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From Neo-classical Entrepreneur to Socio-economic  
Organization

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## **ABSTRACT**

**Despite the growing role that business has played in the development of capitalism, the neo-classical paradigm has largely ignored the concept of organization. This paper illustrates the neo-classical concept of the firm and the entrepreneur. Analyzing both, the moral and economic thought of Adam Smith, this paper explains why, in the heart of Industrial Revolution, the paradigm elects an unrealistic and quasi-medieval concept of the firm. The paper argues that it is not by chance that the collective actions and thinking were neglected, rather it is necessary in order to maintain the core-values of the paradigm. Finally, the paper discusses if a firm could be a good subject for institutionalizing of socio-economics.**

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## 1. Introduction

Every school of thought has its own core-values. Neo-classical economics (NE) has the self-organized market and its mechanism of allocation, the system of prices. Any other economic institution must be understood as a secondary and derived element. Thus, the prices allocate resources and the market sculpt efficient institutions.

Neo-classical models about markets and prices combine, at least, four assumptions (Langlois, 2001):

- a) Self-interest —a specific cocktail of individualism and utilitarianism— (Etzioni, 1990:24)
- b) Omniscience; that is, certainty and no cost information;
- c) Conscious deliberation, or the so-called rationality principle, which contemplates individuals who are able to consider options and choosing among them follow the criteria of efficiency and, finally,
- d) Representative agent: behavior and action by whichever could be described as displaying the first three elements, and producing identical agents.

With these four elements, the neo-classical approach itself has been able to elaborate a set of theories. These so-called economic laws describe conditions by an efficient allocation of resources.

Many consequences of the neo-classical assumptions have not been specified in the original theories, because they neither refer prices, nor supply or demand. Instead they stipulate secondary elements which are embedded in the core-bases. However, whether it recognizes or not, general market assumptions produce consequences as concerns

behaviors and actions, developed by agents who work inside the diverse institutions of the market, especially consume and production's units.

In this sense, it is possible to stress that NE presents a well-elaborated theory of the consumer (Cf. Damgard et. al, 2003). Neo-classical agents and behaviors maintain an acceptable level of realism. In spite of this, the theory is affected by a considerable level of hedonism, and it undervalues sentiments and no material goods (Dubé et al., 2003).

On the opposite, neo-classical hypothesis about entrepreneurs and firms, which depict the firm as a *black box* and entrepreneur as a *production's engineer*, are very deficient and utterly unrealistic (Baron, 1998; Baumol, 1968). In the real word, the firm and the entrepreneur deny the neo-classical design.

On the one hand, the individualism is denied. For neo-classical economics, the individual "is capable of judging the comparative efficiency of means for obtaining the desire to possess wealth... making entire abstraction of every other human passion or motive"(Mill, 1844:127). Whereas the natural tendency is to consider others with benevolence, altruism, or, in general, as trustworthy persons. In the theory of the consumer, the assumption of the individualism may be accepted without excessive care. However, in the firm, *reciprocal interactions* are "sine qua non" conditions. Organizations are not a stock of information, but knowledge, or structured information. Knowledge "lies in the particular connections between elements, rather that elements themselves" (Loasby, 2002:1237). Relationships that are not price-regulated are a concept foreign of the neo-classical version. In this sense, NE "provides no reason for the prevalence of firms as distinct modes of organization" (Dunn, 2000:422; see Langlois, 2001; Hodgson 1989). Inside organizations individual and collective rationality work together, forming new structures or forms to decompose and codify the information. Nevertheless, NE is not able to explain the role of collective actions and "collective thinking" (Etzioni, 1990:187).

On the other hand, “entrepreneurship escapes neo-classical modeling by definition due to its relationship to novelty and change” (Brouwer, 2002:84). This is in contradiction with both *omniscience* and *representative agent* conditions (See Langlois, 2001). In NE, entrepreneurship “needs to be defined with reference to a setting or context (e.g. start-up firms) and in terms of actions taken by an individual with such specific setting” (Vecchio, 2003:304), however, a wide psychological approach supports that environmental influences cannot totally explain the entrepreneurial behavior. Personality dimensions must be included by predicting (Cf. Ahearn et. al, 2003). In fact, NE “is not able to assume behavioral characteristic” (Hodgson,1989:250).

Despite the fact that bounded rationality (Simon, 1961) and opportunism (Williamson, 1985) have been introduced in the core assumptions of Institutionalism, old hypothesis, especially the instrumental rationality, continue in the models. The complexity of the non-ergodic processes are not observed (Dunn, 2000), and the paradigm is unable to work with total uncertainty. The American economic chaos produced after September 11<sup>th</sup> 2001 is an example (Cf. Beunza and Stark, 2003:152-3).

It can be said then, that, neo-classical firm and entrepreneur are obsolete, or, at least, incomplete. Nevertheless, both are theoretically and practically maintained. This paper offers a tentative explanation.

The structure of the argument is as follows. In the next section I summarize the role that firm and entrepreneur play in the general equilibrium models, detailing neo-classical prototypes as necessary corollaries of the pivotal assumptions of the paradigm. Showing the historical deficiencies that both concepts present, I argue that the neo-classical firm and entrepreneur were stillborn. I support that the neo-classical silence about real (or realistic models of the) firm and entrepreneur is intentional. I affirm that an obsolete version was accepted because NE would have otherwise been obliged to eliminate the assumption of individualism, the representative agent and his perfect deliberation. Concretely, I argue that

the “power center” (Etzioni, 1964; 1990) which characterizes organizations should damage the neo-classical principle of the representative agent, and moreover that, collective thinking could violate the strategic rationality.

The third section is dedicated to the Smithian’ business thought. Although Adam Smith<sup>1</sup> is the putative founder of the classical school of economics, the NE is a cocktail elaborated with many elements. It certainly contains a big part of Smith’s theories, but it includes other “refinements” by Malthus, Bentham, Mill or Pareto as well. Nevertheless, neo-classical mistakes in the concepts of the firm and the entrepreneur arose from classical economics, and, concretely from the Smithian thoughtfulness. That NE does not analyze organizations as elements with diverse logic of the market, and with collective rationality, is a part of the legacy of Smith. The section stresses the mistakes of his arguments analyzing both moral (sympathy) and economic (invisible hand) theories. I conclude that Smith was not able to define an “impartial spectator” and a “principle of sympathy” for entrepreneurs, and that, therefore, he preferred to silence the concept of authority and hierarchy, confining the entrepreneur in the function of inciting the division of labor. I argue that both authority and hierarchy appear in his model as the product of an “artificial” evolution of the market, understanding this expression as that selection process which is “applied methodically” under the control of the human agent (Hodgson, 2002:267). This idea is opposite to “natural” evolution of the invisible hand.

Neglected entrepreneurial aspects are wide and profound; *Trojan horses*; falsifiable (Popper, 1965) and critical elements of the NE. However, socio-economics, intends “to consider actions by the community and the state as first step” (Etzioni, 2003:108), offers a very incomplete design of the entrepreneur. The last part of this paper is devoted to encouraging socio-economics to developing the firm as potential shared institution.

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<sup>1</sup> Employed contractions: WN (I,1,i): “Inquiry into the Nature and Causes of the Wealth of Nations” (1776), Book I, Chapter 1, section, 1. TMS (I,1,i): “Theory of Moral Sentiments” (1759), Part I, Section 1, Chapter 1.

## 2. Neo-classical entrepreneur and firm

For NE the company is a *black box* and the entrepreneur is a production function. Business is a technical unity which produces articles and the entrepreneur is the agent who provokes and controls the production process —the transformation of inputs into outputs— according to the technical rules specified.

In this standard analysis, the study of the business is very similar to that of the consumer (Cf. Hicks, 1942). There is a difference; however, which is the result of technological determinants and not another group of questions which should be included inside this box of so-called *business organizational problems*. Therefore, “there is no need, no room, for entrepreneurial action” (Adaman and Devine, 2002:333).

Many authors (Cf. Dun, 2000; Groshal and Moran, 1996; Etzioni, 1990; Hodgson, 1989) have pointed out the fragility of this theoretical body with relation to the figure of the entrepreneur and the business. Nevertheless, this paradigm (Cf. Demsetz, 1995) has certified; firstly, that economics produces theories about the processes of the market. In order to make predictions about prices, in a “self regulated market” (Polanyi, 1944:129), it is not strictly necessary to know how entrepreneurs lead firms or how the division of labor is directed and controlled. As Demsetz explains (1993:164) other firms, represented by the market, are treated as a perfect substitute in production. In this sense, management by definition is eliminated.

Secondly, it has been argued that life inside the firm could be understood from a market’s criteria. Edith Penrose (1959) asserted that the role of human intentionality inside organizations could not be explained with neo-classical arguments. With a contradicting view, Kerr and Jermier (1978) assert that most of the essential aspects of the leading firms, could be structured and reduced to a set of routines. Nelson and Winter (1982) maintain that those routines could be explained as a natural evolution inside a business.

In summary, NE is only interested in *the result*: a certain quantity of products which will be sold in the market. *How* the production is made —a purely technological function (Baumol, 1993:12)— is not an interesting topic.

In my opinion, this is not a feasible enlightenment. The NE presents an unrealistic and partial conception of the firm and the entrepreneur for two reasons. Firstly, its firm is not analyzed as an *organization*. Secondly, the context is not understood as a *hierarchical phenomenon of thinking*, but as another price-relation. Its firm is designed as a collection of individuals who work in the same place, but not together, having the individual as its decision-making unit (Cf. Etzioni,1990:4). Not being an organization, the firm has no opinion about collective goals; provides no reason for collective thinking or no material synergies; it revolves exclusively around the efficiency of the means. The firm was governed by “a passive calculator” (Baumol, 1993:13) who captained a technical function.

Obviously, this description depicts single-unit enterprises, with an individual or a small number of owners and few laborers, where subjectivity, culture or spiritual factors, are absent, and each bilateral relationship could be explained through wages, profit, and technique.

Nevertheless, researchers in economic history who focus on the eighteenth and nineteenth centuries, the period in which economics consolidated itself as a discipline of scientific character (Minowitz, 1993), offer unequivocal conclusions: if the capitalistic firm could have only emerged after production factors had become mobile and property rights had been established (Weber, 1927), then the classical firm could be perfectly capitalistic. If, in accord with Marx (1844) and Schumpeter (1954), it was possible to understand this process as a simple evolution of the system, then it can affirm that, when economics was born, the evolutionary process had started. Acceleration of industrial growth, capital accumulation (Mills, 1996:277), technological shocks (Romer, 1994), lengthy diffusion of the innovations (Rosenberg, 1994), etc., can be largely observed.



The industrial revolution put the machine at the same level as the worker as a source of industrial progress. In this capitalistic environment, technology is perpetually hungry for new capital, which forces the enterprise to increase its size in order to subsist. This growth results in the fading away of the old characteristics of the entrepreneur.

In the age where classical and neo-classical paradigms were born, the firm was not a technological individual but a company which increased. Neither entrepreneur was an isolated owner organizing technical labors of “executors.” The ingenuity of the businessman had been replaced by the rationality of the manager, and the synergy of the company remained stuck to the area of fabrication. In a historical moment where the phenomenon of wealth was deliberately isolated from other social phenomena (Cunningham, 1968; Polanyi, 1944); where economics aspired to be treated with mathematical precision, the question is: why, starting with Adam Smith, were the firm and entrepreneur treated with obsolete models?

Let me clarify this allusion. As it is known, Smith chooses a pin factory (WN,I:1) to demonstrate the efficiency of division of labor; this is one of his core arguments. Curiously, after describing the process, Smith does not refer to the pin factory again. In his age, cotton —an industry where division of labor incites technological innovation (Subiyana, 1996) — is the most used and cited example by thinkers. WN (I) demonstrates that Smith has ample knowledge of the cotton industry of his time; however, he employs pins and rejects cloth. Why?

Mills (1996) argues that Smith did not understand the importance of the inventions of his time. Indeed, contributions of Watt, Hargreaves or Arkwright are not named in WN. However, in my opinion, more factors must be analyzed.

Some of Smith’s ideas were originals and others were taken by contemporary authors (James, 1963:76). The pin factory must be placed in the latter category. In fact, between 1722 and 1723 in Paris, “*Traité de la Richesse des Princes*” by Erns Ludwing Carl was

published. This book describes the division of labor comparing the production of pins, with exhaustive division, and nails from a traditional factory. This description attracted the attention of Smith, who copied and reproduced it in the first chapter of WN. Nevertheless, Viner (1965:108) notes that while Carl meticulously explained how the industry was directed by the entrepreneur, discussing widely the appropriation of profit, Smith did not make any mention of the entrepreneur.

In my opinion, Smith found some disadvantages in the cotton industry. Needing many production plants, it presented coordination and organization problems. For example, the cotton industry employed a system of piece rates for paying wages. This system was an incentive to laborers, but also to employers to speed up productions. “Elaborate structures for piece rates were steadily developed in the cotton industry”(Tunzelman, 1995:6). These structures required the harmony of opposite interests, because English labor was very expensive. While in the pin industry, the division of labor was simple and only one foreman was needed each day to supervise the work; in the textile industry, division and mechanization is much more complex. Moreover, the supervisor must be changed by the authority of one *captain of industry* (Marshall, 1919) whose labor could not be understood as technical routine.

If Smith had elected the textile industry, he would have been faced with the authority and power of the “able but uncultured business men” (Marshall, 1890, I) and the hierarchical relation, which could move the system of prices (Coase, 1937). In the extreme, authority of the king, lord, or clergy, on a large scale would not be destroyed, rather replaced by the authority of the entrepreneur on a micro level. A pin factory without reference to entrepreneur, in a Taylorist style, permitted him to avoid these details.

This convenient and opportune oversight by Smith has not been corrected.

From Smith, economics has advanced. Bounded rationality; incomplete contracts; opportunistic behavior; asset specificity; imperfect competitive market; etc., have been

included, refining some core assumptions. However, these variations contribute very little to what approach understands about the dynamics of entrepreneurship. The NE is unable to address “the issue of entrepreneurship owing to its epistemological standpoint” (Adaman and Devine, 2002:334). There is a promising future in NE located in the transactions costs approach, specifically in Williamson’s version (1985). His model about the opportunistic behavior, with asset specificity, has contributed to explaining the diverse efficiency of governance structures. This is a big step, because the existence of internal elements and relationships in the business are admitted as factors of efficiency. However, “despite Williamson’s frequent mention of ‘adaptability,’ transaction-cost economics is in the end grounded in the same processes of static optimization as neo-classical theory” (Langlois, 2000:10). Research building on the works of Commons (1934) and Coase (1937) maintain most of the core assumptions of paradigm. We are far from understanding the firm’s collective actions and thinking.

Smith maintained an illustrative silence about the internal organization of the *black box*. I think that the silence is an answer, as the inactivity is a decision. In this sense, I support that the firm, which can divide the labor, and the entrepreneur, who directs the process, are the *Trojan horses* of the NE. I affirm that, inside the firm, all the defects of the core assumptions of the paradigm —specially the individualism and the conscious rationality— are shown. In others words, I understand that neo-classical theoreticians described the firm as a *black box* —in spite knowing that it was an unrealistic concept— because other description gravely damaged the validity of the core assumptions of the model.

What organization has NE? What organization needs you? Although organizations are an old invention, new ones are doted by specific characteristics. Knowing which of these characteristics are refused by the NE is our immediate purpose.

Organizations (Etzioni, 1964:3) are characterized by (a) *division of labor*; (b) presence of one or more *power centers* and (c) *substitution* of personnel. Requirements (a) and (c)

could be satisfied if employment relations were regulated by modern markets. In a labor market, whoever laborer, whichever time, could be removed and replaced by other laborer whose labor produces similar results. The paradigm accepts that, in human repeated processes, *how* the product is realized has effects in *what* and *how many* is made, but it supports that, on most occasions, the *how* could be reduced and integrated into technical functions. Thus, in a simple division of labor, laborers are totally interchangeable. If, it is not work —action of man— but time which is bought or sold, *how* the division of labor is realized is not so important.

Requirement (b) is more complex. Only if production can be identified with fabrication, then a simple (neo-classical) *control center* is required. This control is called to maintain efforts in the direction signaled by technological plans, and controllers should have technical or bureaucratic legitimation “spurs efficiency” (Brouwer, 2002:99). If production exceeds fabrication, and spontaneous actions and outstanding achievement are included, then sources of legitimation must be enlarged. Conferring authority is not equivalent to offering a technical legitimation or a bureaucratic power, “rule of nobody” (Arendt, 1958:45). Non-bureaucratic forms of authority present some disadvantages for the NE, because the personality or leadership, the no logical or illogical rationality (Pareto, 1917), etc., prevent the firm from working as a *mechanism* such as a *clock*.

The paradigm of classic science, the Newtonian mechanic, finds its symbolic expression in the medieval invention of the clock, which is a manifestation of a simple and instrumental rationality. The clock gives hope to modern science for many reasons. On the one hand, it is an *invention*; that is, it was conceived and produced by man, but, after being produced, the clock worked *without human intervention*. On the other hand, having a *complex structure*, the clock’s behavior was easy to describe, following universal laws conceivable by human reason.

Under the potential of an innovation, it was difficult to resist the temptation to approximate social reality, especially in economics, with this description. Campwell (1971:19), Skinner (1975:180), and others support that works by Smith should systematically be applied to the Newtonian order to ethics (TMS) and to economics (WN). In this last science, the clock made that the utopia of a self regulated market a reality. In spite of harboring a complex network of transactions, the market could function automatically and guide itself by predictable universal laws. Time which can modify the environment to the behavior of the actors decreasing the capacity of prediction (Cf. Fitzgibbons, 1995), was little by little eliminated. With time is also the subjective content of human action. Science should be objective; no political inkling, moral evaluation, particular feeling, nor social custom should influence, neither one's conclusions nor one's premises (Minowitz, 1993).

Only two factors, both around the firm, could refuse this creed: the personification of the entrepreneur, and the hierarchical relationship.

Neo-classical theories, certainty and uncertainty, have supported that, with relation to the entrepreneurial function, the major role is played by the economic framework, that is, economic conditions and environment, which —following Newtonian principles— could be explained with mechanical or technical hypothesis. The mitigation of the uncertainty of the environment (Knight, 1921); the innovation (Schumpeter, 1934); the development of the information (Arrow, 1963); the reduction of inefficiencies (Kirzner, 1997); the combat of market's opportunism (Williamson, 1985), etc., “are economically grounded justifications, rather than behaviorally based” (Vecchio, 2003:306). In others words, it is the environment of market competition which induces entrepreneurial adaptive changes. The firm and entrepreneur are limited to following spontaneously the laws of the environment, which is governed by a superhuman and invisible power.

However, in the real world, a “nexus” of contracts or property rights (Alchian and Demsetz, 1972; Jensen and Meckling, 1976) could not completely explain the birth,

growth, and death of the firm. Obvious relationships between success (profit) and internal organization (Adaman and Devine, 2002) were not contemplated. There are no-technical events inside the organization that the “invisible hand” cannot control and that cannot be explained by “natural” evolution.

The *black box* needs to be opened. Nevertheless, when the box is opened, the psychology of the entrepreneur emerged. Differences between entrepreneurs and non-entrepreneurs, with respect to behaviors, values, or tendencies were detected (Silverthorne, 2001; Baron, 1998; ). Entrepreneur, being “so special,” hinders the standard modeling of the productive agent. He does not work like a clock. At best, it should be as like a *rooster*.

“Behavior has replaced action... Society expects for each of its members a certain kind of behavior, imposing innumerable and various rules, all of which tend to normalize its members, to make them behave to exclude spontaneous action and outstanding achievement” (Arendt, 1958:40). Inside firms, entrepreneurs may establish social systems that are routine in character, but their own characters are never routine. Entrepreneurs act spontaneously; they do not follow technical rules when looking for authority and hierarchical collaboration.

Authority and power of businessman creates firms; hierarchical relationships create organizations. Inside organizations, the system of prices is moved by the authority of the businessman, who is embedded in different types of organizational structures (Adaman and Devine, 2002:331). Two firms in the same sector with identical capital, technological development and human resources; working in the same legal and economic environment, can obtain diverse results. Therefore, the difference must be found in organizational factors.

Evidence illustrates that results of entrepreneurial action can not be understood as the aggregation of individual results. Inside the firm, the ability of agents to maximize utility is not unlimited, because cooperation and reciprocal service are needed. Cooperation can

create supra-individual forms, collectivities which cast doubt upon the efficiency of individualism. For both reasons, in my opinion, neo-classical thinkers, starting with Smith, maintained obsolete models.

### **3. Ambiguities by Adam Smith**

Adam Smith is not a liberal author. He is “unambiguously republican” (Gáspár, 2003:598). On the one hand, self-interest motivates his prototype of man. On the other, this philosopher attempts to convince us that self-interest has two dimensions: the first —the private dimension—is oriented to one-self; the second —the public dimension— is directed to other persons. On the one hand, Smith affirms that the invisible hand efficiently governs and controls our market, but he supports, on the other, that, if it is needed, *other* mechanical principles, as the sympathy, prevent agents confuse self-interest and egoism.

The result of his “affable” republicanism is a wonderful ambiguity, which increases when he analyzes the businessman and the firm. The private dimension of the entrepreneurial self-interest, described by Smith through the “amiable and respectable virtue of prudence” (TMS,I:5) and the public dimension, described through justice and benevolence, are on bad terms. His entrepreneur is, simultaneously, benefactor and enemy of the society. As, after Smith, Schumpeter (1934) assumed, the entrepreneur, who accumulates capital and encourages the division of labor, is the principal motor of the social progress. Thus, he is designed as the major “benefactor of the Society” (TSM;IV:2). As, after Smith, Marx (1867) denounced, the businessman has the power to destroy himself, the mechanism of the competitive market, and, therefore he is “enemy of the Society” (TSM;IV:2). This is the Smithian businessman. Invisible hand and sympathy are not able to cut this Gordian knot; this is the major Smithian headache.

I propose to analyze both dimensions of the entrepreneurial self-interest: *the prudent and benefactor businessman* and *the egoist and unsociable entrepreneur*. However, as I see it, these descriptions must be placed as elements of a major theory: that of prices and equilibrium.

Maximizing his utility function is the goal of the neo-classical agent as an individual and as a firm. Utility functions are individual and not transferable (in mathematical language utility functions are independent). Therefore, if each agent is able to maximize his own function, then the system will obtain equilibrium, which is the global result of the aggregate of the individual utility functions. According to McCauley (2001:296), “the economic profession has married itself to the notion of equilibrium and efficient market” therefore, equilibrium is a desirable state.

The “invisible hand” is a curious mechanism for obtaining equilibrium. It does so by maintaining the hypothesis of functional independency and perfect individualism, which results in matching supply and demand. Agents maximize their utility functions and obtain their goals, following the reaching of equilibrium they trade to remain at equilibrium. In this sense, the “invisible hand” maintains that actions and behaviors, which are beneficial for one agent, are moral (Cf. Hausman, 2002:1768); that is, beneficial for the society. Tending to equilibrium, agents and the society as a collection of agents, create a social harmony.

Because the non invertibility of demand and supply as functions of price, Osborne (1977), McCauley (2002) and others have stated that NE is internally self-inconsistent. The idea of utility maximization is only an equilibrium condition assuming that utility *is time-invariant*.

This unrealistic hypothesis could be understood as an arbitrary assumption; however, it presents an important philosophic base. The “invisible hand” is not only a system, but a *mechanism*, an automatic and involuntary mechanism; the clock of economics. With it,



every agent conforms “unconsciously” to economically correct behavior. Smith supports that “it is not from the benevolence of the butcher, the brewer or the baker that we expect our dinner, but from their regard to their own interest” (WN, I:2)

There are two conditions for a correct working of this mechanism:

- 1) Individual must exactly know and describe his utility function, and
- 2) Each individual must be diligent, “continually exerting himself to find out the most advantageous employment for whatever capital (or work) that he can command” (WN, IV:2).

If both conditions are fulfilled, then the “invisible hand,” and “his own advantage naturally, or rather necessarily, lead him to prefer that employment which is most advantageous to the society” (Ibid.).

Are these conditions ever satisfied? In this sense, it should be recognized that Smith designs two scenarios: the original or natural state, and the political state, so-called by Smith the “civilized and thriving country” where firm and entrepreneur emerge. In the first state of things, both conditions are satisfied, and self-interest and the “invisible hand” produce social equilibrium. On the opposite side, with elements which produce the harmony in the natural state, the political state cannot guarantee the equilibrium. Therefore, new *moral* elements must be added. However, Smith likes to respect the spirit of the model, and he presents moral elements as “natural” evolution of the system.

His attempt was unsuccessful and his entrepreneurial theory could be understood as the corollary of this failure. The Smithian enterprise and entrepreneur hail from an artificial selection process, which are principally characterized by “the fact that it is under the control of a human agent” (Hodgson, 2002:267).

Foster (1997:430) supports that the major failure of biological analogies in economics lies “in the creative and cooperative dimension of human behavior in the economic domain.”

With the opposite view, Nelson and Winter (1982) understand, as Smith, that “internal organization of the firm could involve the internal selection of habits and routines.” I will show following the thought of Smith, that it is Foster who is correct.

#### **a) The natural state and the social harmony**

Smithian’s natural state, very similar to that of John Locke, is defined as “that original state of things, which precedes both the appropriation of land and the accumulation of stock. In this state the whole produce of labor belongs to the laborer” (WN, I:8). As it has been said, in this stage of the society, both conditions for equilibrium are candidly satisfied by everybody.

With respect to the perfect knowledge about self-interest, Smith strictly follows the design of Locke. “Second Treatise on Government” (1690, VIII:87) supports that humans, being born with a title of freedom, have by nature a power to judge for themselves. Each individual is his best judge, because only he knows perfect and completely what is beneficial and harmful for himself and what is the advantageous employment for his resources. Smith pays homage to Locke (Cf. Macintyre, 1988:238; Dumont, 1977:116), affirming that “every man is, no doubt, by nature, first and principally recommended to his own care. And as he is fitter to take care of himself than of any other person, it is fit and right that it should be so” (TMS, II:2,1,10).

Despite that it only presents a natural division of labor, this state presents simple commercial activities, derived by the natural “propensity to truck and barter.” There are no workers, no capitalists or entrepreneurs; but individuals. There are not different behaviors among men due to their commercial functions. In natural societies, Smith describes (WN, I:10), “the varied occupations of every man oblige every man to exert his capacity and to invent expedients for removing difficulties which are continually occurring... every man is a warrior. Every man, too, is in some measure a statesman, and can form a tolerable

judgment concerning the interest of the Society and the conduct of those who govern it” (WN, V:1,3).

The individual has neither a landholder nor a master to share with him because the effort of laboring is the price paid by the appropriation (Myrdal, 1953:92); therefore, each individual desires to reduce the cost. Furthermore, it can be supposed that everyone is motivated “to find out the most advantageous employment” for whatever result of his labor. This, therefore, satisfies the second condition for equilibrium.

Economics interpreted these ideas affirming that utility functions were formed in the private sphere of the individual. There were not interdependencies among functions. They were not connected directly but indirectly around the “invisible hand.” The next step on the development of the NE was to add the premise that utility functions were stable and that if some variations were observed there was a simple explanation: a change in the individual’s preferences. If utility functions were independent, and both conditions were satisfied, the “invisible hand” obtained equilibrium, the efficiency and the social and spontaneous harmony.

Unfortunately, most neo-classical economists have only read WN; therefore, the mistake has entered into economics: the title of perfect freedom and knowledge that Locke supports and Smith rescues result only possible in a natural state (Cf. Calderón, 1997:122). Commercial society is not a natural state. It presupposes political (artificial) institutions, rules of game, limitations.

#### **b) The political state and the social unbalance**

How is the tendency to equilibrium modified by the political environment? Locke and practically every modern philosopher understand that the political state was born by necessity, and as result of a social contract. Smith affirms (WN,V.2) that “civil government, so far as it is instituted for the security of property, is in reality instituted for

the defense... of those who have some property against those who have none at all... It is only under the shelter of the civil magistrate that the owner of that valuable property, which is acquired by the labor of many years, or perhaps of many successive generations, can sleep a single night in security”.

In this artificial scenario, the concurrence of independent utility functions and the “invisible hand” do not necessarily guide individuals and the society to equilibrium, because both general conditions —knowledge about self-interest and motivation to looking for the best employment for resources— can not be satisfied.

When the appropriation of land and the accumulation of stock (and the consequent scarcity) force a movement from the original state to a political state, conditions change. In the productive point of view, society is divided into three parts: laborers; landholders; and entrepreneurs; that is, merchants and master manufacturers “who live by profit.” Out of the simplicity of the natural state, ambiguities of the self-interest, limits of knowledge, and uncertainties of the consequences of actions enter (Cf. Hausman, 2002:1770). Everybody is affected, but everybody is not affected in an identical form and measure: laborers are affected by gross ignorance; landholders by indolence, and entrepreneurs by egoism. I would like to stress that the major uncertainty of the political state is not the information, which “is problematic only when access is costly” (Loasby, 2002:1227), but the agent himself. Inside an uncertain universe, the individual could exaggerate joys and pains. He is not able to define exactly his utility function and, therefore, he cannot maximize it.

Smith expressly recognizes difficulties. In fact, when he notes that the equilibrium is not assured, he is hastened to observe the evolution of the system. He gives an opening to a third element, a new concept —the voice of the moral agent— described as the sympathetic and impartial spectator.

Let me clarify the nature of this emergence, because this third element of the Smithian theory must not be understood as an artificial evolution, but as a natural development.

The voice of the moral agent is absent in the natural state, however this absence must not be understood as an innovation but as silence. The third element is *in* the self-interest of the agent, but it is asleep. It only awakens when it is necessary to do so (Cf. Frantz, 2000:13).

Hausman (2002) supports that, by nature, some people have competence to be leaders; however, there are not, they are “choosing not to use” the competence. The choice to enact the role of the leader or not, is made in terms of a preference. It is possible that, changing the circumstances, someone decides to be the leader. With an identical argument, Smith supports that in a natural state, individuals develop the propensity to truck, barter, and exchange (WN, I:2). This is not the effect of any contract, but of the accidental occurrence of their passions in the same object at that particular time. For harmonizing this propensity, individuals require no self-denial, no self-command, and no great exertion of the sense of propriety. Relationships consist only in the instantaneous material exchanges.

When Society progresses, living in a civilized and thriving country, bonds are necessary, and relationships awaken another propensity: sympathy. This natural evolution will help individuals with ambiguities in their interests.

Sympathy is a natural capability: through it, man is able to put himself in the position of the other, feeling his sentiments. Smith says, “sympathy with the person who feels those passions, exactly coincides with his concern for the person who is the object of them. The interest, which, as a man, he is obliged to take in the happiness of this last, enlivens his fellow-feeling with the sentiments of the other, whose emotions are employed about the same object” (TMS, I, 2:ii).

Everybody is sympathetically united with the others. In this sense, Smith opens TMS (I:1.a) affirming: “how selfish so ever man may be supposed, there are evidently some principles in *his nature* which interest him in the fortune of others and render their happiness necessary to him.” In his “Astronomy” (IV:6.1) Smith supports that “the

principles of connection and mutual attraction eliminate completely difficulties where old theories had stumbled.” Both constitute the third Smithian element. Frank (2000:9) underlies that Smithian sympathy “played the same role in human society and moral affairs as gravity played in physical universe. Toward sympathy, people can keep in their own orbit and in harmony with others.”

In the “Treatise of Human Nature” (1739-40; III.1.), Hume, best friend and great influence for Smith, affirms: “when you pronounce any action or character to be vicious, you mean nothing, but that from the constitution of your nature, you have a feeling or sentiment of blame from the contemplation of it... Vice and virtue, therefore, may be compared to sounds, heat or colors... are not qualities in objects but perceptions of the mind.”

In this sense, it is possible that perceptions of other agents could help the ambiguities of the self-interest. Thus, the sympathy produces an unconscious collusion of judges. If these judges are objective; that is, if these judges are the result of the no utilitarian sympathy, they are able to produce an impartial judgement. The majority opinion is converted in the “expect advise” of the “impartial spectator”.

Smith supports that, by nature, the individual hopes and desires for public estimation. In other words, individuals like to consume “admiration and appreciation.”<sup>2</sup> These “merchandises” are in their utility functions, beside others material articles. The second type could be bought with money; however, the first can only be achieved with morality. Sympathy results in the agent’s behavior and the behavior expressed as correct by the impartial spectator to become similar.

In this theory, the essence of the “invisible hand” —an automatic and spontaneous mechanism— is perfectly respected. Furthermore, the inclusion of moral variables must be

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<sup>2</sup> This behavior is called by Etzioni (1990) “interdependent utility”: “altruistic acts are explained by actor’s pleasure” (26).

understood as a natural evolution of the system of freedom, because these elements are not under the control of a human agent.

If Smithian and NE theories are well-conceived, then the “invisible hand” governing rational individuals, who maximize one utility formed by material consumption and natural sympathetic happiness, will produce equilibrium and efficiency. Moreover, these elements must explain the function of all the secondary institutions including the firm and entrepreneur.

I will immediately show why this is not possible and illustrate the problems that political state creates in laborers, landholders, and entrepreneurs, and how sympathy comes to the rescue. I will explain how and why, when the entrepreneurial environment is analyzed, the efficiency of the natural mechanism is annulled and the movement derives artificial evolution. I will begin by explaining how and why self-interest is affected and if sympathy is able or unable to correct ambiguities.

#### b.1. The laborer

Tending to equilibrium, in a political state, the major affectation is suffered by laborers. When natural division of labor is changed by technical division, work is sectioned into very short tasks, producing many consequences in the cognitive mechanisms of laborers. In the original state, “man had a considerable degree of knowledge, ingenuity, and invention, which was generally sufficient for conducting the whole simple business of the society...unlike the civilized state, where few men sometimes possess an improved and refined understanding” (WN,V:1.3).

By laborers, technical division produces simple and repetitive operations. Exercising their capabilities and cognitive mechanisms is not necessary. If the understanding is not practiced, Smith concludes “gross ignorance and stupidity overtake.” These features, “in a civilized society, seem so frequently to benumb the understandings of all the inferior ranks

of people” (WN, V:1.P.3,art.2). Reading these sentences, it is impossible to forget those others written by Frederic W. Taylor (1911:75): “the pig-iron handler is not an extraordinary man difficult to find, he is merely a man more or less of the type of the ox, heavy both mentally and physically.” Due to the perverse effects of the division of labor, many people, affected by “gross ignorance and stupidity,” are unable to define their own interest; therefore, the first condition for equilibrium is not satisfied.

On the other hand, now the whole produce of labor does not belong to the laborer. On most occasions, ordinary wages are not sufficient for the laborer to support a family (WN, I:8). Many laborers, unable to improve their condition, become indolent and loafers, thus the second condition of equilibrium is also not satisfied.

In brief: in a political state, the laborer does not know his own interest; neither is he diligent. Because the laborers’ class represents the majority in the society, it must be concluded that the mechanism of the “invisible hand” needs to be helped.

#### b.2. The landholder

With respect to the citizens non-laborers—who are owners of lands or have accumulated stocks— changes produced are very different. I start with the ambiguities of the landholder’s interest.

“Rent, considered as the price paid for the use of land is naturally a monopoly price. It is not at all proportioned to what the landholder may have laid out upon the improvement of the land, or to what he can afford to take; but to what the farmer can afford to give” (WN,I.11). With these conditions, it must be concluded that, if he is a rational agent, “in adjusting the terms of the lease, the landholder endeavors to leave him no greater share of the produce than what is sufficient to keep up the stock from which he furnishes the seed, pays the labor, and purchases and maintains the cattle and other instruments of husbandry, together with the ordinary profits of farming stock in the neighborhood” (Ibid).



Nevertheless, Smith notes: “sometimes, indeed, the liberality, more frequently the ignorance, of the landholder, makes him accept somewhat less than this portion” (Ibid).

Landholders get placed in an enviable monopolistic position of maximizing their utility function. However, they have problems with the second condition to equilibrium: they suffer indolence, “which is the natural effect of the ease and security of their situation, renders them too often, *not only ignorant, but incapable of that application of mind* which is necessary in order to foresee and understand the consequences of any public regulation” (WN,I,11: conc.).

Summarizing: landholders, as well as laborers, have some problems in the tendency to equilibrium. In the case of the manual laborers, the problem is located in the self-interest, being in a big proportion a no-culpable ignorance, and in the case of the landholders, the problems turn around the second condition, because the indolence is a voluntary psychological characteristic of this class.

### b.3. The entrepreneur

Smithian’s entrepreneur presents very special characteristics.

WN (II:3), continuation of the discourse started in TMS (IV.1), is dedicated to the distinction between productive and unproductive work. There, Smith separates productive work —“which adds value to the object that is incorporated”— and unproductive work —“which is not concrete nor creates any kind of particular commodity able to be sold.” Smith qualifies those people who add value as “benefactors of Society,” while he suggests that the unproductive workers “are enemies to Society” (TMS, IV:2.i).

Smith provides an ample list of individuals integrated in this last category: military, civil servants, artists, doctors, judges, priests, lawyers, “men of letters in all classes,” those who, as Marx (1867) denotes, “even though are neither productive nor are particularly destructive, but, nevertheless know how to appropriate a good part of the material Wealth

by selling one's immaterial commodities or putting them to use." It can be observed that all have an intellectual activity, like that of an entrepreneur.

In this panorama one question emerges: is the entrepreneurial function productive or unproductive work? In WN (I:6), Smith supports: "the profits of stock, it may perhaps be thought, are only a different name for the wages of a particular sort of labor, the labor of inspection and direction. They are, however, altogether different, are regulated by quite different principles, and bear no proportion to the quantity, the hardship, or the ingenuity of this supposed labor of inspection and direction. They are regulated altogether by the value of the stock employed, and are greater or smaller in proportion to the extent of this stock."

Indeed, if there is not relation between function and effort, skill or confidence, then I must conclude that the activity of the entrepreneur is not productive work, but "passive" behavior, similar to that of landholder. Smith does not have the same conclusion as I WN (II:3) affirms: "in that rude state of Society... it is not necessary that any stock should be accumulated or stored up beforehand in order to carry on the business of the Society... But when the division of labor has once been thoroughly introduced, a stock of goods of different kinds, must be stored... A weaver cannot apply himself entirely to his peculiar business, unless there is beforehand stored up somewhere, either in his own possession or in that of some other person, a stock sufficient to maintain him, and to supply him with the materials and tools of his work, till he has not only completed, but sold his web."

If the accumulation "must, evidently, be previous to his applying his industry for so long a time to such a peculiar business.", then it is needed, firstly, that some persons have previously accumulated stocks (capital), and, secondly, that a part of these persons employ their stocks in maintaining labor. In other words, that someone promotes the birth of the firm. Because the division of labor is the major cause of "the greatest improvement in the productive powers of labor" (WN,I:1), and wealth and prosperity are effects of the

productivity of the labor, then persons, who employ their capitals creating business and maintaining labor, deserve to be qualified as “benefactors of the society” (TMS, IV,2:5). Although the entrepreneur presents intellectual or passive nature, in the language of WN whichever benefactor of the society is a productive agent.

Under what aspects is entrepreneur productive? Under aspects of prudence and parsimony.

In TMS (IV:1.8), Smith distinguishes between two types of people. The first type are those who employ their accumulation of stocks in order to obtain commodities “which later are put to public show.” These individuals are motivated by their luxury and caprice. The envy that the luxury produces among the rich incites new accumulations and new luxury. Most of landholders could be included in this category. The second type of person is the prudent man “able to refrain from present appetites and in the end better able to satisfy them in other occasions in the aspect of property just as well as that of utility.” This individual can invert the stock, obtained through his frugal behavior, in maintaining labor and developing its division. In the Smithian way of thinking, entrepreneurs seem to be prudent men: “Parsimony, and not industry, is the immediate cause of the increase of capital” (WN, II.3).

Developing his own interest, which is perfectly known to himself, and doted by a great level of diligence, prudence, and frugality, the entrepreneur promotes the division of labor. In contradiction to the ignorance of the laborers and the indolence of the landholders, the self-command of entrepreneurs appear as tending to harmony and fulfilling all conditions of equilibrium. Moreover, everyone sympathizes with them, because “the resolute firmness of the person who acts in this manner and in order to obtain a great though remote advantage, not only gives up all present pleasures, but endures the greatest labor both of mind and body, necessarily commands our approbation. That view of his interest and happiness which appears to regulate his conduct, exactly tallies with the idea which we naturally form of it. There is the most perfect correspondence between his sentiments and our own” (TSM, IV:2).

The sympathy and admiration to the entrepreneur that are shown in TSM are in opposition with some of the statements of WN. In WN, many negative judgements about the entrepreneur can be found. In fact, it should be acknowledged that Smith does not love those “who live by profit.” They do not suffer the disadvantages of mechanical laborers; in contradiction, they know perfectly their own interest. The landholders have no psychological defects; contrarily, they continually exert themselves to find the most advantageous employment for their capital. In fact, they have “frequently more acuteness of understanding than the greater part of country gentlemen” (WN, I:11). Nevertheless, Smith thinks that they ignore the “public interest” and reject the sympathy.

As promoters, the Smithian entrepreneurs are motors of prosperity and wealth. However, in developing the division of labor, that is, in their movements in the market *after* the promotion of the division of labor, the entrepreneurs' behavior presents irreversible defects. Smith does not explain what the role of the businessman is inside the firm after it is born. He only explains how the social harmony could be affected by entrepreneurial characteristics.

The self-command of entrepreneurs promotes the division of labor; however, after this the entrepreneurs do not have a special role. Additionally, as the activity of the firm continues, other bad entrepreneurial tendencies emerge. Smith concretely observes

- a) A tendency to monopolistic situation and
- b) An exclusive corporation spirit.

Both conclude with a conspiracy against the social harmony.

With respect to competence in the market, Smith explains a “good management can never be universally established but in consequence of that free and universal competition which forces everybody to have recourse to it for the sake of self-defence” (WN I:11). While the price of monopoly is upon every occasion the highest which can be attained, “the natural

price or the price of free competition, on the contrary, is the lowest which can be taken, not upon every occasion, indeed, but for any considerable time together. The one is upon every occasion the highest which can be squeezed out of the buyers... the other is the lowest which the sellers can commonly afford to take, and at the same time continue their business” (WN, I:7). Competence reduces prices of merchandise until a natural price is obtained. With this price, the quantity of every commodity brought to market naturally suits itself to the effectual demand. In this sense, for any considerable period, the market overtakes equilibrium.

Smith verifies, however, that “when the stocks of many rich merchants are turned into the same trade, their mutual competition naturally tends to lower its profit, and when there is a like increase of stock in all the different trades carried on in the same society, the same competition must produce the same effect in them all” (WN, I:9). Thus, competition is opposed to the self-interests of businessmen. The conclusion is obvious: “the interest of the dealers, in any particular branch of trade or manufactures, is always in some respects different from, and even opposite to, that of the public. To widen the market and to narrow competition is always in the interest of the dealers. To widen the market may frequently be agreeable enough to the interest of the public; however, to narrow competition must always be against it and can serve only to enable the dealers, by raising their profits above what they naturally would be, to levy, for their own benefit, an absurd tax upon the rest of their fellow citizens” (WN, I:11, Conc.).

In the long term, competence is beneficial for the society, but in the short term and in relation with each dealer, a monopolistic situation is more beneficial. The dealer knows his own interest well and, therefore, the “invisible hand” cannot secure equilibrium.

Therefore, sympathy is the only resource that is able to obtain equilibrium. In this sense, the impartial spectator proposing free competition as “moral action” is necessary.

However, the second bad entrepreneurial tendency, the strong corporation spirit, does not allow sympathy to act; the example of wages is very illustrative in this area.

As has been illustrated, technical division of labor produces gross ignorance and indolence in laborers. Smith understands that sympathetic relations may be able to eliminate these failures. His argument is that new division of labor has overtaken old guilds and other professional relationships. Without these associations, some connections between profession and social place were destroyed. Following technical division, only rents permit placing laborers in the society (Weber called “proletariat of consumers”). Making progress is, therefore, equivalent to improving rents; that is, to obtain large wages. However, normally, entrepreneurs like low wages, because they obtain higher profit. Is it possible that entrepreneurs sympathize with the laborer who likes to improve his condition? It is indeed possible, because “the liberal reward of labor... increases the industry of the common people. The wages of labor are the encouragement of industry which, like every other human quality, improves in proportion to the encouragement it receives... Where wages are highly... we shall always find the workmen more active, diligent, and expeditious than where they are low” (WN, I:8).

If entrepreneurs and laborers, working together, can obtain improvements, does not sympathy emerge? The answer is offered by Smith: “masters are always and everywhere in a sort of tacit but constant and uniform combination, not to raise the wages of labor above their actual rate. To violate this combination is everywhere a most popular action, and a sort of reproach to a master among his neighbors and equals” (WN, I:8). Note that it is the “impartial spectators” of masters who hinder the sympathetic equilibrium. It is possible that the profit obtained through low wages and indolent laborers is the same as that obtained through high wages and diligent and expeditious laborers; however, entrepreneurs always opt for control of the industry with subsistence’ s wages.

In this discourse, Smith compares merchants and manufactures with clergymen. Both begin well; however, both damage society in the end. “The clergy of an established and well-endowed religion frequently become men of learning and elegance, who possess all the virtues of gentlemen, or which can recommend them to the esteem of gentlemen, but they are apt gradually to lose the qualities, both good and bad, which gave them authority and influence with the inferior ranks of people, and which had perhaps been the original causes of the success and establishment of their religion” (WN, V:2). The authority of the clergymen is maintained “employing all the terrors of religion” (Ibid). The authority of the businessman is maintained employing the “remunerative power” and the poverty of the laborers.

At this stage, if equilibrium is obtained, it will be under the control of an association of entrepreneurs. This artificiality in the “control” center of organization is the major preoccupation of Smith.

In spite of this, society needs entrepreneurs to promote the division of labor, if society admits that they have organizational control, the free market disappears, prices increase, and wealth retrogresses. Is it very odd the theoretical position of Smith? His model speaks consciously about the firm as a division of labor in a *black box*.

Smith finishes the first book of WN with the next terrible sentences: “it comes from an order of men (entrepreneurs) whose interest is never exactly the same with that of the public, who have generally an interest to deceive and even to oppress the public, and who accordingly have, upon many occasions, both deceived and oppressed it.” I would like to conclude by asking Mr. Smith why, if knowing that neither economics, nor sentiments, could prevent the permanent social unbalance, he has not permitted that the moral person, exclusive solution for his headache, to enter into his model.

In the Spanish translation of the WN (Alonso Ortiz,1794:319), the translator adds the last cited paragraph: “We judge the tendency of the class, but there are entrepreneurs who,

lovers of the nation and its common good, negotiate looking for their own interests without damage for the public interest.” Note that both demand moral actors.

#### **4. Socio-economic organization**

Two types of factors explain why, in the last three decades, the number of followers of socio-economics (SE) is increasing. Firstly, many theoreticians have been attracted by the quality of its assumptions, especially its determination to include the *person* as a subject and an agent of social processes. Secondly, many scientists, observing the hard and continuous (theoretical and practical) defects that the rival paradigm —the neo-classical— produces, hope that the new paradigm replaces the old. Nevertheless, despite its growth of initiates and followers, SE presents an exponential tendency where the finishing line can be seen only in the distance; the path opened is very, very long.

It is known that the neo-classical body of hypothesis is manageable but not realistic, and that formal models of rational choice explain nothing; however, in the real world the “neo-classical paradigm plays a major role in our public policy, dialogues, intellectual life, and the social and political philosophies that the public embraces” (Etzioni, 1990:2).

Everyone understands that the human heart is occupied by self-interest, but, also, by other *lodgers*, such as altruism, love, or, even, stupidity. Everyone also knows that in the human head, instrumental rationality, collective thinking, and the compulsive and routine actions exist together. However, the three core assumptions of the NE —individualism, utilitarianism, and rationalism— are maintained as roots of business school programs, and, many “experts,” entrepreneurs, and governors, apply these theories.

From time to time, some defects are detected in the function of the *invisible hand* —i.e. starvation, corruption, or a simple light distribution problem— taking on the first page of the newspapers. However few people believe that the system is dying. Defects are



understood as “collateral and secondary effects” of the system and we continue living in a neo-classical world.

In others words, people —theoreticians, politicians, or businessmen— understand that NE is not yet a *falsifiable* theory (Popper, 1965), essentially because there is not a new *formal developed* paradigm and SE has not “become institutionalized” (Etzioni, 2003:106).

In this context, SE can be understood as a declaration of intentions, not as a “competitor’s paradigm,” neither as an ordered system. Some people ask if SE is called to replace the NE, or if it is only called to awaken the moral conscience of *individuals*. Some people question if SE hopes to be a “winning horse” or if it will play the role of the preachers which James Buchanan (1994) demands for the NE.

When in “The Third Way” Etzioni describes the “Good Society,” he develops a “new utopia,” accepting that, despite many efforts, the way to achieve it is “not fully etched” (2000:13). However, that does not diminish the way, although it will be a long and hard travel, finally there is a way, and every way develops its nature when it is walked. To the extent that the elements of the “third way” are more etched and SE hypothesis are more developed, the arrival of the “Good Society”, although asymptotic, will be closer. In this sense, electing the more efficient system of walking is vital.

Because NE is a paradise by individuals, SE requires a different paradigm, one of diverse core-values. In the NE, families, associations, communities, states, and others collective actions cannot prosper. In this sense, Etzioni (2003:108) supports that SE “is more likely to consider actions by the community and state as the first step.” My thesis is that, understanding the little collective actions, such as those of the firm, will allow easier progression to the larger collective actions such as the state or the community.

Recognizing my economic slant, I understand that a good complementary system to developing SE may be starting with the more *falsifiable* elements of the NE. “It is a grave

error —Etzioni affirms (2003:110)— to treat the economy as a self-sustaining system, to view the market as separate from the society.” From a methodological point of view, I believe that it is also a grave failure to treat the firm as a collection of individuals. Evidence suggests that in some cases, probably few, the global price of farmer’s products, for instance cereal, could be explained by supply and demand. Nevertheless, there are very few cases where entrepreneurial behavior can be explained as the summation of individual behaviors.

Both focuses are naturally complementary. Obviously it is necessary to think about a non-automatic market, a market without clock mechanism. However, in my opinion, *practical* fatal errors of the NE are not located in the conceptions of the bigger systems and relations, but in the structures that they have in their own. It is in the working and development of these structures, where human persons result direct and profoundly affected.

In the third millenium, undeniably corporations occupy an outstanding place in society and a big part of the population are greatly affected by their entrepreneurial decisions. Most of these corporations follow neo-classical *logic*. Nevertheless, as has been illustrated, inside the general equilibrium models, “there is no place for salient institutions, such as the money or the firm” (Dunn, 2000: 422).

I understand that this schizophrenia can largely be *exploited* by SE. The following tentative list shows some greater reasons for this affirmation:

- a) While the NE supports that the firm and the market are alternative methods of coordinating production and that “the distinction between firm and market appears to be more a matter of degree than kind” (Masten, 1993: 197; Cf. Coase, 1937), evidence shows that there are fundamental differences between allocation by prices and allocation by authority.

- b) Relations between labor markets and society cannot explain relations between firms and the community. Entrepreneurial behaviors must be analyzed from interstitial and interdisciplinary paradigms, such as SE.
- c) While the neo-classical agent seeks to maximize utility, business behavior tends to satisfaction (Cf. Simon, 1959).
- d) While the neo-classical utility function includes only material elements, the firm, which tends to survive, needs to include no-material or moral elements.
- e) While the neo-classical environment is the certainty or, in the best of the cases, the probabilistic uncertainty, the firm works in uncertainty and, even, in a chaotic environment. Routines, very useful in the first case, cannot resolve many problems presented in the complexity. Past and present centuries have presented periods characterized by non-deterministic complexity and fundamental uncertainty.
- f) While the NE only admits limits “on the power of individuals to receive, store, retrieve, and process information without error” (Williamson, 1985:21; Cf. Simon, 1956), the firm, defined as collective thinking, admits barriers to reason. While the neo-classical individual is always able to correctly formulate the problem, being the estimation of the probabilities of the major problem, the firm needs the concurrence of many people to define what is the problem and what are the alternatives.
- g) While in the NE the individual is the decision-making unit, the firm needs to define supra-individual units. Instantaneous market’s contracts do not create synergies. They appear always inside human processes which are repeated, that is, processes where personal connections (not technical relations) are repeated. Frequently, the person moves the individual.
- h) Corruption can be manifested at both the individual level and the group level; members can act cooperatively to organize corruption (Bac, 1996), etc.

- i) Business behavior hinders that general equilibrium models employs representative agents.

## 5. Conclusions

Indeed, the NE lacks a coherent model of business and businessman. Core assumptions, especially individualism and instrumental rationality, make it impossible to explain complex organizations. Smithian's balance itself is obligated to conclude with a call to morality. This failure permits results in the emergence of a theoretical scenario in which SE is developed. In this interstitial and interdisciplinary paradigm, the firm can constitute a shade piece of thought and reflection.

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**Table 1:** Principal Critics. Degree of intensity (white/low; black/high)

<b>CRITICS</b>	<b>Neo-classical consumer</b>	<b>Neo-classical Firm</b>	<b>Neo-classical Entrepreneur</b>
<b>Self-interest</b> <b>Individualism</b>	Hedonism No sentiments No immaterial good	Reciprocal interactions Dependence Reciprocity	Great Individual
<b>Omniscience</b>	Prices do not contain all relevant inform.	Evolution	Novelty Change, Risk
<b>Conscious Deliberation</b>	Bounded rationality	Hierarchies Collective thinking Knowledge	Imagination Optimism Risk' evaluation
<b>Representative Agent</b>	Preferences Altruism	Capabilities	Personality dimension Behavioral Characteristics

**Table 2.** Smithian Agents

	<b>Natural Division of Labor</b> <i>No appropriation of land</i> <i>No accumulation of stock</i>	<b>Technical Division of Labor</b> <i>Appropriation of land</i> <i>Accumulation of stock</i>		
<b>Agent</b>	Individuals	Laborer	Landholder	Entrepreneur
<b>Self-interest</b>	Perfect Knowledge	Ambiguities Limited Knowl <b>Ignorance</b> <b>Stupidity</b>	Ambiguities Limited Knowl	Perfect Knowledge
<b>Employment Resources</b>	Most advantageous Diligence	Loafer	<b>Indolence</b>	Most advant. Diligence
<b>Principal Defect</b>	None	Ignorance	Indolence	<b>Egoism</b>
<b>Invisible Hand</b>	Correct Working	Incorrect working Insufficient		
<b>Sympathy</b>	Not necessary Sufficient	Necessary Not sufficient		
<b>Economic State</b>	Equilibrium	Unbalanced		
<b>Social State</b>	Harmony	Conflict		

**TITLE**

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