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A Critique of Kirzner's Finders-Keepers Defense of Profit

THEODORE BURCZAK* burczak@denison.edu
Economics Department, Denison University, Granville, OH 43023, USA

Abstract. This paper criticizes Kirzner's use of the finders-keepers ethic to justify entrepreneurial profit. It does so by pursuing two lines of argumentation. First, Kirzner's defense of the justice of entrepreneurial profit is based upon treating the wage-for-labor-time exchange as legitimate. There are good reasons for doubting the justice of the wage-labor exchange. The paper argues that the profits earned by a capitalist firm employing wage-labor can not be considered to be just if we accept the juridical principle of imputation. The juridical principle of imputation asserts that people should be held legally responsible for the actions and results of the actions for which they are factually responsible. If we consider hired human beings always to be responsible agents, as is true in David Ellerman's (1992) rendition of the labor theory of property, Kirzner's defense of entrepreneurial profit generated in a capitalist enterprise is weakened. Second, the paper criticizes Kirzner's thesis that in a market economy everyone has, in principle, an equal opportunity to be an entrepreneur directing a productive enterprise or to be an entrepreneur engaging in speculation. Kirzner reaches this conclusion because he believes that credit markets in a free economy do not systematically discriminate amongst types of borrowers. This conclusion has been called into question by credit rationing models demonstrating that asset-poor individuals can be systematically denied access to loans. The credit rationing literature erodes the underpinnings of Kirzner's application of the finders-keepers ethic to the evaluation of entrepreneurial profit earned through speculation or productive creativity because it implies that all individuals do not in principle have an equal opportunity to be an entrepreneur.

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Israel Kirzner has for many years developed and championed a theory of the market as a discovery process. He argues that an understanding of the market process derived from the work of Hayek and Mises offers a more realistic and descriptive portrayal of a capitalist market economy than does the theory dominating mainstream economics depicting the market economy as a perfectly competitive, general equilibrium system. Kirzner also insists that if the Austrian theory were more widely accepted, the popular idea that it is possible and desirable to challenge the justice of the outcomes of a market process guided by the rule of law would be discredited. As he puts it, understanding the market as a discovery process makes end-state notions of distributive justice "highly problematic" (Kirzner 1995:46). In a similar vein, Hayek (1976) maintains that in a market economy, conceptions of social justice are a "mirage." For Kirzner, a proper conception of the functioning of the market process, combined with the widely held acceptance of a finders-keepers ethic, should also produce an acceptance of the justice of free market outcomes, especially entrepreneurial profit.

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While Kirzner's theory of the market as a discovery process has considerable descriptive merit, it has some shortcomings, and this paper exploits these deficiencies to challenge his normative conclusions. After presenting Kirzner's theory of the market discovery process and his belief that supplementing this theory with a finders-keepers ethic undermines notions of distributive justice, this paper criticizes two claims supporting his normative defense of market outcomes.

First, Kirzner's defense of the justice of entrepreneurial profit is based upon treating the wage-for-labor-time exchange as legitimate. Yet there are good reasons—some of which we will see are consistent with Kirzner's own defense of entrepreneurial profit—for doubting the justice of the wage-for-labor-time exchange and hence the justice of the profits generated in capitalist firms created by such exchanges. The paper argues that the profits earned by a capitalist firm employing wage-labor can only be considered as just if we deny that human beings are responsible agents while employed by an entrepreneur. If, however, we consider hired human beings always to be responsible agents, as is true in David Ellerman's (1992) rendition of the labor theory of property, Kirzner's defense of entrepreneurial profit generated in a capitalist enterprise is weakened.

Second, the paper criticizes Kirzner's thesis that in a market economy everyone has, in principle, an equal opportunity to be an entrepreneur directing a productive enterprise or to be an entrepreneur engaging in speculation. According to Kirzner, in a market economy that places no statutory limits on the economic activities in which an individual may participate as long as those activities do not infringe upon the property rights of others, every person in principle has the same opportunity of acting upon an entrepreneurial insight as any other. Specifically, ownership of wealth provides no entrepreneurial advantage: a poor person who notices an opportunity for entrepreneurial gain is in principle no less able to seize this opportunity than is a wealthy person. Kirzner reaches this conclusion because he believes that credit markets in a free economy do not systematically discriminate amongst types of borrowers. Thus, a poor entrepreneur who notices a speculative or productive opportunity has the same access to credit, after transactions costs are taken into consideration, as a wealthy entrepreneur. This conclusion has been called into question by credit rationing models demonstrating that asset-poor individuals who are not able to provide collateral to lenders will be unable to obtain credit, *no matter the interest rate they are willing to pay*. The credit rationing literature erodes the underpinnings of Kirzner's application of the finders-keepers ethic to the evaluation of entrepreneurial profit because it implies that all individuals do not in principle have an equal opportunity to be an entrepreneur. To extend an old adage, "It takes money to make money entrepreneurially," and this possibility further challenges Kirzner's belief that a finders-keepers ethic can undergird the normative conclusion that entrepreneurs should necessarily be able to keep the profits that they find.

Given these two criticisms, this paper maintains that it is possible to accept Kirzner's *arbitrage* theory of profit and the finders-keepers ethic in situations where everyone in principle can be a finder, but still reject his defense of profits generated through productive creativity and speculation. To be clear, the paper does not challenge the justice of the finders-keepers ethic per se, but rather its use to evaluate the justice of profits received through speculation and by the entrepreneur organizing a capitalist firm. Thus, the

finders-keepers ethic has only limited applicability in a normative defense of incomes generated in an unregulated capitalist market economy.

1. The Arbitrage Theory of Profit and Finders-Keepers

The Austrian theory of the market process starts from a perspective about the nature of human knowledge that is compactly summarized as "subjectivism." According to the Austrians, knowledge of economic opportunity, technology, potential market demand, and resource availability is subjective in the sense that each individual has his own perception of cost conditions, market demand, and resource availability. These perceptions may be unique to each individual, and thus they may turn out to be wrong. One entrepreneur, for instance, may be out-competed by another, because his perception of feasible technology proves to be too costly. The main point here is that conventional economics generally treats all this knowledge as *given* to economic actors. Knowledge of profit opportunities, technology, and resource endowments is objective knowledge, and the economic problem is how to utilize this knowledge in a way to achieve the optimal level of economic output. In contrast, for the Austrians, economic knowledge is partial, dispersed, ever-shifting, and potentially wrong. The economic problem is then how to coordinate individual actions sparked by subjective perceptions and imaginings.

The central actor in the Austrian conception of the market process is the entrepreneur. Entrepreneurs are alert to the possibility of economic gains, or profits, that arise from disequilibrium price discrepancies. For instance, an entrepreneur may profit from arbitrage: buying a commodity from a low-priced producer and immediately reselling it at a higher price to a consumer who, the entrepreneur alertly notices, values the commodity more highly. Prior to the intervention of the entrepreneur, the producer and consumer are ignorant of each others' existence. The consumer was unaware that the producer offered the commodity for sale, and the producer did not notice the potential customer willing to pay more than he was asking. Entrepreneurship can also be speculative: the entrepreneur speculates that a commodity currently selling for a low price will sell for a higher price in the future, after taking into consideration the interest expense of carrying the commodity. Finally, entrepreneurship can take the form of what Kirzner calls "productive creativity": buying low priced inputs and combining them to produce a commodity with a higher price. For instance, an entrepreneur might buy oranges and rent capital and labor-time to manufacture orange juice that consumers value more highly then the inputs individually. The lure of profit is to find and act upon these price discrepancies in order to try to get something for nothing (Kirzner 1979a:11). In Kirzner's (1979a:150) words, "What the market process does is to systematically translate unnoticed opportunities for mutually profitable exchange among individuals into forms that tend to excite the interest and alertness of those most likely to notice what can be spontaneously learned."[1]

Central to the Austrian understanding of entrepreneurship is that it is an activity entailing no opportunity cost. To see this most clearly, we can contrast entrepreneurship with deliberate search behavior. Searching involves looking for opportunities that are known to exist, and it can be understood to involve the comparison of costs and benefits. For instance, when we search for a library book, we have good reason to believe it exists, and it is sensible to ask

whether the benefit we expect to receive upon locating the volume is worth the additional time we expect that it will take to find it. Entrepreneurial behavior is different than search. We act entrepreneurially when we notice a potentially valuable resource that, prior to its discovery, we had no idea existed. For instance, if when searching for a library book, we happen to perceive a different—previously unknown to us—book that stimulates a startling insight, this alert noticing is entrepreneurial in nature. The flash of inspiration that caused us to perceive this book did not involve the deliberate forfeit of any other opportunity. We did not weigh the expected additional costs with the expected additional benefits.

Given that there are no opportunity costs associated with entrepreneurship, Kirzner also advances the potentially questionable claim that entrepreneurial activity does not require the prior ownership of any resources. Take the case of arbitrage in which we notice a resource that we can purchase, with a check drawn upon an account with a zero balance, and immediately resell at a higher price, enabling us to deposit the proceeds in our checking account before the initial check clears. In the case of speculation or productive creativity, we may have to borrow the funds to finance our purchase of the low-priced resources, since the higher-priced output will not be available for sale until the future. But again, as long as we are able to obtain the credit needed to initiate the speculative or productive endeavor, we do not need to possess any assets to be an entrepreneur.

From Kirzner's (1992a:224) subjectivist perspective, the profit that the entrepreneur earns by acting upon perceived price discrepancies is a discovered gain, a gain that did not exist for human purposes until its discovery. Thus, he believes that "it is plausible to treat the discovery of a hitherto unperceived opportunity as its *creator*, its originator. That which is grasped by the discoverer did not, in a relevant sense, exist at all prior to its discovery" (Kirzner 1992a:221). Entrepreneurial discovery creates an opportunity whose existence others were previously ignorant. Understanding market exchange as motivated by the discovery of previously unnoticed and unthought of gain allows us, in Kirzner's view, to apply the widely held ethical belief in finders-keepers to evaluate the justice of entrepreneurial profit. Kirzner observes that many of us accept the rule of finders-keepers, or first come-first served, when we need to decide how to reward property rights to a scarce resource with no previously existing property title that is, in principle, available to any particular person to appropriate. If this observation is correct, and if we understand profit to be the reward for alertly grasping previously unnoticed economic gain, then we should, from Kirzner's perspective, accept the justice of entrepreneurial profit. This is the essence of what Kirzner characterizes as an arbitrage theory of profit and his use of it to advocate a finders-keepers ethic to evaluate the justice of market incomes.

This analysis allows Kirzner to draw broader conclusions about the justice of wage and property incomes earned in a market economy. He argues that all exchanges exhibit an element of entrepreneurship. Sellers of factor services must always decide whether a particular offer should be accepted or whether they should hold out for a higher price. In an economy out of equilibrium that is permeated by true ignorance of possible opportunities, every decision to sell or to buy is contingent upon an entrepreneurial judgment. As such, Kirzner believes that all incomes contain an element of entrepreneurial profit, and the legitimacy of these incomes can therefore also be evaluated with a finders-keepers ethic. In effect, he asserts that finders-keepers supports the justice of all income receipts resulting

from uncoerced exchanges in a market economy. Thus, it is unnecessary (and perhaps even inappropriate) to apply other criteria to evaluate the justice of the market determination of income.

Insofar as entrepreneurship takes the form of pure arbitrage this paper has no qualms with an application of the finders-keepers ethic to justify profit incomes. Arbitrage does not involve renting laborers. Nor does it require prior asset ownership. However, unless it is undertaken by an independent contractor, productive creativity calls for the employment of wage-labor. There is reason to doubt whether finders-keepers is sufficient to justify entrepreneurial profit in this context. In addition, this paper will argue that in contrast to Kirzner's belief, both productive creativity and speculation do require the possession of resources, so that the receipt of entrepreneurial profit in these cases is not in principle available to everyone, as the finders-keepers ethic requires.

2. Profit, Productive Creativity, and the Labor Theory of Property[2]

Unless the entrepreneur is an independent contractor, productive creativity involves buying or renting inputs, including labor time, at a low price and selling the output produced by these combined inputs at a higher price. A critical question in determining the justice of entrepreneurial profit earned through this method is to examine the justice of the wage-for-labor-time exchange. To accomplish this task, we will begin by evaluating Kirzner's essay, "Producer, Entrepreneur, and the Right to Property" (1979b), in the light of David Ellerman's (1992) version of the labor theory of property. This comparison raises the issue whether it is legitimate to treat labor as an input, or in other words, for workers to assume the legal status of things.

Kirzner begins his attempt to justify entrepreneurial profit received through establishing a firm by seeking to pinpoint who bears responsibility for production. He argues that we should consider an individual who makes the entrepreneurial decision to initiate a joint production process to be the responsible agent of production. After all, if the entrepreneur did not hire the factors of production that constitute the firm, there is no guarantee that anyone else would have assumed this role. Thus, if the entrepreneur had not taken the initiative, the product of the firm may have never appeared. As the responsible agent, entrepreneurs should appropriate the product and receive the profits (and losses) from the enterprise.

Kirzner draws this conclusion by first differentiating between the concepts of productivity and responsibility. For Kirzner, responsibility refers to the necessarily human and willful initiative to undertake production. To be productive, on the other hand, does not require the exercise of human will. A resource can be productive simply if its presence contributes to the realization of an entrepreneur's decision to produce a commodity.

To clarify this conceptual distinction we might consider the contribution of a gun in an armed robbery. The gun helps to realize the robber's vision of a successful burglary, and as such is productive. But since it is an inanimate object without a will, the gun can not share responsibility for the crime with the robber. Given this distinction between productivity and responsibility, Kirzner (1979b:189) maintains that it is pure entrepreneurship that is "is responsible—in the sense relevant to the ethical connotation of 'what a man has produced'

—to the *entire* product." "[T]he necessarily indivisible entrepreneur is responsible for the entire product. The contributions of the factor inputs, being without an entrepreneurial component, are irrelevant for the ethical position being taken" (1979b:195). He quotes Frank Knight to reinforce this view:

> 'Under the enterprise system, a special social class, the businessman, direct economic activity: *they are in the strict sense the producers, while the great mass of the population merely furnishes them with productive services, placing their persons and their property at the disposal of this class*' (quoted in Kirzner 1979b:189).

We can accept the separate links that Kirzner establishes between entrepreneurship and responsibility and between responsibility and the creation of the entire product. The controversial issue to notice at this juncture is the rather curious position rented workers assume in this analysis. It would seem that in order for the entrepreneur to be the regarded as the solely responsible agent of a joint productive venture, workers must play a similar role in the firm as do guns in a robbery: they are the instruments of the entrepreneur's will.

Ellerman's version of the labor theory of property challenges Kirzner's conclusion that the entrepreneur should be the sole appropriator and receiver of profit in the capitalist firm by pursuing a line of argument that is similar to Kirzner's. For Ellerman, like Kirzner, the relevant question is to determine who is responsible for production in the capitalist firm. Once the responsible agent of production is identified, Ellerman proposes that we can call upon the "juridical principle of imputation" in order to establish the just appropriator of the entire product. This widely-accepted principle maintains that people should be held legally accountable, or responsible, for the consequences of the actions for which they are factually responsible. Kirzner also appeals to the juridical principle of imputation in his defense of entrepreneurial profit.[3] Despite this similar appeal, the two differ in their judgments of who bears the factual responsibility for production in a capitalist firm. In Ellerman's view, the agent responsible for production is not Kirzner's indivisible entrepreneur alone, but all the workers—mental, manual, and entrepreneurial—who labor in the firm together.

Understanding Ellerman's definition of the concept "appropriation" is crucial to grasp the meaning of his labor theory of property. There are two dimensions to his notion of appropriation. First, appropriation refers to being the first owner of a newly created asset. For instance, a car that emerges at the end of an assembly line is not yet owned by anyone. It is not born with a property right automatically already attached to it. Someone must become the first claimant, creating a property right to the vehicle. Second, Ellerman uses the term appropriation to mean being the last owner of a productive input. For instance, in the same automobile factory, some agency must be the last title holder to the inputs, e.g., the electricity and labor time, extinguished or used up in the process of production. He thus speaks of the appropriation of the entire product, by which he means being the first owner of produced output as well as being the last owner of the used up productive inputs. As we will see, Ellerman views legal responsibility for the results of economic activity to entail appropriation of the entire product.

While Ellerman's theory begins from the Lockean position that people have a natural right to the product of their labor, he understands the nature of this right differently than

Locke. Ellerman defends the position that the right to the entire product of one's labor is an inalienable right that should not be transferred, even with consent. The typical employment contract in a capitalist enterprise is consequently illegitimate. This contrasts with Locke who believes that it is just for a person to sell his labor time to, say, an entrepreneur, giving the entrepreneur the legal right to appropriate the entire product resulting from the laborer's efforts. Ellerman points out that when worker B sells his labor time to entrepreneur A thereby granting A control rights over B's labor time and allowing A to appropriate the entire product of B's labor, the worker is no longer legally responsible for the results of his productive activities. The entrepreneur becomes the last owner, and hence appropriator, of his employee's labor time. As such, the worker assumes the legal status of an inanimate object while employed by the entrepreneur.

It is worth quoting Ellerman at length to see how he conceives the legal "thingification" human beings undergo when they become rented laborers in a conventional firm.

> A person has the legal role of a thing from the viewpoint of decision-making if the person is not a legal party to the decisions about the services performed in that role. The owner of an entity rented out is . . . not a legal party to the decisions about the entity's use. Therefore when the entity hired out is a person, the person has the legal role of a thing. The person in the role of the owner of the entity hired out, that is, in the labor-seller's role, is not a legal party to the decisions made within the scope of the employment contract. Decision making power is not delegated from the employees to the employer; the employer decides in his own name. The legal decisionmaking authority is alienated and transferred to the employer (Ellerman 1988:1118).

Since they do not participate in the appropriation of the entire product of the firm, hired laborers are not legally responsible for all of their actions while on the job. Nevertheless, they remain factually responsible for the results of their intentional actions. Central to Ellerman's theory of property is that it is impossible to alienate factual responsibility. Current law only pretends that it can be alienated when it fails to apply the juridical principle of imputation to the capitalist firm.

One purpose of law courts is to determine factual responsibility for criminal behavior in order to assign legal responsibility. When jurists do this, they are applying the juridical principle of imputation. When legal responsibility does not line up with factual responsibility, most people believe that an injustice exists that needs to be rectified. In the realm of production and resource allocation, Ellerman considers one of the roles of economists to be the identification of the factually responsible agents of production, in order to determine how the juridical principle of imputation should be instituted in an economic context. It is impossible to alienate responsibility for one's actions, whether one is a bank robber or an employee, and if the juridical principle of imputation is to apply in production, all workers should participate in the appropriation of the entire product of the firm. In particular, workers should be the last owner of their labor time. Ellerman concludes that because it is factually impossible to alienate responsibility for one's actions, it is unjust for a worker to be transformed by a legally recognized labor rental contract into the means (a thing without legal responsibility) to an entrepreneur's ends.

The comparison between a bank robber and an employee may illustrate why Ellerman believes that workers' consent to give up legal responsibility for the entire product of their labor efforts in exchange for a wage is unjust. If a rich murderer uses a considerable cash payment to entice a willing poor person to bear the legal responsibility for the murder, a court would not recognize this contract by jailing the pauper for the crime, even if he agreed to the exchange. Such a contract violates the juridical principle of imputation. Likewise, an entrepreneur's appropriation of the entire product and his receipt of profit from a productive firm employing wage-labor are based on what Ellerman regards as a fraudulent wage-for-labor-time exchange. For an economist who accepts all the implications of the juridical principle of imputation, the only way in which joint production can be justly organized is if it occurs in a labor-owned, self-managed firm in which all manual, mental, and entrepreneurial workers participate jointly in the appropriation of the entire product.[4]

In his attempt to identify the entrepreneur as the just appropriator of the entire product, we have seen that Kirzner also makes an implicit appeal to the juridical principle of imputation. This principle animates his linkage between the entrepreneur's responsibility for creating (finding) the firm's output and the entrepreneur's just receipt (keeping) of pure profit. But if we investigate Kirzner's reasoning more carefully, it is apparent that his finders-keepers theory of entrepreneurial profit harbors a potential contradiction and that he errs in his specification of the agent(s) factually responsible for production. Kirzner insists that there is "an entrepreneurial element in *every* human action and decision," (1979b:197), including the choice to supply labor services at every moment of production (1979b:198). He notes that picturing a capitalist enterprise to be the result of an entrepreneur's decision to combine non-entrepreneurial, purely productive inputs is merely an analytical convenience in order to highlight the entrepreneurial role in facilitating the market process. In a real world clouded with uncertainty, workers also act entrepreneurially when they decide to accept a particular job rather than another, conceivably more rewarding one (Kirzner 1992b:94–100). It is thus apparent that from Kirzner's perspective it is impossible to sustain Knight's description of real-world, flesh and blood workers as passive, nonresponsible beings that are no different than inanimate capital goods subject only to the directing entrepreneur's will. Yet the crucial question remains: if workers are in possession of their decision making powers, or their entrepreneurial wills, at every minute of their services, how we can justify the legal treatment of workers in a capitalist enterprise as things that share no legal responsibility for production? How can we defend the singular entrepreneurial agent as the sole appropriator of the entire product of a joint productive enterprise, as Kirzner does?

One possibility is to think of employees as independent contractors, so that we interpret what workers sell to the entrepreneur to be the *product* of their efforts, and not control over their labor activities. To take this approach would mean that what Kirzner calls "productive creativity" collapses into arbitrage. This is the gambit that Prychitko (1998) attempts in his defense of Kirzner's application of the finders-keepers ethic to the positive ethical appraisal of the entrepreneur's appropriation of the entire product. Prychitko argues that we could conceive of individual workers as self-managed firms of one, who sell the products that their labor efforts are responsible for creating to the highest bidder that they can discover. Since Ellerman's labor theory of property requires that firms be self-managed if they are to adhere to the juridical principle of imputation, and since workers might be thought of

as self-managed firms of one, Prychitko (1998:84) reasons that there is no contradiction between the labor theory of property and a finders-keepers defense of profit.

While this interpretation may have analytical purchase for some readers, a typical employee in a capitalist enterprise working on, say, an assembly line would surely not be astonished if he were fired for stepping off the line to talk to his stock broker on a cell phone. He would not be surprised because he knows that he has not sold the product of his efforts to the directing entrepreneur. He has rented his time to that entrepreneur, who thus enjoys the right, within limits, to command the employee as she pleases during the contracted period. The actual servitude resulting from a labor-rental contract and the appropriation of an employee's labor time by the hiring entrepreneur do not disappear by analytically construing an employee to be a self-managed firm of one.[5] If one accepts the juridical principle of imputation, as Kirzner does, it appears that Ellerman's normative conclusions can not be so easily dodged.

3. Entrepreneurial Profit and Credit Rationing

In his book, *Discovery, Capitalism, and Distributive Justice* (1989), Kirzner fleshes out his portrayal of the actors on both sides of the labor market as entrepreneurial. He does this to reinforce the applicability of finders-keepers to an ethical evaluation of all income receipts in a capitalist economy, including wage incomes, and not just pure profits. Because real world labor markets are never in equilibrium, self-owners of labor time must act, in part, as entrepreneurs since wage incomes are never guaranteed prior to their receipt. Kirzner (1989:116) describes the entrepreneurial nature of the labor supply decision as follows:

> Inevitably the laborer must determine for himself—in an open-ended world fraught with inescapable uncertainty, pervaded by the sheerest of utter ignorance—which job to apply for, which job to accept, and what wages and working conditions to hold out for. This means that the more successfully "entrepreneurial" laborer will in fact enjoy a job offering wages, working conditions, prestige and prospects for advancement, which may substantially exceed those won by a fellow laborer with equal talents *qua* laborer, but with less potential as an entrepreneur.

The decision of a worker to sell his labor-time is entrepreneurial because the worker has to judge which producer, in what industry, offers the greatest chance for his labor to be most productive and hence to be rewarded with the highest possible wage.

Yet one wonders whether this kind of analysis undermines Kirzner's intentions. After all, if workers are entrepreneurs when they evaluate different employers in search of the most "profit" (or the highest wage), what prevents workers from using these same entrepreneurial insights to initiate their own productive enterprise? Is there, in his view, any difference between an entrepreneurial employee and an entrepreneurial employer?

Kirzner seems to suggest that workers who do not employ their entrepreneurial facilities to direct a productive enterprise prefer to take fewer risks than those who do. He asks us to imagine two men, Jones and Smith, who each own no resources but who both believe that cab driving is a rewarding economic activity. Kirzner contrasts the case of Jones, who borrows money to rent a taxicab and becomes an independent cab driver, with the case of

Smith, who rents his labor time to an owner of a fleet of taxicabs. Both the independent contractor Jones and the wage-laborer Smith act entrepreneurially when deciding to work in the taxi-driving industry. For Jones, there is no guarantee that the cab driving business will generate enough revenue to cover all of his opportunity costs. Smith, also, "never was *assured* of anything at all . . . . In selling his driving services to Brown, the fleet owner, Smith is not simply transforming these services into their fully known cash value, he is taking a step into the dark, uncertain entrepreneurial future, guided by his entrepreneurial hunches" (Kirzner 1989:118). The only difference between Jones and Smith appears to be that Jones is willing to take the risk of running his own firm to exploit the perceived opportunity in the taxi business, while Jones is not willing to incur this risk.

There are two problems with Kirzner's analysis and conclusion. First, in this example, the amount of risk incurred by Smith and Jones is not very different, contrary to Kirzner's claim. Since Jones borrowed the money to finance his the purchase of his cab, if the cab business is not profitable, all he runs the risk of losing is the labor time he devoted to the enterprise. The lending bank or capitalist bears all the risk if Jones does not generate enough revenue to pay back his loan. But this is the same exact loss to which Smith is exposed. If the fleet owner Brown goes out of business and is unable to pay Smith his wage, Smith will have lost perhaps the same amount of labor time as Jones. On the other hand, if the cab business proves to be extremely successful, Jones will gain entrepreneurial profit, while Smith will receive no more than his contracted wage. What then prohibits Smith from starting his own cab driving business? For that matter, if Kirzner is right that factor owners are all making the same kinds of entrepreneurial judgments, why would anyone ever choose to work for someone else if credit were easily accessible to all?

Kirzner's discussion of the cab drivers Smith and Jones reveals that he sees the entrepreneurial profit that accrues to the independent contractor Jones as readily available to Smith. Nothing stands in Smith's way of himself receiving this profit except either (i) his choice not to pursue it, or (ii) his inability to notice that being an independent contractor has more potential rewards, without incurring any more risk, than does being an employee in a firm offering taxi services. It is apparent that Kirzner thinks that perceptible opportunities for gain are "*in principle* available to others," not just to the entrepreneurs who happen to notice and grasp them (1995:40, emphasis added). For Kirzner, lack of fungible assets poses no barrier to acting upon entrepreneurial insights. Thus, he can write: "Entrepreneurial profits . . . are not captured by owners, in their capacity as owners, at all. They are captured, instead, by men who exercise pure entrepreneurship, for which ownership is *never* a condition" (1979a:94). He draws this conclusion because he believes the asset-poor can not be systematically denied credit in an unregulated market economy.

If Kirzner is right that anyone can borrow to finance a speculative or productive investment project, whether or not they can demonstrate any collateral, then he is correct that any perceptible opportunity for gain is in principle available to others. However, contemporary theories of credit rationing suggest that Kirzner's presumption that credit is available to anyone willing to pay market rates of interest is not an accurate description of reality.[6] If everyone does not, in principle, have equal access to credit, then in the context of both production in a capitalist firm and speculation, everyone does not, in principle, have the opportunity to be an entrepreneur.

Bowles and Gintis (1986:68–71) call Kirzner's belief that the possession and distribution of wealth do not affect the outcomes of economic processes the "asset neutrality proposition." They contend that the widespread acceptance of this proposition is due to the fact that the economics discipline is preoccupied with general equilibrium, perfect competition models, which practitioners use to show that the distribution of income would be the same irrespective of whether capital hired labor or labor hired capital (Samuelson 1957). The asset neutrality proposition supports the classical liberal belief that wealth holders have the same power in the determination of economic outcomes as do households with few assets. Although the perfect competition, equilibrium foundations for this conclusion are not compatible with Kirzner's own thinking, the conclusion of the asset neutrality proposition parallels his contention that the possession of wealth does not determine whether or not an entrepreneurial opportunity will be realized. Bowles and Gintis, however, maintain that the asset neutrality proposition is false because credit markets are inherently plagued by imperfections that may prevent the asset poor from obtaining any credit no matter how high an interest rate they are willing to pay, while those possessing assets suitable as collateral to lending capitalists will be able to obtain loans at market rates of interest.

Bowles and Gintis follow the model of Stiglitz and Weiss (1981) to make their case. Stiglitz and Weiss's work shows that asymmetric information may prevent the interest rate from being an equilibrating variable in the loan market. While demanders of credit may react in traditional fashion to interest rate movements, credit suppliers, like banks, are not necessarily eager to increase their lending when the demand price of loans rises. Banks care about the expected returns on loans, not simply the interest borrowers are willing to pay. The two classic problems of markets with asymmetric information—moral hazard and adverse selection—prevent there from being an isomorphic relationship between interest rates and expected returns. Since the willingness to lend is determined by the expected return on loans, the interest rate consistent with the optimal expected return for lenders may not be the interest rate that demanders are willing to pay.

The problem here is that lenders can surmise the types of risk borrowers might take, but they cannot know the decisions that borrowers will actually make after the loan contract is signed. Because lenders can not know the risks borrowers will incur once a loan has been initiated, they attempt to infer this information from the interest rate borrowers are willing to pay when calculating their expected returns. In particular, lenders understand that as interest rates rise, borrowers have greater incentive to increase the risks they take and are thus more likely to default. The increased likelihood of moral hazard at higher interest rates means that high interest rates may not be correlated with increased returns for the lender. In addition, banks know that as interest rates rise, the pool of willing borrowers is more likely to include risk-loving borrowers who will take actions incompatible with the interests of the bank. Since banks have difficulty identifying these borrowers, if they do not attempt to infer who are risk-loving individuals from the interest rates potential borrowers are willing to pay, the probability of bad lending decisions increases with a rising interest rate, thereby lowering bankers' returns. In sum, the problem of adverse selection and the possibility of moral hazard mean that raising the interest rate in response to an excess demand for credit may influence the pool and behavior of borrowers in such a way that the expected returns of lenders declines. Because "the interest rate directly affects the quality of the loan in a

manner which matters to the bank," credit markets may consequently experience *persistent* excess demand (Stiglitz and Weiss 1981:409).[7]

Although Stiglitz and Weiss do not draw any critical conclusions from the possible existence of credit rationing in an unregulated banking industry, Bowles and Gintis insist that credit rationing vitiates the asset neutrality proposition. One strategy banks employ in response to ignorance of the risks borrowers will take is to demand that loans be partly collateralized. As a result, the potential borrowers who are ultimately approved for loans are more likely to be those who possess assets that can be easily liquidated.[8] This means that wealth-holders possess a decided advantage when they seek loans to finance entrepreneurial endeavors, and it helps to explain the correspondence Kirzner (1979a:97) notices, and dismisses as insignificant for his theory, between individuals who undertake entrepreneurial activity and individuals who fill the capitalist role. That is, contrary to Kirzner's belief, entrepreneurs usually are capitalists because the asset poor are unable to obtain credit, no matter the interest rate they are willing to pay, while owners of significant assets face no such restriction.

Kirzner recognizes that arguments for the existence of credit market imperfections damage his position that entrepreneurial opportunities are in principle available to everyone. He maintains, however, that most theories of financial market imperfection ignore the existence of transactions costs. He argues that if a potential entrepreneur is willing to pay the market rate of interest but is unable to obtain financing, this is not an indication that credit is being rationed but a sign that there are transactions costs requiring the entrepreneur to offer higher interest rates to make the loan worthwhile to the bank. For instance, Kirzner remarks that the reputation of a potential entrepreneur may be unknown to a bank, and thus he will be asked to pay above market interest rates. Although such a requirement could render the entrepreneurial endeavor unprofitable, we must face the fact that there are social costs of "securing recognition of one's competence and trustworthiness" that may result in some entrepreneurs facing higher borrowing costs than others (Kirzner 1979a:101). Kirzner thus echoes George Stigler's (1961) conclusion that it is inappropriate to label credit markets as imperfect simply because different would-be entrepreneurs with varying and unknown reputations are asked to pay higher rates than "the" market interest rate.[9]

While we can accept Stigler's (1961:289) dismissal of the existence of credit market imperfection when this charge "rests ultimately upon the inability of borrowers to get cheap funds," the charge of credit market imperfection levied by Stiglitz and Weiss and by Bowles and Gintis is linked to the apparent *inability* of some borrowers, particularly asset-poor individuals, to obtain funds at *any* price. "[I]t is a mistake," Bowles and Gintis (1990b:306) assert, "to treat the [the existence of credit rationing] simply as a reflection of the existence of *frictions* in exchange relations. . . . Friction will produce out of equilibrium alternations between excess demand and excess supply but not consistent . . . quantity constraints" that prevent access to credit to some potential entrepreneurs. A critical interpretation of the credit rationing literature calls into question Kirzner's employment of the Chicago-school notion of transactions costs to buttress his claim that entrepreneurial opportunities are in principle available to all.

Kirzner also pursues another line of defense against the claim that credit markets are imperfect. "If a new idea hold forth promise, even after all trading costs have been taken into account, of a yield to capitalists higher than they can obtain elsewhere," he (1979:102)

argues, "their failure to exploit it constitutes an entrepreneurial error on their part." Thus he might explain the purported existence of credit rationing as another example of the pervasiveness of entrepreneurial error in an economy out of equilibrium. One wonders, however, if the inability to obtain credit from a lending capitalist by an asset-poor, would-be entrepreneur constitutes an entrepreneurial error on the part of the capitalist, where exactly does this error lie? Is the capitalist making an entrepreneurial error when declining *to lend* to the asset-poor entrepreneur? Or is the capitalist making the entrepreneurial error by failing *to notice* the opportunity that the asset-poor and frustrated entrepreneur sees? If the theory of credit rationing is correct in its conclusion that it is sometimes impossible for lenders to acquire the necessary information about the credit risks a borrower will take, it is difficult to see how we might interpret that *impossibility* and the credit rationing to which it leads as an entrepreneurial *error*, an error that a competitive market could potentially correct. If the second reading captures Kirzner's meaning (that the lending capitalist himself does not notice the actual opportunity seen by our frustrated entrepreneur), it would not challenge the conclusion that capitalists do have an advantage in acting upon entrepreneurial possibilities. Both interpretations of the existence of credit rationing as an instance of entrepreneurial error undermine Kirzner's belief that entrepreneurial opportunities in the cases of speculation and productive creativity are in principle available to everyone.[10]

Kirzner (1995:38–39) asserts that "[w]hat the entrepreneur sees is a prospective increment of value which others, although in no way handicapped as compared with our entrepreneur, have somehow failed to see." If the asset poor are systematically denied access to credit, we can be confident that all potential entrepreneurs face no handicap in seizing upon profit opportunities only in the case of pure arbitrage. The possibility of credit rationing means that when an opportunity involves production or speculation, an alert, asset-poor, would-be entrepreneur will face possibly insurmountable obstacles when attempting to grasp that profit when compared to a wealthy entrepreneur. Thus, what Kirzner calls entrepreneurial profit would seem to be partly enabled by the prior ownership of assets and thus not solely a reward for entrepreneurial alertness. If a "profit" opportunity requires the prior ownership of capital, perhaps it can and should be justified by what Kirzner calls "the fruit of the tree" ethic. That is, it is widely-believed, according to Kirzner, that an individual may legitimately appropriate output that emerges from a justly-held asset. In cases where we might use the fruit of the tree ethic to justify an income receipt, there would be no need to apply a finders-keepers ethic. This ethic would be applicable only in the evaluation of pure arbitrage opportunities.[11]

Denying the applicability of the finders-keepers ethic in cases involving production and speculation appears, however, to put Kirzner's positive theory of entrepreneurship in grave jeopardy. Real-world instances of a pure arbitrage that require no interest expense because they do not involve the passage of time are likely to be rare, if not existent. Most, if not all, profit opportunities have a speculative or productive element. In order to say that the fruit of the tree ethic alone justifies income receipts from speculative and productive activities, one would have to accept that all the relevant factors of production were paid according to the value of their marginal products. Yet this could be so only in a world where all gains from speculative trade and production were exhausted. In such a world, there would be little, if any, room for entrepreneurship. This line of reasoning undermines, in ways that this author

rejects, the insights of Austrian economics concerning time, ignorance, and knowledge (Burczak 1994).

As an alternative, we might argue that pure profit opportunities are abundant in productive and speculative ventures, but that they are not in principle available to everyone because of the existence of credit rationing. Insofar as the finders-keepers ethic requires that any person may be a potential finder, this ethic can not justify the receipt of pure profit. We might thus search for another ethic that is consistent with a world of ceaseless change and widespread ignorance and with a defense of free market outcomes. Our alternative interpretation indicates, however, that there are constraints on individual choice and impediments to entrepreneurial action. We might therefore legitimately conclude that these constraints and impediments call for a theory of *distributive* justice in order to understand the nature and possible ethical shortcomings of an unregulated capitalist market process. Perhaps the applicability of a finders-keepers ethic could be re-established in an institutional environment where the possession of wealth did not confer any entrepreneurial advantage.

4. Conclusion

There are two major problems with Kirzner's attempt to apply the rule of finders-keepers to a positive ethical evaluation of profit and capitalist income. First, we have seen that the profits an entrepreneur receives through the establishment of a capitalist enterprise employing wage labor may be unjust if we believe that individuals should always be legally responsible for their intentional actions and the results of their intentional actions. Ellerman's labor theory of property demonstrates that in a capitalist enterprise, employed workers assume the legal status of things. Considering that Kirzner employs liberal discourse that places the highest value on individual responsibility, Ellerman's demonstration should make uncomfortable those initially persuaded by Kirzner's defense of the justice of entrepreneurial profit. This is especially true since he attempts to ground the justice of profit in the responsibility of the entrepreneur for the entire product. Yet Ellerman's analysis raises the possibility that we consider workers as co-responsible with the directing entrepreneur for the entire product of the firm. If so, workers should share profits with the directing entrepreneur if we accept Kirzner's own arguments that the just receipt of income and responsibility for production are somehow linked.

Second, Kirzner's defense of the justice of profit relies upon the possibility that all individuals, in principle, have an equal opportunity to pursue entrepreneurial opportunities. The credit rationing literature calls into question this possibility. If asset-poor individuals are systematically denied access to credit, they will not be able to act upon disequilibrium price discrepancies that can not be instantaneously realized, and thus they may not be able to receive entrepreneurial profit. Kirzner notes that in a world out of equilibrium all income receipts are partly due to entrepreneurial alertness. Inasmuch as the possession of wealth gives some individuals an entrepreneurial advantage in many market transactions, there would seem to good reason to challenge the justice of many income receipts in an unregulated market economy. The market process may be biased, systematically working for the benefit of the wealthy in avenues not open to the asset-poor. Thus, contrary to Kirzner's arguments against the notion of distributive justice, a subjectivist might legitimately conclude that

government has an important role to play, in the name of justice, to redistribute wealth in order make entrepreneurial opportunities in principle available to all.

Notes

1. See Kirzner (1985:116) where he makes the distinction among arbitrage, speculation, and productive creativity.
2. This section borrows from and expands upon Burczak (1996/97:6–8). Some of the ideas expressed here are debated in an exchange published in *Rethinking Marxism*: Cullenberg (1998), Prychitko (1998), Boettke (1998), and Burczak (1998).
3. This paper simply attempts to draw out the implications of this widely-held principle for a theory of economic justice without investigating more deeply its philosophic foundations. Ellerman grounds the principle in inalienable natural rights. Hayek (1960:71–84) argues that we assign responsibility to individuals for their actions in order to promote good social consequences. Burczak (2001) connects the juridical principle of imputation to an Aristotelian concern to foster human flourishing.
4. To be absolutely clear, a labor-owned, self-managed firm need not hold title to any of the capital equipment used in production. In Ellerman's understanding, a labor owned firm is consistent with a workers' cooperative that rents all of the nonhuman means of production. A system of labor owned firms also does not require either state planning or state ownership of productive resources.

   Perhaps the widespread existence of what Cornuelle (1992) calls the "employee mentality" is due to the legal thingification workers experience in the capitalist enterprise. Ellerman's advocacy of labor-owned firms might be seen in light of Cornuelle's (1992:9) call for "ways to liberate people from their proletarian status."
5. In his famous article on "The Nature of the Firm," Coase (1988:54) quotes F.R. Batt to make a similar point about the nature of employment in a capitalist enterprise:

   "The master must have the right to control the servant's work, either personally or by another servant or agent. It is the right of control or interference, of being entitled to tell the servant when to work (within the hours of service) and when not to work, and what work to do and how to do it (within the terms of such service) which is the dominant characteristic in this relation and marks off the servant from an independent contractor, or from one employed merely to give to his employer the fruits or results of his labor."
6. While this paper does not explore the merits of this empirical proposition, see D. Evans and B. Jovanovic (1989) for some evidence supporting the hypothesis that lack of financial capital may lead to the inability to obtain credit.
7. The Austrian literature of which I am aware is generally critical of Stiglitz's work. See for instance Thomsen (1992:29–62). But Thomsen (1992:42–43) does observe that "individuals in a Hayekian world could attempt to infer information from prices if it were profitable for them to do so." This observation is one of the central building blocks of the credit rationing literature. Zappia's (1997) interesting paper develops the theme that the recent "Post-Walrasian" microtheory literature along the lines of Bowles and Gintis, and Stiglitz and Weiss is compatible with a Hayekian perspective.
8. Because voluntary self-enslavement is not permissible in Western society, individuals who lack financial assets but who possess considerable human capital are not able to use their human capital as collateral. As Bowles and Gintis remind us, not all forms of wealth may be pledged as collateral in financial transactions.
9. McCloskey (1990) puts forth the identical argument in a critique of Bowles and Gintis (1990a).
10. Ionnides (1993) develops a related perspective on Kirzner's theory of profit.
11. For ease of exposition, the following paragraph makes no distinction between the "reap where one sows" ethic, arguing that a person may legitimately appropriate the product created by the sweat of his brow, and the fruit of the tree ethic.

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