Berkey* case decided by the U.S. Court of Appeals (2d cir.) in 1979. Berkey accused Kodak of violating the antitrust laws. When Kodak introduced the Instamatic 110 and the revolutionary new film, Berkey lost sales of its older style cameras. Berkey claimed that, when a firm as large as Kodak has as high a market share as Kodak had, the large firm has a duty to disclose ahead of time information about its new products so that other firms, such as Berkey, could have a head start in the market, producing compatible equipment. Kodak's failure to do this, argued Berkey, must be construed as part of a plan to monopolize trade. The Appeals court decided that, even though a firm may have a large market share, it has no duty to disclose information that it has accumulated through legal business channels. In my opinion, the judiciary is much more sensitive to the proprietary concerns of the entrepreneur than either of the other branches of government.

For these reasons, I wish to object to Mr. Shelp's idea that we start a centralized data collection effort. Unless we are also more sensitive to the importance of circumstantially-relevant business information and its protection, we may well undermine one of the necessary conditions for successful entrepreneurial activity in our economy. While aggregated business data may not reveal circumstantially-relevant business information, the process in which, say, Commerce collects this information is likely to prove no more reassuring to the business community than what has occurred in the past.

# Session 6: Is Entrepreneurial Opportunity Still Alive in America?

Albro Martin explains that entrepreneurship is a vital component of successful large firms, not just small enterprises, and that successful entrepreneurs generally have served an apprenticeship mingling with the crowd, and learning the hard way what the public wants. Moreover, he says opportunity lies all around us and in every sphere, waiting to be discovered.

*Commentators:* Richard McKenzie
Robert Friedman

"... [S]how me the company that refuses to rest on its laurels—like 3-M, or IBM—and I will show you a company which constantly practices entrepreneurial innovation. And within those walls of such companies, freedom—just as much as the individual innovators can handle—is present."—Albro Martin

"You should expect 'paper entrepreneurialism' and, for that matter, Washington entrepreneurialism, when you introduce economic policies, including the regulation of markets and taxation, which distort investment decisions."—Richard McKenzie

"Virtually all initial financing for businesses in this country comes from personal savings—or the savings of friends, families and associates. Such financing is essentially a bet on people, not a bet on a business plan. That is a financing system that works very well on the whole—arguably too well in wealthy communities. But it does not work that well in low income communities, nor does it work out well in communities hit by firm closings."—Robert Friedman

Dr. Albro Martin: Words are like electrical circuits. If you overload them, they will not serve you well at all. We have to be sure what we all mean, therefore, when we talk of "entrepreneurship."

To some people, entrepreneurship simply means being in business for oneself, and generally by oneself. In other words, anybody who goes out in a moment of weakness and buys an establishment full of coin-operated washing machines is an entrepreneur, even though he may bring to that venture no aspect of a creative act whatsoever.

To others it means the ability to come up with great ideas for a product or a service. Endless discussions of entrepreneurship, usually ending in agreements to disagree, vague or contradictory conclusions, and finally the inventing of new words when the traditional word would be perfectly usable if better elucidated, are ample evidence that a more rigorous definition and theory of entrepreneurship—including its ultimate role in economic society—are needed.

Definitions of entrepreneurship usually fall into a logical trap. For example, it is usually agreed that entrepreneurship has something peculiarly to do with small business—itself a very imprecise term. Small business, like the Broadway theatre, is the "fabulous invalid" of economic life, it is not dead, but everybody seems to be eager to predict its imminent demise. Therefore, no home is said to remain for entrepreneurship except within the warm, safe womb of "big business." But any such conclusion runs head-on into the fashionable notion that, in professionally managed big business, no such thing as entrepreneurship is possible. just wheeling and dealing, maximization of short-term financial results, and always being prepared to jump to better pickings when the going gets rough.

Entrepreneurship is clearly not a lot of things. It is not inventiveness, the typical entrepreneur lives on the ideas of others. It is not risk bearing, that is the capitalist's function, and it can be "prudent" investment or risk-capital investment. As we shall see, the entrepreneur may or may not risk his own capital. If he does, it is not in his role as entrepreneur. He does, however, risk something that in one sense is much more important than money: his reputation.

A better definition would be that the entrepreneur is the person who sees a good thing product, service, or process – and puts it in the way of becoming a reality and a going business. In show business he is called the "producer", in professional sport, the "promoter." In business, he is the "entrepreneur," a French word that means organizer of a business undertaking.

The entrepreneur deals in entrepreneurial innovation. In the words of the late Joseph Schumpeter still the most clearheaded theorist of the phenomenon—he is the person who "takes the untrodden path." The social function of such entrepreneurial innovation is to facilitate economic growth. Economies can grow only by finding ways to produce more "utility" from a given supply of resources. To put it less abstractly, economic growth means a secular upward trend in the production of socially useful goods and services per capita of the population. Entrepreneurship is thus a pragmatic concept. A person can claim to be an entrepreneur not on the basis of his intentions, but on the basis of his realizations. Failures do not count.

What are the forms of entrepreneurial innovation? Product, service, process, and control—those four words say it all. A better or a new product, a service that fills some need, perhaps as yet unfelt; a production process that involves lower unit costs, or makes a better product, or both; organizing triumphs to solve knotty financial, development, or marketing problems; the ability to know how and when to merge with others in a business for the purpose of bringing order to an industry or other activity. The facets of such innovation are endless, as are the combinations.

But, it might be argued, surely all—or most—true innovation is found in new, small firms. Certain kinds of innovation are probably more at home in small, more or less informal groups. Take so-called high-tech businesses, for instance, in which there is little investment in fixed capital but many long hours of brilliant, highly individualistic human brainwork. In these cases, however, it is important to distinguish between the act of invention, which is not itself innovation, and the guiding of such efforts along paths that lead toward a coherent, viable, profit-promising business. Innovation will be found at the heart of every successful new business, whether it is a flower shop, a quick-food emporium, or a videotape rental library. It had better be there, because if it isn't, the enterprise will last only as long as the proprietor's working capital.

What is the one common essence of this entrepreneurial spark? I would say that it is a longing for freedom, a knowledge of what to do with freedom, and the courage to seek freedom. This is far rarer than we may realize, and it is doubtful whether it can be inculcated where it does not already clamor to be recognized and released. Most of us are merely imitators, for which we make a fair living. Only a small percentage of us are willing and able to take the untrodden path. That is why so much of history is about failures—there are so many more of them—and why the enduring heroes of history are so few in number.

Is there real entrepreneurship in the big, diversified bureaucratic corporations? If there is, why is it so hard to see? The answer to the first question is, yes, although superficial differences between the way innovation is carried on in large and small enterprises often mislead us. It is usually hard to perceive in the large firm because it is bureaucratized. This means that one of the challenges to the corporate entrepreneurial spirit lies in the problem of getting around bureaucratic obstacles. All breakers of new ground, or walkers upon untrodden paths in society, have to thrust aside a lot of obstacles that would seem insurmountable to most of us.

The big company that does not practice entrepreneurial innovation will not survive. Never mind that the formula for success is not published, or the ingredients in generous supply. But show me the company that refuses to rest on its laurels—like 3-M or IBM— and I will show you a company that constantly practices entrepreneurial innovation. And within the walls of such companies, freedom—just as much as the individual innovators can handle—is present. And the rewards are quick and certain, not to mention the penalties for failure.

So much for theory. Where are all these entrepreneurial opportunities? They lie all around us, based upon the rapid changes that are taking place in the way we live. Technology accounts for many. For example, the mass entertainment market, such as movies via TV in the home, is in such a state of flux that no one would bet on what it will look like ten years hence. Billions of dollars worth of computing equipment are now in place, pleading silently, "Use me!" But social changes are an even more stimulating opportunity. One of the most startling statistics before us is the one relating to housewives employed full time outside the home and the worrisome problems that millions of employed mothers face every day. Caring for the aged—or for all of us, for that matter—is a field ripe for cost-saving ideas. All these problems and opportunities invite entrepreneurship. But the opportunities for entrepreneurial innovation are not to be discovered by listening to some college professor or detached observer like Alvin Toffler. A closer look at entrepreneurial innovation reveals that the best ideas seem to occur to people who have spent their apprenticeship years mingling with the crowd, noting what the crowd needs and wants. "New business" arises out of "old business." Entrepreneurship is a matter of building on what is known and believed, not of spontaneous generation.

**Dr. Richard B. McKenzie:** In considering the issue of whether entrepreneurial opportunity is alive and well in the United States, I did some reflecting on the industrial policy literature. I went back to Robert Reich's book, *The Next American Frontier*, and I discovered on second reading that there is a good deal in that book that I can agree with.

Reich describes a phenomenon in the book which I might refer to as an "entrepreneurial dialectic." He charts the history of entrepreneurship in the United States, starting with the period 1870 to 1920—which he describes as the "error of mobilization." This is a period during which, he says, there was one major new invention introduced in this country about once every fifteen months—not something created here, but simply applied to the production process here. The entrepreneurial talent was one of application and of expanding skills and operations to sizes never before imagined. But in the process, the economy became a little bit more rigid because it was dependent upon large-scale production. So the strengths in the system began to show up as weaknesses by the 1920s, because with tremendous production power came ruinous competition. Entrepreneurs then set about trying to manage the largeness of their own organizations and markets.

These entrepreneurs began to develop managerial science, both to manage the firm and to manage their markets. This brought on the era in which management science became the vogue. But management science allowed firms to become ever larger and thus even more inflexible. It also allowed people to think in terms of planning the entire economy.

This period of management science extended to about 1970, at which point the U.S. was producing on such massive scales in such an inflexible system that the country began to decline, primarily because the economy was opened up to competition from abroad and was unable to compete effectively in normal goods markets. As a consequence, the whole process began to turn into what Reich calls "paper entrepreneurialism." Profits could not be made by producing goods and services, so we turned to making profits by shuffling papers. Paper entrepreneurialism is the process by which profits are created through acquisitions, mergers, tax avoidance, and tax evasions. This period of decline, with entrepreneurial talent trapped inside large unproductive bureaucracies, encouraged such paper entrepreneurialism.

Because entrepreneurial talent is trapped in this way, says Reich, we need a dramatic change in the economic system. In particular, he insists, we must become more dependent on "economic democracy." Economic democracy at the firm level will break management science's hold. Developed at the larger, national level, it will break the hold that large firms have on policies and the direction of the economy.

It seems to me that there is a grain of truth in Reich's view of the entrepreneur. But it also seems to me that his error is that he muddles the facts sufficiently to come up with the wrong solution in his call for industrial policies, such as planning boards, planning councils, economic development banks, and the like.

My view is that the paper entrepreneurialism, which he says emerged in the 1970s, was a natural outgrowth of some other forces connected with government policies. We should expect paper entrepreneurialism and, for that matter, Washington entrepreneurialism, when government goes in for the types of economic policies, including the regulation of markets and taxation, that distort investment decisions. When government is opened up to such economic control, it can be anticipated that entrepreneurial talent will gravitate toward the center of that power. Entrepreneurs understandably look upon government power as a resource they can enlist in the pursuit of their own private motives or profits.

Thus, it should have been expected that during the 1970s much more talent would be involved in paper shuffling and acquisitions, tax avoidance, and tax evasions. It should be no surprise that more people come to Washington trying to lobby for special privileges or that many others come to Washington to try to defend themselves against those who came for special privileges.

The difficulty is that Reich proposes the problem as the solution. He proposes industrial policy councils that supposedly would chart a new course for the U.S., but what they likely would do is hasten the decline. The main reason for this is that the entrepreneur is not likely to be represented on those planning boards and economic redevelopment banks because the entrepreneurs do not have their political network of suppliers and buyers and customers to help them get the rewards. Indeed, the entrepreneur would be discriminated against in this process, not helped, as other people used the power of planning boards to extract goodies from government—and to discourage competition by increasing the tax and regulatory burden on the rest of the population.

Industrial policy enthusiasts have charted a program that actually will suppress entrepreneurialism in this country. Paradoxically, the advent of paper entrepreneurialism offers a great deal of hope to the United States economy because it demonstrates that entrepreneurialism is not dead out there, but very much alive. Just provide people with a few simple incentives, and they will go for it. I believe that if we continue on a course of trying to get government out of the economy, people will once again redirect their energies to the private, productive sector of the economy and away from counterproductive political activity.

Mr. Robert Friedman: When we were starting a newsletter three years ago, we tried to figure out what to call it. Eventually we decided that the best title was the "The Entrepreneurial Economy." We thought that was both an accurate description and a worthwhile prescription. This economy is the most entrepreneurial economy in the world. The opportunity for entrepreneurship is alive and well here, and we owe much of our economic vitality to that. That was brought home very clearly when I had the opportunity last year to visit some European countries and to see what was happening there.

Having said that, it seems to me the relevant question is: Are we as entrepreneurial as we might be? Are we reaping the full benefits that entrepreneurship holds for this country? My sense is that there are some barriers, so that we are not reaping the full benefits. I would like to discuss five barriers that limit U.S. potential. Before going through those, however, let me just note that the role of entrepreneurship in this economy has been growing since 1950. Because I have spent much of my life in the area of entrepreneurship and the job creation potential of entrepreneurship, I have pondered whether this is something that has always been going on and we just did not realize it until David Birch supplied the numbers to prove it, or is this a relatively new phenomenon? My sense is that the role of entrepreneurship has grown in this country over the last 30 years. You can see it in the business formation rates. We were forming 90,000 new businesses a year in 1950. By 1970, that had gone up to 250,000 a year. Now it is more like 600,000 to 640,000. And those are conservative numbers.

This increase is the response of an economy being forced to change very rapidly reflecting changes in resource economics, demographics, technologies, and U.S. entry into a global economy. New opportunities are opened up by these changes. There is also enormous dislocation caused by it. And we must remember that often it is negative pushes as well as positive pulls that trigger entrepreneurship.

To return to the five barriers. The first is the notion of who might be an entrepreneur. Too many of us carry around the notion that an entrepreneur is a white male engineer in his mid-30s who is going to start a high tech venture. Clearly, there are many of those, clearly, they are very important. But in terms of the number of entrepreneurs and the number of those new business starts that might fit that model, this means only a few thousand of the 600,000 new firms. It does not include the rate of business formation by women, for instance, which is now increasing at three to five times the rate of male entrepreneurship. I believe this is the response of a group in the population for whom job and income opportunity is constricted in the existing labor market and who thus are searching for an alternative way.

Potential entrepreneurs are the "new immigrants" to the economy. They may be dislocated workers. There is much talk about the need for creative responses to plant closings. For the most part we talk about retraining; we talk about severance pay; we talk about relocation; we talk about counseling. The problem is that in many communities there are few jobs. We overlook the fact—especially when compared with Europe—that many of the people being displaced from their jobs are themselves the best source of new economic vitality in their communities.

There are examples of company towns in Europe where the company has shut down, and deprived the community of its entire job base, but where the seeds of renewal were found in cultivating the entrepreneurial potential of the people who lost their jobs. They replaced 20 or 30 percent of those jobs—in Sweden as many as 65 percent of the job base—by cultivating the latent entrepreneurial potential of the people who were left. And that is something that we do not do very well. Much potential is lost because dislocated workers are not considered entrepreneurs.

We talk about the youth employment problem. My favorite example of how a youth enterprise can arise happened here in Washington—run by Kimi Gray at Kenilworth Parkside public housing complex. She found that some kids in her housing complex were running a PCP ring. She called them in and gave them just two options. "Either I'm going to bust you, or you can sell chocolate chip cookies." It was what might be called entrepreneurship by necessity. They chose the second option. It cost $600 to buy a cart and to buy the ingredients to get going, but the kids paid that back in a few weeks. They will market them at the entries to the subway. I am sure they will do fairly well.

So I think we need to broaden our sense of who can be an entrepreneur. It is widening, but it is still a restrictive definition that misses many opportunities.

The second barrier concerns the income-maintenance system. Fifty-one million people in this country receive benefits under one or more of the income maintenance programs. unemployment compensation, Social Security, AFDC, general assistance. The system was designed to support a few people on a temporary basis. The nature of the "social contract" was. "We will support you as long as you do not seek training, as long as you do not work, as long as —of all things— you do not try to create a business of your own or try to employ yourself."

That system has turned many of the people with the greatest possibilities for achieving self-sufficiency into welfare cheats, when in fact they should be local heroes. I have collected some case studies of people receiving welfare, unemployment compensation, or Social Security who started businesses, often quite successful ones, while they were receiving benefits. They are quintessential welfare cheats. They will not often allow me to use their stories for two reasons. One is that they do not want to be identified, because the stigma of welfare is still strong. And second, what they did was technically illegal and they could be prosecuted.

Is that really a set of incentives and disincentives that serves our larger purpose? Is it in their interest, or in the interest of society, to view those who use welfare to get established in business as little more than cheats? That attitude helps to keep the welfare rolls growing and the costs of the system rising—and it inhibits attempts at self-sufficiency on the part of the dependent population.

This morning Carol Steinbach described what the British and the French do with their unemployment compensation and welfare systems. In effect they say, "Look. If you want to try to become self-employed, you can continue to receive benefits"—in the French case, in a lump sum. By taking this attitude, 250,000 businesses have been established in five years, creating roughly 400,000 jobs in a labor market 40 percent the size of that of the U.S. There may be similar latent potential for creating a proportional million jobs in the American economy.

The third barrier concerns business assistance. Again, we seem to be training people to take jobs, not to make jobs. We need instead to make it possible for people to have access to assistance when they take a business idea to the marketplace. The Women's Economic Development Corporation in Minneapolis is one of the best models of what can be done. It is designed to help low-income women start businesses. The Corporation has been operating for 15 months, and 700 women have come to them. Two-thirds of these women have family incomes under $12,000; one-fifth of them are current or former welfare recipients. Ninety-three new businesses have started, and 144 have expanded. To make it work they have reduced business plans to 12 one-page sheets. Now I am used to dealing with business plans with numbers and I find most of the business planning manuals exclusive and intimidating. But the Corporation talks a language that is not exclusive. If a low-income woman hears the word entrepreneurship, she often shares the mainstream image—that is, a white male engineer—rather than herself. WEDC therefore talks in terms of self-employment.

The fourth is seed capital. Virtually all initial financing for businesses in this country comes from personal savings—or the savings of friends, families, and associates. Such financing is essentially a bet on people, not a bet on a business plan. That is a financing system that works very well on the whole—arguably too well in wealthy communities. But it does not work that well in low-income communities, nor does it work out well in communities hit by firm closings. The $500 needed to buy the roses to sell on Valentine's Day is not available because, to the extent that there is that informal lending network, it has to be used for children's needs, not for businesses.

The fifth barrier concerns a slightly different area of capital—expansion finance and debt finance for profitable, growing firms. There are many studies on this, and it is hard to present an airtight case that there is a barrier. But I have heard too many stories of businesses that could not get the expansion finance they needed to think there is not a problem. At a crucial time in its expansion, even Wang Laboratories could not find a single private bank in the State of Massachusetts that would finance its development.

I recently was reading an NFIB study that asked the NFIB membership whether they thought there were financing barriers. What struck me in that study—which concluded generally that there was not a capital market gap— was that it was precisely the small percentage of firms who said they were growing rapidly who also had financing problems. Those are the ones we should care most about.

This phenomenon makes it clear that we need to distinguish entrepreneurship and the entrepreneurial process from the size of business. When I look at Roger Smith and Steven Jobs or the two welfare women in Minneapolis who started a business for which Land O' Lakes, Ocean Spray, and two other major marketers are now vying for marketing rights, I see many more similarities than I do differences. In companies of tremendously different sizes, the process is basically the same. The bottom line is that we in the U.S. are very entrepreneurial, but there is still work involved in reaping its full benefits.

# Conclusion

Mr. William J. Dennis: Providing an overview of the day's proceedings in a few minutes is at best a difficult task. However, if we understand that the degree of entrepreneurship in any society is a function of culture, information, and opportunity, then we have a framework from which to organize the day's discussion and our thoughts.

The United States is blessed with an entrepreneurial culture. American attitudes and values support entrepreneurial endeavor not only in terms of direct social approval, but by providing reasonable "rules of the game" under which to operate. David Birch emphasized the importance of the cultural basis of entrepreneurship, particularly in contrast to European societies whose values both directly and indirectly frequently strait-jacket entrepreneurially bent people. Ronald Shelp made a similar point arguing that, beyond egregious public policy, encouragement and approval of entrepreneurial activity is the stimulant. And Bob Brockhaus outlined the complexity of entrepreneurial motivation mentioning difficulties "outsiders" often have in dealing with the entrepreneurial personality.

Though the importance of culture was often noted, there was no discussion of public policy initiatives to enhance entrepreneurial values. Perhaps, no one believed there are any. Or, perhaps such initiatives are so long term and so indirect, they are not worth noting here. I do not feel that is the case. In fact, public initiatives in support of an entrepreneurial culture may have sufficient substance for a conference to itself. Education issues, immigration issues, and the value of plain old fashioned cheerleading might be featured.

The second organizational theme is information. While we do not normally think of entrepreneurship in terms of information, that is a serious omission. The afternoon's first panel made clear the importance of information to entrepreneurial development as did Israel Kirzner in an indirect manner earlier in the day.

The issue of an information policy was raised by Shelp. For example, he noted the policy-related problems of the service and information industries, such as their lack of coverage in international trade agreements. These and a host of related matters are important issues, whether or not one agrees with Shelp's proposal for a national conference.

The more traditional view of information held by many, if not most, small business owners was expressed by Bob Tollison. Collection of information entails a cost, much of it focused on the respondent. Such respondent burden, known as the paper-work problem, has generally held negative connotations often because of imbalances between value of information provided and value of information used. Larry Moss focused on another aspect of information collection and dissemination, that is, the inadvertent disclosure of circumstantially-relevant information. This fundamental question involved trade-offs between public information and proprietary rights. Neither of these broad issue areas are new, nor are such questions as patent and copyrights. But as the entrepreneurial revolution has given information an increasing value, the policy issues related to it have take on added meaning.

I am surprised that no one mentioned the personal computer in this context, although I do believe I heard Steve Jobs's name mentioned.

Finally, there was the question of opportunity. Our speakers seemed to agree that there was considerable opportunity for entrepreneurial endeavor in the United States. Beyond that point of consensus, however, the question quickly became "how do we as a society expand our opportunity?"

Two strains of thought emerged. One was typified by Kirzner and by Dick McKenzie. While they approached their presentations much differently, each suggested that entrepreneurial development is restrained by governmental intervention. For example, Kirzner argued that searching for opportunities and knowing others are also doing so was the heart of entrepreneurship. Establishing boundaries limits the search. Congressman Tom Delay provided a personal perspective of a businessman turned legislator who saw his own industry attempt to limit entry through public intervention. In contrast, Carol Steinbach—and particularly Bob Friedman suggested that not only can governmental intervention play an important role in stimulating entrepreneurial development, but that specific targets should be identified and means developed to assist their entry into entrepreneurial activity. Both expressed keen interest in the possibility of entrepreneurship as a *direct* vehicle to combat poverty.

Illustrating these divergent paths, Steinbach provided a description of many European initiatives to promote entrepreneurial development. Most of these initiatives, largely alien to the American experience, involved specific governmental activities that focused on specific population targets, notably the unemployed. In sharp contrast, Katsuro Sakoh emphasized that the economic resurgence of Japan following the devastation of World War II was the direct result of a disequilibrium created by the War. The War broke traditional commercial barriers, some legal, some social. The result was creation of an environment permitting current Japanese successes.

From an historian's perspective, Albro Martin believes there is as much opportunity available today as there has been at any time in American history. He does not accept the idea that the age of opportunity has long since vanished. This raises a series of very interesting questions which were not addressed: Why the outburst of entrepreneurial activity in the 1970s? What stimulated this outburst? Was there a particular catalyst? Tom Gray argued that the great economic value of small business and entrepreneurs is their ability to adjust rapidly. Was the revolution, therefore, caused by the inability of large firms to operate in a particularly turbulent environment?

Gray made turbulence, uncertainly, and disequilibrium a central part of his presentation, but Birch and Shelp also mentioned it in the context of employment policy. McKenzie used the idea of change as a central argument to his thesis that government cannot plan and directly aid development of entrepreneurs.

It has been a good day. But perhaps the major disappointment in a one day conference is the number of questions raised and for reasons of time left unaddressed. Hopefully, those questions will be addressed at a later point.

Dr. Stuart Butler: My perspective is slightly different from that of Mr. Dennis. He stressed many of the themes that he saw running through the discussions today. I will try to suggest some of the specific policy implications of the day's proceedings. Congressman DeLay showed us his busy schedule. That should bring to our attention the fact that most people in the Congress and the Administration are always faced with the situation of being unable personally to evaluate data that may be critically relevant to their decisions. Organizations like The Heritage Foundation and the National Federation of Independent Business must therefore distill the facts and point to their implications so that political decisions are made with the best information.

With this in mind, two or three points gave me some food for thought, and they will affect our work in the future. I would preface those by noting that, among the decisions made in Congress these days, a very high proportion deals with economic growth and job creation. So it is a great concern to all of us involved in public policy just how little Congress and the typical voter understand about what makes entrepreneurs tick, and hence, where jobs come from.

This lead me to my first policy conclusion, namely, that it is very important to give as wide publicity as possible to the findings of people like David Birch—people who have studied intensively where jobs are coming from. The results of this work are vital to the policy process. And this should give us some concern about how policy will be developed, since if, as Birch says, small business entrepreneurs tend to be averse to dealing with bureaucracies and filling in forms, then it becomes very difficult for government to help them. Ideas like national industrial policy require people in government to deal in a frank and easy manner with the people creating jobs. So that type of policy is not likely to be very effective in stimulating entrepreneurship.

If jobs do come principally from the small business sector, there is another piece of bad news. And that is that it is big that counts most in Washington. It is generally the lar_ sectors in the society--including those within the business community that have the biggest clout when it comes to policy decisions in Washington. NFIB has been a partial antidote, but it is still an uphill struggle for the small businessman to be heard in the corridors of power. Thus we should have a somewhat pessimistic view of our ability ever to be able to get a set of policies that actually fit the reality of where jobs and enterprise come from.

Bob Friedman mentioned a very important aspect of the whole issue when he emphasiz hat you find entrepreneurship in the most unusual places. Entreprenet ip involves a lot more than middle class and rich people. That is also a source of some problems, since it is very difficult to get decisionmakers in Washington to recognize the potential of entrepreneurship in low-income neighborhoods. They tend to be skeptical of proposals that rest on that assumption. So it is important that policy makers hear the clear message from this conference that the stereotype of entrepreneurs be changed and that Congress recognize that entrepreneurship does in fact spread much wider than is commonly thought.

Another point relevant to public policy concerns the whole issue that Israel Kirzner developed the critical importance of competition as a method of making people open their eyes and look over their shoulders. Competition is a vital stimulus encouraging entrepreneurship. But one look at the nature of policy making, particularly on Capitol Hill, makes it clear that incumbency tends to win out That is true in political elections, and it is also true in decisions about entering markets. There is always a tendency for incumbents to be successful in using the law to shut out competition. There is basic tension in the public policy area between the competition and the pressure exerted by incumbency.

A final issue has percolated throughout this conference. What do you do to help entrepreneurs? There was much less consensus about how to help it than there was about the nature of entrepreneurship itself. Taxation? David Birch was skeptical about the importance of subtle tax changes in encouraging entrepreneurship decisions, particularly the basic decision of whether to go into business or not. The relationship between taxation and entrepreneurship is by no means crystal clear.

A related issue is capital. Again there is deep division about not only the need for capital but also about how to provide capital in a way that does not distort or destroy the entire entrepreneurial process. Government at many levels is attempting to channel money to entrepreneurs. But somehow the entrepreneurs often seem to get lost in the process, and the result is often rather different from that desired. The whole issue of training is also controversial—to what extent entrepreneurs can be trained. In particular, can somebody from a bureaucracy, or from a larger corporation for that matter, train people to behave in a way that in a real sense, is quite alien to the "educator's" own attitudes?

So what can we do to encourage entrepreneurs? Maybe I am showing my conservative prejudices, but I think that, if there is a single message, it is that perhaps we should not do anything—or at least we should put more of our efforts into removing barriers that frustrate entrepreneurship. Once we start to help, we begin to run into trouble.

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