HERBERT DAVENPORT'S *ECONOMICS OF ENTERPRISE* AND ENTREPRENEURSHIP: A CENTENARY APPRECIATION

RICHARD M. EBELING*

This year marks the hundredth anniversary of the publication of Herbert J. Davenport's (1861-1931), *The Economics of Enterprise*, which appeared in the early months of 1913.

Both mainstream economists as well as many «Austrians» seem to have long since forgotten Herbert Davenport. But during his time he was recognized as one of the early formulators of a subjectivist conception of opportunity cost, a harsh critic of Alfred Marshall's attempt to partly preserve the «real cost» doctrine of the Classical Economists, and a lucid expositor of the central role of the entrepreneur in a dynamic vision of the market process.

His earlier article, «Proposed Modifications in Austrian Theory and Terminology» (*Quarterly Journal of Economics*, May 1902), and his book, *Value and Distribution* (1908) were «friendly criticisms» meant to clarify inconsistencies or ambiguities in the «Austrian» approach with which he was, in general, highly sympathetic.

Born in Vermont, he earned a PhD in economics under J. Laurence Laughlin (a strong defender of laissez-faire economics) at the University of Chicago, but was also influenced by (though critical of) Thorstein Veblen. For many years he served as the Dean and Department Chair of the College of Business at the University of Missouri. He later served as a professor of economics at Cornell University.

* Profesor de Economía en la Northwood University. Además, es ex presidente de la *Foundation for Economic Education* y académico asociado del Ludwig von Mises Institute (Auburn, Alabama).

Procesos de Mercado: Revista Europea de Economía Política
Vol. X, n.º 2, Otoño 2013, pp. 415 a 421

According to Paul Homan, he was a captivating classroom professor: «One remembers him most vividly and typically leaning back in his chair, his penetrating eyes touched with the shadow of a smile, as of triumph, while he deployed his arguments, humorously but with devastating order and precision, usually at the expense of someone, preferably Marshall, whom other people took seriously and whom he regarded as hopelessly muddle-headed.»

Understanding the Causal Logic of the Market Process

The Economics of Enterprise presents his full analysis of the market order in terms of subjectivism, causality, and entrepreneurial competitiveness.

That the case for some unidirectional causality in economic events was difficult to defend was clearly appreciated by Davenport. «Prices have their setting in a great moving equilibrium,» he said, «all the parts of which are related to all the other parts, and are in close interdependency with the them … The lines of causation are not easy to trace or even the direction of them easy to establish.»

The way out of the maze for Davenport was to ask the reason for all economic activity, the ultimate force behind market events. «There could be no motive for production if there were no wants to be satisfied,» he declared. Therefore, «human wants are the dynamic facts behind all economic activity.» And marginality logically flowed from this starting point: «The importance … of [the] least pressing want expresses the significance of the loss of any items of an entire series or stock. The least significance or least utility in the stock is the *marginal utility* of that stock.»

The value of goods emerged out of the comparison of the respective marginal utilities or significances of goods. On this basis, individuals subjectively made their judgments as to the relative value of goods to themselves and made their price offers.

The «cost» of the offer was the utility of that which was foregone or given-up in the making of the choice. This was a primordial aspect to all choice, whether for isolated Crusoe or for societal man. In the carrying out of market exchange, for each individual the «cost» of a choice, said Davenport, was «not … the labor devoted to the earning of a dollar, and not … the dollar itself, but the alternative application of the dollar.»

Thus, in the analysis of market causalities, «the primary is with the demand side.» But, Davenport hastily added, «this is not to deny the importance —the secondary importance— of supply, for if there were no limit to production, no price would attach to the product.» Supply was crucial precisely because it delimited the point to which wants could be satisfied.

However, the decision as to what extent a want should be satisfied was a matter of the comparison of the marginal utilities of the alternative uses towards which the supplies could be directed. As a consequence, reasoned Davenport, attempts «to explain price by an appeal to the supply side of the market price equation is hopeless, unless on terms of a constant reference to the principle of opportunity cost.»

For while price was the outcome of the interaction of supply and demand, «the costs of production which lie behind supply are themselves in large part, resultants of other directions of demand.» Hence, wants had to be seen as the primary factor behind the guiding of the applications of supply.

The Market Process Begins with the Actions of Individuals

But how did demand guide the directions of supplies? How did the supplies come to be distributed among the alternative uses in a manner that reflected the relative valuations that demanders placed upon them? Davenport insisted upon a strict methodological individualistic understanding of the market process in answering this, which Wesley C. Mitchell, in his review of the book, called Davenport's «ruthless consistency with which he reduces economic phenomena to terms of individual activities in pursuit of gain.»

«In the price problem,» Davenport said, «the need is to understand precisely how the particular individuals arrive at their respective demand prices. There is no one single homogeneous utility nor any one single aggregate demand price. Utility, for purposes of the analysis, is an individual category.» To assume otherwise would require attributing to the society as a whole those qualities that Davenport said was essential to what we call the human personality —thought, will, consciousness, and memory. «So far… as we know, there is no social organism in the sense of a personality fulfilling that fourfold test, fulfilling, indeed, any one of the four tests,» he concluded.

The solution to the problem of supply and demand coordination, therefore, had to be found within in the boundaries of methodological individualism. In pursuit of this solution, Davenport turned his attention to the role of the entrepreneur. In the competitive economy the entire process was «captained» by the entrepreneurs, he said.

The entrepreneur's motive was his own gain. And it was the prospect of this gain that prompted, induced, and guided him in offering bids for the things that could assist him in achieving that goal. But while the prospective price of the product was the incentive, it was also the limit of his bids. The entrepreneur was the buyer of services and the seller of resulting products. «The sale price is the purpose, the justification, and, in this sense, the cause of the outlay prices,» said Davenport.

The Central Role of the Entrepreneur in the Market Process

Here was the mechanism by which the logical causality between demands and supplies was brought into actual implementation in the complexity of market activities. The entrepreneur stood, Davenport argued, «as the intermediary in the case, representing in his hiring and buying of productive factors, the demand of the purchasing public, and representing in his cost computations, the degree of scarcity of the productive factors relative to the demand for their products.»

On the one hand, it was «the entrepreneurs who furnished the demand for all … the things which are called production goods,» he explained. On the other hand, it was «the competition of the entrepreneurs of each industry with the other entrepreneurs of the same industry, and the competition of the entrepreneurs of each industry with those of other industries» that brought about the emergence of factor prices. All the money outlays, the objectified market «costs» that an entrepreneur had to incur, all traced back to the demand for other things as reflected in the bids of competing entrepreneurs.

The positioning of wants and demand as the primary causal agent, therefore, did not deny the relevancy of supplies or the importance of «costs.» Indeed, Davenport emphasized that the actual world of economic events was one of perpetual change.

There was a constant whirlwind of changing demands, modified supply conditions, and new technological methods of production. «The flexibility of cost —its sensitive response to each and all changes in the conditions or the forces involved in the situation,» he said, «makes cost as the focal point of all these [changes], the strategic point from which all of these are most effectively studied.»

These «costs» that served as the «strategic point» from which all the changes in the economy were reflected back to the myriad of wants and uses on the part of consumers and entrepreneurs were, themselves, given a subjectivist foundation by Davenport.

The Entrepreneur's Expectations and the Meaning of «Cost»

«The various markets in which he [the entrepreneur] must hire and buy are fluctuating in their prices,» he said. «And the price at which he will finally market his product is uncertain … His alternative lines of activities, also, are subject to uncertainties.» *All of the entrepreneur's calculations, therefore, were expectational.*

His computations of «costs of production,» Davenport went on, «appears to be backward-looking computation,» but in reality was «only a basis for a further and forward-looking computation.» The entrepreneur's glance was turned towards those future —uncertain— opportunities that still lie before him, and from which he would have to choose the one that he believed offered the greatest net advantages.

Ultimately, then, the entrepreneur's «cost» of production was reducible to his individual judgments, estimations, and expectations of what he saw as the opportunities and their relative future market values. «The cost computation must stand as a purely personal and individual computation … it must express and report his [the entrepreneur's] method, process and decision,» Davenport argued.

And as a consequence, «The bearing of cost … is significant only for such persons as undertake the cost.» The prices of the factors of production —the market «costs»— were, then, in Davenport's perspective an «objectified» reflection of the interacting individual, subjective entrepreneurial interpretations of uncertain future market opportunities; interpretations of ultimate consumer demands and the imputed worth of «supplies» that could serve those demands that were in competition with each other.

From the «dynamic facts» of demand to the «purely personal and individual» quality of cost, in the hands of Davenport the market process became an analysis in subjective relationships bound together by the gain-seeking activities of competing entrepreneurs.

The causal connections were evident to him: goods had value because they served wants; production had its motive in the creation of goods to satisfy those wants; and for equilibrium, the supplies of goods and factors of production needed to be so distributed that no net advantage existed for the shifting of «supplies» from one alternative use to another in the service of the competing demands.

The critical issue was to explain how an equilibrium might tend to come into being —an explanation, as Davenport emphasized, that would run in terms of the individual actions of personalities possessing thought, will, consciousness, and memory. For Davenport, entrepreneurs exemplified such personalities.

Market «costs» were all reducible to the subjective estimates of the respective entrepreneurs whose competition generated the objective factor prices. The «flexibility of cost» and the «strategic point» of cost phenomena for the analysis of change and adjustment, therefore, were reducible to an analysis of entrepreneurial flexibility and adaptability on the basis of their perceptions of the ever-fluid configuration of market conditions.

Davenport's Understanding of Economics and a Road Not Taken

Having accepted the subjectivist causality of the «Austrians» for understanding the social and market order, Davenport's exposition was an extension of it to incorporate a dynamic process of entrepreneurial initiative and action by which the causal chains were given substance in an actual world of change, uncertainty, and interconnection. Or as Philip Wicksteed expressed it in his review of Davenport's book, that the author «is concerned with the consistent working out and application of economic principles now generally accepted but seldom applied with adequate firmness and thoroughness.»

How different is this conception and exposition of the market process and its integration of the entrepreneur in 1913 from much of the economist's theory and analysis of today, one hundred years later!

It highlights two things:

First, that one hundred years ago, Herbert Davenport's analysis in *The Economics of Enterprise*, with its focus on entrepreneurship, subjectivism, and future-oriented uncertainty in a world of change to understand market processes, was considered a «cutting-edge» of economic theory.

Second, that it dramatizes the analytical «road-not-taken» by economists due to the Walrasian-Paretian general equilibrium path chosen by the mainstream of the economics profession during the past one hundred years. And it suggests what mainstream economics might have been like today if Davenport's «Austrian»-type subjectivist market process analysis had been followed and developed, instead.