Appendix B: The Argument for a New Program in Marconomics and Entrepreneurial Economics

Introduction

The teaching of classical economics in universities still relies on material based on concepts and illustrations that are more than 200 years old. Many of the assumptions and certainly the characterization of economic or human activity they used back then were constrained by the limited knowledge they had at the time. Unfortunately, those concepts have never been changed to take into account the vast leaps in human understanding, in sociology and psychology that now comprise a more robust understanding of human behavior, wealth creating activity, and in particular, entrepreneurial behavior. We are still teaching 200-year old conceptions.

Instruction in economics, therefore, needs a new pedagogical proposition: one that takes into account the fact that economic behavior is neither "rationally based" nor does it rely on the concept of a single utility theory value of "satisfaction." The proposal is that a new genre of economic thinking be introduced. For example, the concept of Marconomics has been empirically tested and challenges utility theory as an expression of buying behavior.

It reveals a new paradigm that gives rise to innovation and entrepreneurial behavior in economics and leads to a proposed new program of study delving into entrepreneurial economics, the substance of which incorporates marketing concepts and innovation.

Individuals do not purchase goods and services on the basis of price alone, which is the focus for conventional economic analysis. Instead the research finds that customer behavior can be accounted for from two variables. The first is an expectation one has of the performance of a product or service and, second is a perception as to the worth of the item in question. This forms the background for a new paradigm in economic thinking. It posits that there needs be a "new economic order" that truly includes human behavior as we understand it.

Some of the material for such an undertaking is already an historical fact and the program builds on the thinking of such luminaries as Joseph Schumpeter, Ludwig von Mises, Frank Knight, Ronald Coase, and the more contemporary, Israel Kirzner and other colleagues. It also leads to new fields of research in economics and the development of new models of economic and political behavior. There is the need for a new, alternative hypothesis that the world is ready for a socially oriented, human dimension and practicable school of economics, based on market forces, the individual and society.

Proposed New Direction

The study of economics in western and developing countries generally follows on the genre and philosophy of the Adam Smith School of Economic thinking. The core of the discipline rests on a "black box" approach wherein the development of an economic event focuses on the output from the economic activity rather than the process itself. Thus, the methodology deals with input-output models that are proscribed by assumptions as to any variable or condition that might impact on the system. It is the classical "ceteris paribus" position where all other things are held as equal or constant which orders out any effect from exogenous variables that may be antecedent or consequential to the economic event under study.

There are numerous articles, discussions, and even texts that hold this approach is problematic and not reflective of economic affairs. There is a growing body of evidence and an abundance of historical precedence that argues economics is more accurately defined by process rather than systems or assumptive rationalization. For example, it was Richard Cantillon in 1730, cited but also ignored by Adam Smith, who developed theories that were more entrepreneurial and process-oriented than classical. His theory of price (based on the costs of production) and a theory of output (determined by factor inputs and technology) was the first to incorporate information and the role of a creative individual as determinants of economic output. Others followed including J. B. Say (1767–1832), Ludwig von Mises (1881–1973), the inestimable Joseph Schumpeter, (1883–1950) who espoused a more development-driven brand of economics that incorporated the role of the individual, inclusive of the entrepreneur as the principle genesis of economic wealth. Modern discussions on job creation cite the role of new start-ups (entrepreneurship) as primary in economic growth (Litan, 2010).

The inestimable William Baumol's text on "Good Capitalist-Bad Capitalist" sets the groundwork even better for a new direction in economic thinking. Those who hold capital, but do not earn it are prone to the "bad capitalist position." The 2008 economic disaster is a result of the thinking that held dear the "free market" notion, one built not on rationality and entrepreneurial behavior, but on the "droit de seigneur," the right of the lord to rule his serfs. Free markets meant only to eliminate barriers to making money; greed as the model. Entrepreneurship is an individual undertaking that draws its opportunity from the environment and infrastructure around it. It should be a symbiotic endeavor, but in the last few decades it has become predatory to the diminishment of the middle class. Perhaps it is time to rethink the approach.

This oft ignored alternate school of economic thinking, which transited through history somewhat in parallel with the neoclassical school holds to what is referred to as methodological individualism, an approach that embeds human action and the role of individual agents (i.e., buyers and sellers) as the foundation of

economic activity. As it is, the advocates of subjective individualism or the Austrian School of economics tend to minimize the use of mathematical models and instead propose that a valid economic theory is one derived logically from basic principles of human action, a method called praxeology. This school of thought engages the view that economic activity is expressed through human action including decision-making in simple as well as complex situations. In earlier times von Mises held to the notion that economic activity is the conscious action an individual exerts to improve his or her satisfaction. In this proposition praxeology is not concerned with actual achievement of an end satisfaction but rather the manner in which satisfaction is reached, although there is doubtlessly satisfaction associated with the successful consummation of a transaction. Nevertheless, it is the process that is manifest most importantly in the human activity.

In earlier times the behavioral aspects of psychological and sociological were neither available nor were they incorporated into the identity or description of customer behavior. The principles of marketing and consumer behavior were yet to be developed. Those who sought to explain the elements of economic transaction could not possibly have known that decision-making was the consequence of multiple factors that were hardly contained in a single observation such as "satisfaction" or "condition." The effort to employ *utility* as a measure of *relative satisfaction* permitted early economists to employ the artifice of increasing or decreasing utility as a means of explaining economic behavior. Hence the individual presumably strove to increase utility as a means of achieving satisfaction.

Even to this date it is current practice to apply the utility concept in building demand curves for a product or situation through such constructs as the indifference curve. This effect plots the combination of commodities that an individual or a society would accept to maintain a given level of satisfaction. Further, classical economists derive individual utility and social utility as the dependent variable of a utility function (such as an indifference curve map) and a social welfare function, respectively. They then go on to create more complex models such as the "Edgeworth boxes"

in contract curves that incorporate an effect called the Pareto efficiency measure, which is coupled with production or commodity constraints and accompanied by more assumptions, enables them to deal with welfare economics.

But the fundamental difficulty with all this is the omission of sociological reality. We now understand that economic human behavior can hardly be explained by such an artifice as a utility curve and the concomitant "satisfaction" one might derive from a product-price relationship. Classical economists also understood this but to waive the importance of behavior they employed a number of assumptions to constrain the reality and thus were able to rationalize a convenient structure on which to play out any number of presumptive but hardly reflective activities of consumer action. It is now evident that these self-same assumptions fail in any test for efficacy. Consider that the fundamental assumption in Utility Theory is that the decision-maker always chooses the alternative for which the expected value of the utility is a maximum. If that assumption is accepted, utility theory can be used to predict or prescribe the choice the decision-maker will make, or should make, among the available alternatives. However, in order to accept the assumption it is necessary to accept additional, supporting assumptions, at least 10 in all including that consumers are rational decision-makers, that they are consistent in applying their preferences, that they are Bayesian decision-makers, and so on. If one can draw an analogy it would be where Christmas is explained by Santa Claus who delivers toys to good little boys and girls, the acceptance of that assumption is further based on more assumptions that reindeer pull the sled, are able to fly and that elves make all the toys and they are delivered all in one night to millions of children.

There are additional economic dictums equally suspect, if not greatly problematic. The notion of comparative advantage is questionable as an explicative model asserting the validity of free trade or any other kind of trade. Nations do not trade, individuals and organizations do! The only advantage one might defer to is seen in Michael Porter's competitive model. The theory of the firm is vested in the individual or entrepreneur who is often irrational

and overcomes any scarcity of resources with new knowledge. Then there is the immense deference to consumption theory where economic infrastructures are conveniently ignored.

Historically, few economists have placed the entrepreneur in the central role of explaining economic growth. There have been some, Karlsson, Friis, and Paulsson (2004), Holcombe (1998, p. 60) who cite that "*the engine of economic growth is entrepreneurship*." But for the most part "not the least of which neoclassic economists, place the entrepreneur in the wings." A few studies have placed the entrepreneur within the framework of economic analysis, Goel (1997), Glancey and McQuaid (2000), Yu (1997), and a couple of volumes by Casson (1990) and Livesay (1995). Furthermore, Wennekers and Thurik (1999) and Henrekson (2002) have made the effort to link entrepreneurship and economic growth. However, few studies in economics have established the case for the role of entrepreneurship in the economy. For the most part the convenience of mathematical manipulation was more acceptable than the complexity of creative destruction or entrepreneurship.

Finally, economists have long ignored the vital role that entrepreneurship plays in developing and sustaining an economy. In part the problem was that entrepreneurial behavior did not fit into a box nor did it have a limited number of variables that could easily be set into a formula or subsumed to be held constant while the model was worked. For almost the entire 20th century economists assumed there was no role for entrepreneurship in economic thought. It wasn't until the last decade of the century that entrepreneurship began to show up in economic and recognition was given to its importance in economic growth. Rocha tells us that, "Despite the long time required to achieve its deserved room, entrepreneurship has recently gained an increasing importance as one of the key explanatory factors of economic growth and development."

As we enter the 21st century there is an overpowering need to reassess the foundations of economic thinking and to perhaps build a new structure that more concisely defines economics and its application to the real world. It is clear by any academic examination that economics needs improvement. With one or two

ignored exceptions not one economist, for example, was able to, or could have predicted the 2008 financial crisis. Indeed, they are by any measure unable to predict most events with any accuracy. Studies continue to reveal the consistent failure of economic prognostications. Lester Thurow, former dean of the MIT Sloan School of Management put the issue in place when he noted that, "*One of the peculiarities of economics is that it still rests on a behavioural assumption — rational utility maximization — that has long since been rejected by sociologists and psychologists who specialize in studying human behaviour. Rational individual utility (income) maximization was the common assumption of all social science in the nineteenth century, but only economics continues to use it.*"

Beyond Classical Economics

New findings and developments in this area, referred to as "behavioral economics" are featured in the works of Daniel Kahneman and Amos Tversky, 2002 Nobel laureates, and others who introduced the first move toward economics that is inclusive of human involvement or individualism. More recent works of the author have melded the effects of consumer behavior into a direction of economic thought that advances behavioral economics even further and in step with the reality of the market place (Blawatt, 2008). This is the banner, at least in part of a rational school of economic thinking. It is radical, as compared to mainstream economic thinking yet logical in its methodology. It is a body of thought and investigative analysis that truly requires its own epistemology and school of education. Accordingly, a new program is proposed for a radical new direction without or within the classical school of economics to initiate the new thinking and perhaps, in time to blend it within the discipline as a whole.

There is no little discussion among academics and business managers concerning the efficacy of economic theories now taught in educational institutions. The concepts of demand, comparative advantage, and consumption theory are without foundation and when tested do not stand serious scrutiny. The recent introduction

of "behavioral economics" is taken as a signal that conventional techniques are suspect if not obsolete. There has been no little criticism of the application of utility and expectancy theories since the findings are considered problematic at best and at odds with market behavior (Harrison, Johnson, McInnes, and Rutsrom, 2005). Even the introduction of behavioral economics, "the new interdisciplinary study of the interface … between economics and psychology" (Lea, 2001) does little to move the discipline toward a realistic tableau that better defines individual economic behavior. The effort by Kahneman and Tversky (1979) using a single psychological variable is considered a seminal work toward resolving the ambiguities often found in prior research. The problem is it little matters what variable is singled out for improvement of economic theory there is no one measure, preference, utility, satisfaction, desire, and so on, that can effectively represent individual economic behavior (Foxall, 2003).

A major concern is the use of demand curve analysis. The origin of this artifice can be traced back to Adam Smith, David Ricardo and even before these giants of the discipline to the 13th century writings of Muslim philosopher Ibn Taymiyyah who observed that "if desire for goods increases while its availability decreases, its price rises. On the other hand, if availability of the good increases and the desire for it decreases, the price comes down." Thus for more than seven hundred years this simple observation, which is presumably credited to human behavior has guided economic thought and as a result influenced the results of history over and again with mixed, and some would say catastrophic results. On another tack the topic is not sufficiently scientific as to establish a solid platform from which one might determine solutions of any merit. David Ricardo and John Maynard Keynes, for example, were cited on their conflicting views on inflation where Ricardo proposed it was due to the increase in money supply, while Keynes argued it was due to an increase in aggregate demand (Dooley, 1989).

Many business and economics professionals have criticized the prominence of complex mathematical models built on microeconomic foundations. It is suggested the economics profession rewards mathematical brilliance above a greater practical investigation of empirical data and like all professions economists often

get stuck in defending certain ideologies, seeking to find data to support their own ideology rather than having a greater flexibility to understand when the model gains greater limitations. In part the problem is based on the need to dismiss a number of concepts that have outlived their usefulness. Weintraub (1961) declared that some of the classical elements of Keynesianism should be set aside as was the case for the "cost theory of value, the subsistence theory of wages, the equation of exchange and similar major ideas …"

In consideration of today's economic confusion and the bailout of banks as another example, Krugman (2010) observes that "What's so mind-boggling about this is that it commits one of the most basic fallacies in economics — interpreting an accounting identity as a behavioral relationship. The knowledge that S = I doesn't imply the Treasury view — the general understanding that macroeconomics is more than supply and demand plus the quantity equation — somehow got lost in much of the profession."

However, the use of the demand curve goes beyond the simple explanatory position of demand and the supply of goods. It postulates the existence of an ideal equilibrium point at which place there is a balance, if not harmony to the supply of goods and services at a stable price. An economy is in equilibrium at that point where buyers are presumably content to purchase no more goods and suppliers are willing to produce no more goods since it would only result in lower prices and less profit. So it is that from the setting of corporate pricing to health care administration to great events such as depressions, recessions, wars, and the dynamics of growth, all are interpreted in the light of supply and demand. Schumpeter (McGraw, 2007) disagrees arguing that the change brought about by entrepreneurs makes the idea of equilibrium, for example, misleading.

The Entrepreneurial — Human Behavior Dimension

Classical economic models of behavior have a limited allowance for the role of the individual. The human decision-making process

is not a one-dimension act but is seamed with emotions, motives, experiences as well as the cognitive dimensions of "rationality." The assumption that a chosen single mechanism, touched by a hint of behavior reflects the whole of human action in the acquisition of goods and services is a position that can only be seen as extremely narrow and "ex-academe." Any account of human rational behavior must include the significance of the full scale of human emotions in choice behavior (Simon, 1978).

An individual is compelled by needs, wants, and desires to improve her or his "state of satisfaction," moderated by internal and exogenous variables such as economics, timeliness, involvement level, and so on. Generically, the process is expressed in five steps: (a) problem recognition, (b) search, (c) alternative evaluation, (d) choice, and (e) post purchase behavior. Within this progression Hansen (2000) finds that four elements have an effect on the final buying decision. They are price, quality, involvement, and emotion. His findings are consistent with most descriptive models of consumer decision-making. There is a general overlap of personal, social, and psychological variables with no clear indication that a single item is accountable as an expression of economic behavior. In Hansen's model price has an impact on the buyer's involvement and perception of quality. There is an established association in that an individual might perceive lesser or higher quality in relationship to price. Higher prices may be interpreted to reflect higher quality and vice versa thus quality plays a role in defining ones attitude as well as buying intention. Zeithaml (1988) found there was a defining relationship between price, perception, and quality that establishes a consistency for buyers.

The decision criteria and motivations in purchasing a product or service are then seen to center on two aspects: a physical characterization that implies a promise of performance and a dimension that addresses the perceived value of the item. In the first issue the consumer has an expectation the product has the ability to function as expected to do. Will it fit comfortably if it is a dress? Will it shape steel if it is a manufacturing tool? On the one hand there is the need for an item to perform a simple *utility* function. On the other hand there may be a desire that the item embodies

a number of features and *benefits* that supersede a single, parsimonious function.

The second criterion is the acknowledgment of the investment that has been made in creating the product or service and the acceptance by the buyer of having to compensate for that worth; that is, to pay for the product or service. At one extreme one can appreciate the desire to pay as little as possible, the lowest possible *cost* to the buyer for an item. Commensurately, there is the realization that an item may embody a *value* that is beyond the cost level. In this there is the anticipation of accommodating needs beyond the physical plain to the more intangible level where *value* is a purely subjective perception, matched by a willingness to pay for that prospect at a level well beyond cost. To conclude then, there is an *expectation* as to a product or service in what it will provide to the buyer even as there is a *perception* as to the worth or value of the transaction.

Above all it should be clear that manipulation of the cost has little to do with encouraging or discouraging the number of items purchased over a finite period of time or quantity. The classical demand curve introduces the notion there exists an "elasticity" that can be induced simply by reducing cost or price. In the context of human behavior, including behavior in the purchase for industrial or B2B goods and services, that simply does not happen. If anything it is a wishful artifice that bears no conjunction with reality. The demand curve is a myth. Not everyone wants a particular product at the same time and thus will respond to price. Some a cued to purchase more on perceived value, while others have limited budgets and are not disposed to buy at all no matter the price.

The underlying demand that powers economic activity comes from consumers, institutions, and industries who/that acquire goods and services to their own purpose and desires. Their motivation has its basis on internal needs, wants and requirements that reflect economic considerations as well as psychological and social drives, rather than purely cognitive dimensions as found in arguments about supply, demand and equilibrium theory. The principle drivers of an economy are the behavioral demand expectations of a population, augmented by trend shifts, changes in technology

and global market access, all being directed by a business and entrepreneurial class.

Program for Marconomic and Entrepreneurial Economics

It is therefore proposed the initiation of a new program that has a full understanding of entrepreneurship and entrepreneurial economics that would include more research, experimental work, studies, and social research with others in the discipline. The thrust of this proposed innovative program of economic application would to develop new conceptualizations in human activity, thereby integrating human behavior into a body of testable economics based on inclusion from the social sciences.

The new program could be developmental, building, for example, building on the economic thought of Schumpeter and more recently William Baumol (1922) and Israel Kirzner (1930) and others. It would seek to establish a branch if not school of entrepreneurial economics that is attuned to the 21st century. It would begin with a review of historical thinking from the early trader-entrepreneurs of the 13th century to Cantillon and F. B. Hawley (*e-100*). It would critically examine the instruments of neoclassical economics and proposes alternate methods for economic analysis that reflect the realities of the new economy (*e-200*). It would then explore and develop the role of the entrepreneur in society as he/she creates economic wealth through innovation and creative production (*e-300*). At a forth level the program would develop a production-based model of economic activity (*e-400*) that stresses the role of new technologies (derived from the manufacturing process), innovation and association with the Kondratieff cycle.

Suggested Courses

Econ e-100, Historical Entrepreneurial Economics
The course is a review of economic history from the perspective of philosophers and economic thinkers who developed a body of

literature and theorems that explained the function of man and economic activity through the last 1000 years to the present age. It generalizes a body of knowledge including the mercantilism of the ancients to the subjective individualism of the mid ages and the managed economies of latter years. The role of the Austrian School is examined and a study is presented of the eminent economists who composed this arena of subjective thinking. It includes the chain from Cantillon to J. B. Say to Knight to Kirzner and Baumol with an emphasis on Schumpeter, the Prophet of Innovation.

Econ e-200, Classical Economics: Challenged and Changed

The five cornerstones of conventional economics are examined, parsed, and replaced or modified with alternative methods and concepts. The tenets of supply and demand, comparative advantage, theory of the firm, economies of scale, consumption theory, and others are tested using current knowledge and research studies, evaluated in the light of existing vigorous states and set aside as being difficult if not unnecessary in the current age of innovation, entrepreneurship and dynamic change. In each case the student is introduced to an alternative technology that is behaviorally directed and market-based. The course submits alternative instruments, if not models for evaluating demand performance, competitive advantage, the theory of the firm, and so on.

Econ e-300, Entrepreneurial Microeconomics: The Individual and Society

The works of Joseph Schumpeter and others are the basis for the course that develops a model of the firm-based on the individual and the role of management as the dynamic and creative force that moves the enterprise to create economic wealth. It presents the argument for "creative destruction" and the consequences in building a nation and serving the will of its political institutions. It belies the notion of equilibrium and stresses the role of the entrepreneur in creating new ventures both within and exclusive of the larger organization.

Econ e-400, Macroeconomics: Strategic Economics
The course explores the consequences of the seller-buyer function in the utility-value paradigm (Blawatt, 2008). It examines the strategic variables that cluster basic economic activities into four fields of the managed economy, (Baumol, 2000). Three fields lend themselves to PLC price curve relationships, while the fourth bears comparison to conventional price-volume relationships using PLC curve variation. It examines the function of *the entrepreneurial, the managed and the mass market economies.*

Econ e-410, Economics for Sustainability and Human Scale
The course explores the potentiality of the economics of smaller scale and unlike the drivers of growth and economies of scale philosophies it develops an understanding of the economics of slow and no-grow systems and the derived sustainability within local, regionally developed economies.

Econ e-460, Entrepreneurial Economic Development
Economic creativity begins with individuals; a fact that is relatively immutable. The works of Sirolli (1999), and a number of proponents of creative economic development based on the individual in contrast to reliance of corporate relocation.

Econ e-470, Conscious Capitalism
The study of human values in capitalism and the importance of entrepreneurial people in the organization, attention is placed on the triple bottom line, PPP as well as the Customer-Team (Employees)-Suppliers-Community- shareholders position and importance.

More courses would be developed as needed.

Appendix

What Should Be a Goal for Economics

Successful development can imply many things, such as (though not limited to):

- An improvement in living standards and access to all basic needs such that a person has enough food, water, shelter, clothing, health, education, etc.;
- A stable political, social, and economic environment, with associated political, social, and economic freedoms, such as (though not limited to) equitable ownership of land and property;
- The ability to make free and informed choices that are not coerced;
- Be able to participate in a democratic environment with the ability to have a say in one's own future;
- To have the full potential for what the United Nations calls human development:
  - Human development is about much more than the rise or fall of national incomes. It is about creating an environment in which people can develop their full potential and lead productive, creative lives in accord with their needs and interests.
  - People are the real wealth of nations.
  - Development is thus about expanding the choices people have to lead lives that they value. And it is thus about much more than economic growth, which is only a means — if a very important one — of enlarging people's choices.

Source: What is Human Development? *Human Development Reports, United Nations Development Program* http://hdr.undp.org/en/humandev