

### 9. Entrepreneurial Profits and Losses in a Progressing Economy

In the imaginary construction of a stationary economy the total sum of all entrepreneurs' profits equals the total sum of all entrepreneurs' losses. What one entrepreneur profits is in the total economic system counterbalanced by another entrepreneur's loss. The surplus which all the consumers together expend for the acquisition of a certain commodity is counterbalanced by the reduction in their expenditure for the acquisition of other commodities.<sup>19</sup>

It is different in a progressing economy.

We call a progressing economy an economy in which the per capita quota of capital invested is increasing. In using this term we do not imply value judgments. We adopt neither the "materialistic" view that such a progression is good nor the "idealistic" view that it is bad or at least irrelevant from a "higher point of view." Of course, it is a well-known fact that the immense majority of people consider the consequences of progress in this sense as the most desirable state of affairs and yearn for conditions which can be realized only in a progressing economy.

In the stationary economy the entrepreneurs, in the pursuit of their specific functions, cannot achieve anything other than to withdraw factors of production, provided that they are still convertible,<sup>20</sup> from one line of business in order to employ them in another line, or to direct the restoration of the equivalent of capital goods used up in the course of production processes toward the expansion of certain branches of industry at the expense of other branches. In the progressing economy the range of entrepreneurial activities includes, moreover, the determination of the employment of the additional capital goods accumulated by new savings. The injection of these additional capital goods is bound to increase the total sum of the income produced, i.e., of that supply of consumers' goods which can be consumed without diminishing the capital equipment used in its production and thereby without impairing the output of future production. The increase of income is effected either by an expansion of production without altering the technological methods of production or by an improvement in technological methods which

19. If we were to apply the faulty concept of a "national income" as used in popular speech, we would have to say that no part of national income goes into profits.

20. The problem of the convertibility of capital goods is dealt with below, pp. 499-505.

would not have been feasible under the previous conditions of a less ample supply of capital goods.

It is out of this additional wealth that the surplus of the total sum of entrepreneurial profits over the total sum of entrepreneurial losses flows. But it can be easily demonstrated that this surplus can never exhaust the total increase in wealth brought about by economic progress. The laws of the market divide this additional wealth between the entrepreneurs and the suppliers of labor and those of certain material factors of production in such a way that the lion's share goes to the nonentrepreneurial groups.

First of all we must realize that entrepreneurial profits are not a lasting phenomenon but only temporary. There prevails an inherent tendency for profits and losses to disappear. The market is always moving toward the emergence of the final prices and the final state of rest. If new changes in the data were not to interrupt this movement and not to create the need for a new adjustment of production to the altered conditions, the prices of all complementary factors of production would—due allowance being made for time preference—finally equal the price of the product, and nothing would be left for profits or losses. In the long run every increase in productivity benefits exclusively the workers and some groups of the owners of land and of capital goods.

In the groups of the owners of capital goods there are benefited:

1. Those whose saving has increased the quantity of capital goods available. They own this additional wealth, the outcome of their restraint in consuming.

2. The owners of those capital goods already previously existing which, thanks to the improvement in technological methods of production, are now better utilized than before. Such gains are, of course, temporary only. They are bound to disappear as they cause a tendency toward an intensified production of the capital goods concerned.

On the other hand, the increase in the quantity of capital goods available lowers the marginal productivity of capital; it thus brings about a fall in the prices of the capital goods and thereby hurts the interests of all those capitalists who did not share at all or not sufficiently in the process of saving and the accumulation of the additional supply of capital goods.

In the group of the landowners all those are benefited for whom the new state of affairs results in a higher productivity of their farms, forests, fisheries, mines, and so on. On the other hand, all those are hurt whose property may become submarginal on account of the higher return yielded by the land owned by those benefited.

In the group of labor all derive a lasting gain from the increase in the marginal productivity of labor. But, on the other hand, in the short run some may suffer disadvantages. These are people who were specialized in the performance of work which becomes obsolete as a result of technological improvement and are fitted only for jobs in which—in spite of the general rise in wage rates—they earn less than before.

All these changes in the prices of the factors of production begin immediately with the initiation of the entrepreneurial actions designed to adjust the processes of production to the new state of affairs. In dealing with this problem as with the other problems of changes in the market data, we must guard ourselves against the popular fallacy of drawing a sharp line between short-run and long-run effects. What happens in the short run is precisely the first stages of the chain of successive transformations which tend to bring about the long-run effects. The long-run effect is in our case the disappearance of entrepreneurial profits and losses. The short-run effects are the preliminary stages of this process of elimination which finally, if not interrupted by a further change in the data, would result in the emergence of the evenly rotating economy.

It is necessary to comprehend that the very appearance of an excess in the total amount of entrepreneurial profits over the total amount of entrepreneurial losses depends upon the fact that this process of the elimination of entrepreneurial profit and loss begins at the same time as the entrepreneurs begin to adjust the complex of production activities to the changed data. There is never in the whole sequence of events an instant in which the advantages derived from the increase in the amount of capital available and from technical improvements benefit the entrepreneurs only. If the wealth and the income of the other strata were to remain unaffected, these people could buy the additional products only by restricting their purchases of other products accordingly. Then the profits of one group of entrepreneurs would exactly equal the losses incurred by other groups.

What happens is this: The entrepreneurs embarking upon the utilization of the newly accumulated capital goods and the improved technological methods of production are in need of complementary factors of production. Their demand for these factors is a new additional demand which must raise their prices. Only as far as this rise in prices and wage rates occurs, are the consumers in a position to buy the new products without curtailing the purchase of other goods.

Only so far can a surplus of the total sum of all entrepreneurial profits over all entrepreneurial losses come into existence.

The vehicle of economic progress is the accumulation of additional capital goods by means of saving and improvement in technological methods of production the execution of which is almost always conditioned by the availability of such new capital. The agents of progress are the promoting entrepreneurs intent upon profiting by means of adjusting the conduct of affairs to the best possible satisfaction of the consumers. In the performance of their projects for the realization of progress they are bound to share the benefits derived from progress with the workers and also with a part of the capitalists and landowners and to increase the portion allotted to these people step by step until their own share melts away entirely.

From this it becomes evident that it is absurd to speak of a "rate of profit" or a "normal rate of profit" or an "average rate of profit." Profit is not related to or dependent on the amount of capital employed by the entrepreneur. Capital does not "beget" profit. Profit and loss are entirely determined by the success or failure of the entrepreneur to adjust production to the demand of the consumers. There is nothing "normal" in profits and there can never be an "equilibrium" with regard to them. Profit and loss are, on the contrary, always a phenomenon of a deviation from "normalcy," of changes unforeseen by the majority, and of a "disequilibrium." They have no place in an imaginary world of normalcy and equilibrium. In a changing economy there prevails always an inherent tendency for profits and losses to disappear. It is only the emergence of new changes which revives them again. Under stationary conditions the "average rate" of profits and losses is zero. An excess of the total amount of profits over that of losses is a proof of the fact that there is economic progress and an improvement in the standard of living of all strata of the population. The greater this excess is, the greater is the increment in general prosperity.

Many people are utterly unfit to deal with the phenomenon of entrepreneurial profit without indulging in envious resentment. In their eyes the source of profit is exploitation of the wage earners and the consumers, i.e., an unfair reduction in wage rates and a no less unfair increase in the prices of the products. By rights there should not be any profits at all.

Economics is indifferent with regard to such arbitrary value judgments. It is not interested in the problem of whether profits are to be approved or condemned from the point of view of an alleged natural

law and of an alleged eternal and immutable code of morality about which personal intuition or divine revelation are supposed to convey precise information. Economics merely establishes the fact that entrepreneurial profits and losses are essential phenomena of the market economy. There cannot be a market economy without them. It is certainly possible for the police to confiscate all profits. But such a policy would by necessity convert the market economy into a senseless chaos. Man has, there is no doubt, the power to destroy many things, and he has made in the course of history ample use of this faculty. He could destroy the market economy too.

If those self-styled moralists were not blinded by their envy, they would not deal with profit without dealing simultaneously with its corollary, loss. They would not pass over in silence the fact that the preliminary conditions of economic improvement are an achievement of those whose saving accumulates the additional capital goods and of the inventors, and that the utilization of these conditions for the realization of economic improvement is effected by the entrepreneurs. The rest of the people do not contribute to progress, but they are benefited by the horn of plenty which other people's activities pour upon them.

What has been said about the progressing economy is *mutatis mutandis* to be applied to the conditions of a retrogressing economy, i.e., an economy in which the per capita quota of capital invested is decreasing. In such an economy there is an excess in the total sum of entrepreneurial losses over that of profits. People who cannot free themselves from the fallacy of thinking in concepts of collectives and whole groups might raise the question of how in such a retrogressing economy there could be any entrepreneurial activity at all. Why should anybody embark upon an enterprise if he knows in advance that mathematically his chance of earning profits are smaller than those of suffering losses? However, this mode of posing the problem is fallacious. Like other people, entrepreneurs do not act as members of a class, but as individuals. No entrepreneur bothers a whit about the fate of the totality of the entrepreneurs. It is irrelevant to the individual entrepreneur what happens to other people whom theories, according to a certain characteristic, assign to the same class they assign him. In the living, perpetually changing market society there are always profits to be earned by efficient entrepreneurs. The fact that in a retrogressing economy the total amount of losses exceeds the total amount of profits does not deter a man who has confidence in his own superior efficiency. A prospective entrepreneur does not consult the calculus of probability which is of no avail in the field of

understanding. He trusts his own ability to understand future market conditions better than his less gifted fellow men.

The entrepreneurial function, the striving of entrepreneurs after profits, is the driving power in the market economy. Profit and loss are the devices by means of which the consumers exercise their supremacy on the market. The behavior of the consumers makes profits and losses appear and thereby shifts ownership of the means of production from the hands of the less efficient into those of the more efficient. It makes a man the more influential in the direction of business activities the better he succeeds in serving the consumers. In the absence of profit and loss the entrepreneurs would not know what the most urgent needs of the consumers are. If some entrepreneurs were to guess it, they would lack the means to adjust production accordingly.

Profit-seeking business is subject to the sovereignty of the consumers, while nonprofit institutions are sovereign unto themselves and not responsible to the public. Production for profit is necessarily production for use, as profits can only be earned by providing the consumers with those things they most urgently want to use.

The moralists' and sermonizers' critique of profits misses the point. It is not the fault of the entrepreneurs that the consumers—the people, the common man—prefer liquor to Bibles and detective stories to serious books, and that governments prefer guns to butter. The entrepreneur does not make greater profits in selling “bad” things than in selling “good” things. His profits are the greater the better he succeeds in providing the consumers with those things they ask for most intensely. People do not drink intoxicating beverages in order to make the “alcohol capital” happy, and they do not go to war in order to increase the profits of the “merchants of death.” The existence of the armaments industries is a consequence of the warlike spirit, not its cause.

It is not the business of the entrepreneurs to make people substitute sound ideologies for unsound. It rests with the philosophers to change people's ideas and ideals. The entrepreneur serves the consumers as they are today, however wicked and ignorant.

We may admire those who abstain from making gains they could reap in producing deadly weapons or hard liquor. However, their laudable conduct is a mere gesture without any practical effects. Even if all entrepreneurs and capitalists were to follow their example, wars and dipsomania would not disappear. As was the case in the pre-capitalistic ages, governments would produce the weapons in their own arsenals and drinkers would distill their own liquor.

*Some Observations on the Underconsumption  
Bogey and on the Purchasing Power Argument*

In speaking of underconsumption, people mean to describe a state of affairs in which a part of the goods produced cannot be consumed because the people who could consume them are by their poverty prevented from buying them. These goods remain unsold or can be swapped only at prices not covering the cost of production. Hence various disarrangements and disturbances arise, the total complex of which is called economic depression.

Now it happens again and again that entrepreneurs err in anticipating the future state of the market. Instead of producing those goods for which the demand of the consumers is most intense, they produce less urgently needed goods or things which cannot be sold at all. These inefficient entrepreneurs suffer losses while their more efficient competitors who anticipated the wishes of the consumers earn profits. The losses of the former group of entrepreneurs are not caused by a general abstention from buying in the part of the public; they are due to the fact that the public prefers to buy other goods.

If it were true, as the underconsumption myth implies, that the workers are too poor to buy the products because the entrepreneurs and the capitalists unfairly appropriate to themselves what by rights should go to the wage earners, the state of affairs would not be altered. The "exploiters" are not supposed to exploit from sheer wantonness. They want, it is insinuated, to increase at the expense of the "exploited" either their own consumption or their own investments. They do not withdraw their booty from the universe. They spend it either in buying luxuries for their own household or in buying producers' goods for the expansion of their enterprises. Of course, their demand is directed toward goods other than those the wage earners would have bought if the profits had been confiscated and distributed among them. Entrepreneurial errors with regard to the state of the market of various classes of commodities as created by such "exploitation" are in no way different from any other entrepreneurial shortcomings. Entrepreneurial errors result in losses for the inefficient entrepreneurs which are counterbalanced by the profits of the efficient entrepreneurs. They make business bad for some groups of industries and good for other groups. They do not bring about a general depression of trade.

The underconsumption myth is baseless self-contradictory balderdash. Its reasoning crumbles away as soon as one begins to examine it. It is untenable even if one, for the sake of argument, accepts the "exploitation" doctrine as correct.

The purchasing power argument runs in a slightly different manner. It contends that a rise in wage rates is a prerequisite of the expansion of production. If wage rates do not rise, there is no use for business to increase the quantity and to improve the quality of the goods produced. For the

additional products would find no buyers or only such buyers as restrict their purchases of other goods. What is needed first for the realization of economic progress is to make wage rates rise continually. Government or labor union pressure and compulsion aiming at the enforcement of higher wage rates are the main vehicles of progress.

As has been demonstrated above the emergence of an excess in the total sum of entrepreneurial profits over the total sum of entrepreneurial losses is inseparably bound up with the fact that a portion of the benefits derived from the increase in the quantity of capital goods available and from the improvement of technological procedures goes to the nonentrepreneurial groups. The rise in the prices of complementary factors of production, first among them wage rates, is neither a concession which the entrepreneurs willy-nilly must make to the rest of the people nor a clever device of the entrepreneurs in order to make profits. It is an unavoidable and necessary phenomenon in the chain of successive events which the endeavors of the entrepreneurs to make profits by adjusting the supply of the consumers' goods to the new state of affairs are bound to bring about. The same process which results in an excess of entrepreneurial profits over losses causes first—i.e., before such an excess appears—the emergence of a tendency toward a rise in wage rates and in the prices of many material factors of production. And it is again the same process that would in the further course of events make this excess of profits over losses disappear, provided that no further changes, increasing the amount of capital goods available, were to occur. The excess of profits over losses is not a consequence of the rise in the prices of the factors of production. The two phenomena—the rise in the prices of the factors of production and the excess of profits over losses—are both steps in the process of adjustment of production to the increase in the quantity of capital goods and to the technological changes which the entrepreneurial actions actuate. Only to the extent that the other strata of the population are enriched by this adjustment can an excess of profits over losses temporarily come into being.

The basic error of the purchasing power argument consists in misconstruing this causal relation. It turns things upside down when considering the rise in wage rates as the force bringing about economic improvement.

We will discuss at a later stage of this book the consequences of the attempts of the governments and of organized labor violence to enforce wage rates higher than those determined by a nonhampered market.<sup>21</sup> Here we must only add one more explanatory remark.

When speaking of profits and losses, prices and wage rates, what we have in mind is always real profits and losses, real prices and real wage rates. It is the arbitrary interchange of money terms and real terms that has led many people astray. This problem too will be dealt with exhaustively in later chapters. Let us incidentally only mention the fact that a rise in real wage rates is compatible with a drop in nominal wage rates.

21. Cf. below, pp. 763–773.