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Entrepreneurship: Productive, unproductive, and destructive—Relative to what?

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ABSTRACT

We identify an ambiguity surrounding institutions and entrepreneurship. While entrepreneurship creates social value at the economy level in the appropriate institutional environment, individual entrepreneurs may create or destroy value in *any* institutional environment. This raises the question: under what conditions does entrepreneurship create social value? Social value creation depends on the entrepreneur's next best alternative, and institutions are constraints on the relevant alternatives. Hence, society is better off when entrepreneurs navigate poor institutions relative to reduced entrepreneurial activity. Furthermore, entrepreneurs engaging in seemingly "productive" activity need not create social value. We illustrate the argument with two examples.

1. Introduction

Over twenty-five years after its original publication, Baumol's (1996) trichotomy of productive, unproductive, and destructive entrepreneurship is seminal to the entrepreneurship literature. Productive entrepreneurship is that which contributes to societal well-being, including the introduction of new products or new production processes. Unproductive entrepreneurship is aimed at obtaining transfers, typically via rent-seeking or violence. Entrepreneurship becomes destructive when resources are expended to capture rents or expropriate wealth.

Baumol suggests that the total quantity of entrepreneurial activity is relatively stable, but the allocation of entrepreneurial resources varies considerably across societies. The variation in entrepreneurial activity is determined by the "set of rules" governing social interaction—in other words, the institutional framework. He thus provides a meta-view of entrepreneurship. Where the rules of the game facilitate market-based innovation, entrepreneurs engage in productive activity; where the rules facilitate corruption or rent-seeking, entrepreneurs choose unproductive and destructive ends (Boettke and Coyne, 2003, 2009).

Empirical analysis broadly affirms Baumol's insights (Murphy et al., 1991; Sobel, 2008). Furthermore, a large body of literature documents that productive entrepreneurial activity has massive implications for economic development; indeed, productive entrepreneurship captures the very essence of economic growth (Holcombe, 1998). Meanwhile, barriers to wealth-creation (e.g., the regulation of entry) have deleterious consequences (Djankov et al., 2002).

Another foundational figure in modern entrepreneurship scholarship, Israel Kirzner, has written several essays on the relationship between entrepreneurship and public policy (Kirzner, 1979, 1982). Kirzner argues that an institutional environment of property rights, market prices, and the rule of law allows for the entrepreneurial discovery of opportunities that are both privately and socially value-creating. The opportunities to which entrepreneurs are alert are "profit" opportunities precisely because they improve social coordination, by directing prices toward market equilibrium; losses are downplayed this framework (Foss and Klein, 2010, p. 110). Meanwhile, socialism, cronyism, and interventionism all hamper this entrepreneurial discovery. Like Baumol, then, Kirzner suggests

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