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A Note on Rothbardian Decision-Making Rents

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ABSTRACT: In his *Man, Economy, and State*, Murray Rothbard introduces the catallactic function of decision-making owner, and the correspondent income of decision-making ability rent. These are supposed to exist both in ERE (they are, therefore, distinct from the capitalist function and his income, from labor and wages, or land and the corresponding rent) and in the real world permeated by uncertainty (they must also be different from the entrepreneurial function and profit and loss). Even though these concepts seem to suggest an important breakthrough into the theory of the firm, we argue that they are problematic. They must dissolve into (at best, be elaborations of) either the standard economic functions present in the ERE (such as labor, for instance), or the entrepreneurial function.

KEYWORDS: decision-making ability, decision-making rents, ownership function, entrepreneurship, firm

JEL CLASSIFICATION: D20, D21, L20, L21, L26

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INTRODUCTION

One elegant way of solving the problems posed by the theory of the firm would be to discover, within the framework of the classical theory of distribution, an economic (or catallactic, in Misesian terminology) function responsible for the creation[1] of firms. By positively identifying and describing this function, by negatively differentiating it from all other functions and by connecting it to a specific form or share of income, a satisfactory theory of the firm could be provided. Rothbard (2009 [1977], pp. 601–603) comes very close to such an objective[2] through his decision-making owner function and decision-making ability rent. After a very brief restatement of the Misesian-Rothbardian theory of entrepreneurship, we will present these concepts as Rothbard introduced them. Then we will discuss briefly some other instances in which he makes use of them, as well as the source of inspiration the author himself mentioned. After an analytical/theoretical critique of the mentioned concepts, we conclude.

THE MISES-ROTHBARD VIEW OF ENTREPRENEURSHIP

There is no doubt that—at least from a theoretical point of view—the closest disciple of Ludwig von Mises was Murray N. Rothbard. This can also be seen, among the many topics these two giants tackled, in their theory of the entrepreneur. The role or economic function of the latter they both see as uncertainty bearing:

> The term entrepreneur as used by catallactic theory means: acting man exclusively seen from the aspect of the uncertainty inherent in every action. (Mises, 1998 [1949], p. 254)
>
> Like every acting man, the entrepreneur is always a speculator. He deals with the uncertain conditions of the future. His success or failure depends on the correctness of his anticipation of uncertain events. If he fails in his

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[1] More precisely, for the creation and structuring, expansion, reorientation/restructuring, reduction or dismantling of firms.

[2] This was pointed out by Joseph T. Salerno, both in the introduction to Rothbard (2009 [1977], p. xliv) and in Salerno (2008, p. 206). In the study guide to Rothbard (2009 [1977]), Robert Murphy also designates this Rothbardian contribution as "fairly unique" (Murphy, 2006, p. 115).

> understanding of things to come, he is doomed. The only source from which an entrepreneur's profits stem is his ability to anticipate better than other people the future demand of the consumers. (Mises, 1998 [1949], p. 288)

> If all people were to anticipate correctly the future state of the market, the entrepreneurs would neither earn any profits nor suffer any losses […]. What makes profit emerge is the fact that the entrepreneur who judges the future prices of the products more correctly than other people do buys some or all of the factors of production at prices which, seen from the point of view of the future state of the market, are too low […]. On the other hand, the entrepreneur who misjudges the future prices of the products allows for the factors of production prices which, seen from the point of view of the future state of the market, are too high. His total cost of production exceeds the prices at which he can sell the product. This difference is entrepreneurial loss. (Mises, 2008 [1951], pp. 7–8)

> We shall deal further with the nature of profit and loss, but suffice it to say here that the active entrepreneurial element in the real world is due to the presence of uncertainty. (Rothbard, 2009 [1977], p. 434)

> They [the capitalist-entrepreneurs] must advance present money in a speculation upon the unknown future in the expectation that the future product will be sold at a remunerative price. In the real world, then, quality of judgment and accuracy of forecast play an enormous role in the incomes acquired by capitalists. (Rothbard, 2009 [1977], p. 510)

> Entrepreneurship deals with the inevitable uncertainty of the future. (Rothbard, 2009 [1977], p. 552)

A distinguishing mark of the Rothbardian analysis of entrepreneurship is the utmost care not to fall into the Kirznerian ("*propertyless*") interpretation of the Misesian entrepreneur.[3] He always insists, therefore, on the entrepreneur as owner of property. In addition, as one of the quotes above also shows, he always speaks about the *capitalist-entrepreneur*, precisely so as not to deprive of any element the person who copes with uncertainty in the real world. For Rothbard he is most certainly an owner (if not, what is he risking?); he is also a capitalist (advances property/

[3] A much-debated topic in the Austrian economics literature. One of the main points of contention is the view laid out in ch. 2 ("The Entrepreneur") of Kirzner (1973). For outstanding analyses of this matter (and much more) see Salerno (1993) and Hülsmann (1997). For Rothbard's views see Rothbard (1997 [1957], ch. 14, *Professor Kirzner on Entrepreneurship*), for example.

resources within a temporal horizon implying waiting/time); he is an entrepreneur because the future he has in view is uncertain, and the resources advanced in production can be lost. The gross income, therefore, of a real world entrepreneur will be composed of several elements: a wage component (if he also provides labor, such as management); an interest component; and a (pure) profit and loss component.[4]

THE ROTHBARDIAN CONCEPT OF DECISION-MAKING RENTS

It is here that Rothbard introduces a supplementary element which we think is problematic. Namely, he identifies the "ownership function" as sufficiently delineated conceptually by the idea of *decision-making*, some sort of ultimate assuming of the resource allocation responsibility/burden. The owner must decide the allocation of his property/resources. And for this decision, Rothbard "rewards" him with a special form of income: *the decision-making rent* (or the "decision-making ability rent"):

> But is there a function which owning businessmen perform, and would still perform in the ERE, beyond the advancing of capital or possible managerial work? The answer is that they do execute another function for which they cannot hire other factors. It goes beyond the simple capital-advancing function, and it still continues in the ERE. For want of a better term, it may be called the decision-making function, or the ownership function. Hired managers may successfully direct production or choose production processes. But the ultimate responsibility and control of production rests inevitably with the owner, with the businessman whose property the product is until it is sold. It is the owners who make the decision concerning how much capital to invest and in what particular processes. And particularly, it is the owners who must choose the managers. The ultimate decisions concerning the use of their property and the choice of the men to manage it must therefore be made by the owners and by no one else. It is a function necessary to production, and one that continues in the ERE, since even in the ERE there are skills needed to hire proper managers and invest in the most efficient processes; and even though these skills remain constant, the

[4] An (self) insurance premium could also be included; or various other rents, such as for self-provided location, for instance. We ignore these further, as they do not change the substance of our argument.

> efficiency with which they are performed will differ from one firm to another, and differing returns will be received accordingly.
>
> The decision-making factor is necessarily specific to each firm. We cannot call what it earns a wage because it can never be hired, and thus it does not earn an implicit wage. We may therefore call the income of this factor, the "rent of decision-making ability." (Rothbard, 2009 [1977], pp. 601–603)

The total gross earnings of an entrepreneur consist then of up to four possible elements: interest, wage, decision making rent and pure profit/loss. At this point, Rothbard comes dangerously close to the conclusions of the very author he strived so hard to differentiate from: Israel Kirzner. Specifically, by introducing this additional distinct function of ownership and its subsequent (supplementary) form of remuneration/income, he ends up separating—something considered as a shortcoming in Kirzner—ownership from entrepreneurship. If this is not so, and if it is still the ownership function that also receives the profit/loss residuum, then we have a function with two incomes, a situation which violates the "one function—one income" principle implied in the theory of distribution.[5] Not to mention the emptying of the catallactic function of the entrepreneur, that would remain without an income share.

[5] See Hawley (1907, p. 112). Frederick B. Hawley has a very interesting treatment of enterprise and entrepreneurship, very much like that of Mises. Without the sophisticated tools of the latter (such as economic calculation, case probability, specific understanding etc.) he manages to de-homogenize the role of the entrepreneur (or, as he calls him, "enterpriser") from various other contributions to the final product: laborer (including manager), capitalist, and insurer. Apart from his theory of entrepreneurship, he is interesting for his methodology (staunch defender of deductive method). Nevertheless, in his "macro" analysis, he is rather pre-Keynesian, considering the business cycle to be a normal occurrence in market economies due to (natural) disproportions between available savings and possible investment channels. See Topan (2009).

OTHER PLACES IN WHICH ROTHBARD EMPLOYS THE CONCEPT

While Rothbard does not make extensive use of the "decision-making ability" and "decision-making rents,"[6] he does mention (at least one of) them several times in *Man, Economy, and State*. First, there is this place (we quote extensively to better clarify the context; the concepts appear in the second paragraph):

> Labor is usually treated as a perfectly divisible factor, as one that varies directly with the size of the output. But this is not true. As we have seen, the truck driver is not divisible into fractions. Further, management tends to be an indivisible production factor. So also salesmen, advertising, cost of borrowing, research expenditures, and even insurance for actuarial risk. There are certain basic costs in borrowing which simply arise from investigating, paperwork, etc. These will tend to be proportionately smaller the larger the size—another indivisibility, with returns increasing over a certain area. Also, the broader the coverage, the lower insurance premiums will be.
>
> Then there are the well-known gains from the increase in the division of labor with larger outputs. The benefits from the division of labor may be considered indivisible. They arise from the specialized machines that must first be used with a larger product, and similarly from the increased labor skills of specialists. Here too, however, there is a point beyond which no further specialization is possible or where specialization is subject to increasing costs. Management has usually been stressed as particularly subject to overutilization. Even more important is the factor of ultimate-decision-making ability, which cannot be enlarged to the extent that management can.
>
> What any given firm's size and output will be is therefore subject to a host of conflicting determinants, some impelling a limitation, some an expansion, of size. At what point any firm will settle depends on the concrete data of the actual case and cannot be decided by economic analysis. Only the actual entrepreneur, through the give and take of the market, can decide where the maximum-profit size is and can set the firm at that point. This is the task of the businessman and not of the economist. (Rothbard, 2009 [1977], pp. 597–598)

Then, after the standard quote provided above, Rothbard mentions the decision-making rents again in chapter ten, when

[6] The same can be said about other concepts touched upon in Rothbard's works, such as "quasi-money" (Rothbard, 2009 [1977], pp. 826–827).

discussing monopoly profits versus monopoly gains to factors of production:

> The monopoly gains must, then, be imputed to either labor or land factors. In the case of a *brand* name, for example, a certain *kind* of labor factor is being monopolized. A name, as we have seen, is a unique identifying label for a person (or a group of persons acting co-operatively), and is therefore an attribute of the *person* and his energy. Considered *generally*, labor is the term designating the productive efforts of personal energy, whatever its concrete content. A brand name, therefore, *is an attribute of a labor factor*, specifically the owner or owners of the firm. Or, considered *catallactically*, the brand name represents the *decision-making rent* accruing to the owner and his name. (Rothbard, 2009 [1977], p. 679; his emphases)

And fifteen pages later, in the same chapter and a similar context:

> Yet many monopolized […] factors are labor factors—such as brand names, unique services, decision-making ability in business, etc. (Rothbard, 2009 [1977], p. 694)

In all these instances, Rothbard seems to assimilate, more or less, the income of decision-making to a type of wage, and to view the decision-making ability as some sort of labor. This can also be found in other works of the great Austrian master. For instance somewhere else, he says:

> The fact remains that just as the costumer earns interest plus managerial wages plus profit, so will a landowner earn interest plus managerial wages plus profit (and "wages" can include wages of "decision-making"). The profit goes to better forecasters, and poorer ones will suffer losses.[7]

For now let us just notice the tension in Rothbard's usage of the concept. On the one hand decision-making is not labor, as it is something logically antecedent to it. Someone has to decide the hiring of laborers (and, presumably, actually hire them, managers included). On the other, it is labor, even if a special type of labor

[7] Rothbard (1997 [1957], p. 308). It is rather peculiar that Rothbard includes, on the previous page, entrepreneurship in the labor category: "Over the whole economy, then, the prices of capital goods are imputed back to land and labor, until finally, the *net* incomes are earned by: land, time, labor (including entrepreneurship)."

(some unique ability or talent, possibly even associated with a brand name).

ROTHBARD'S SOURCE OF INSPIRATION

In a footnote,[8] Rothbard indicates as his source of inspiration a "fertile, but neglected hint" of Eugen von Böhm-Bawerk, who in the introduction to his *Capital and Interest* wrote the following:

> But even where he [the undertaker (BB)/the businessman (MR)] does not personally take part in the carrying out of the production, he yet contributes a certain amount of personal trouble in the shape of intellectual superintendence – say, in planning the business, or, at the least, in the act of will by which he devotes his means of production to a definite undertaking. (Böhm-Bawerk, 1890, p. 8)

So far, it seems that a decision-making function is suggested. But Böhm-Bawerk goes on like this (again, we quote extensively so as not to miss the context):

> The question now is whether, in view of this, we should not distinguish two quotas in the total sum of profit realized by the undertaking; one quota to be considered as result of the capital contributed a second quota to be considered as a result of the undertaker's exertion.
>
> On this point opinions are divided. Most economists draw some such distinction. From the total profit obtained by the productive undertaking they regard one part as profit of capital, another as undertaker's profit. Of course it cannot be determined with mathematical exactitude, in each individual case, how much has been contributed to the making of the total profit by the objective factor, the capital, and how much by the personal factor, the undertaker's activity. Nevertheless, we borrow a scale from outside, and divide off the two shares arithmetically. We find what in other circumstances a capital of definite amount generally yields. That is shown most simply by the usual rate of interest obtainable for a perfectly safe loan of capital. Then, of the total profit from the undertaking, that amount which would be enough to pay the usual rate of interest on the capital invested in it, is put down to capital, while the remainder is put to the account of the undertaker's activity as the profit of undertaking. […]

[8] Footnote 50, p. 602 of Rothbard (2009 [1977]).

> On the other hand, there are many, especially among the younger economists, who hold that such a division is inadmissible, and that the so-called undertaker's profit is homogeneous with the profit on capital.
>
> This discussion forms the subject of an independent problem of no little difficulty—the problem of the Undertaker's Profit. The difficulties, however, which surround our special subject, the problem of interest, are so considerable that I do not feel it my duty to add to them by taking up another. I purposely refrain then from entering on any investigation, or giving any decision as to the problem of undertaker's profit. (Böhm-Bawerk, 1890, pp. 8–9)

Böhm-Bawerk, by deliberately trying to restrict his inquiries to the phenomenon of interest, avoids altogether the thorny question of profit and of the specific economic function thereby remunerated. While he indeed suggests a decision-making function, he does not speak (or suggest, I think) a decision-making rent. And when considering the corresponding income share of the said function, he speaks about profit. Two possible roads open up at this point: (1) either Böhm-Bawerk would have elaborated on the undertaker's contribution apart from labor as *the* entrepreneurial function, remunerated with profit; and, as he abstracted from/assumed away uncertainty in his concept of the "perfectly safe loan" in order to more precisely delimit the role of capital and the fundamental source of interest, this entrepreneurial function would have most probably incorporated uncertainty. (2) Or, he would have discussed this "act of will" type of undertaker's contribution in the context of certainty (or in ERE, as Rothbard has put it); but, then again, what remains of the idea of entrepreneurship as uncertainty bearing?

Whatever Böhm-Bawerk might have thought on these matters is, in a sense, irrelevant. It is not uncommon for later authors to rescue insights from previous ones, and to use them in ways that would have totally surprised the latter. Rothbard's insight, then, must be judged on its own merit. To this we now turn.

AN ANALYTICAL CRITIQUE OF THE CONCEPT

Let us take a closer look at the decision function and the decision-making rents to see if they hold water. A fundamental question to be answered immediately would be: can these rents be negative? Rothbard's answer is no (Rothbard, 2009 [1977], pp. 603–604), and is based on his standard analysis of rent (which must always be positive—no matter how small, but positive—in order to induce the factor owner to partake in the production process). But what is "rewarded" through these (positive) rents when there are losses and in his capacity as entrepreneur the owner has failed to correctly forecast the relevant market data? (He made a wrong judgment; can we in some sense emphasize only the fact that he *made* a decision nevertheless?) We would be in the strange—if not outright contradictory—situation of rewarding the individual (as owner) for the mere fact that he took a decision, only to concomitantly penalize him (as entrepreneur) for his uninspired decision. Does not, one wonders, the idea of decision-making imply the desideratum of *successful* decision-making?[9] And, if so, does not successful decision-making refer to uncertainty bearing and overcoming?

We have stumbled here upon a thorny question: up to what point, and for what purposes is ERE as such useful? Specifically, what remains of decision-making in ERE? Rothbard himself seems to suggest in another place that the answer might be "nothing":

> In the ERE, where all techniques, market demands and supplies, etc., for the future are known, the investment function becomes purely passive and waiting. There might be a supervisory or managerial labor function, but this can be analyzed under prices of labor factors. (Rothbard, 2009 [1977], p. 434)

[9] Even if it might look like we are torturing a bit the texts to find arguments on our side, there are instances in which Rothbard suggests decision-making comes with success/failure, and cannot be meaningfully separated from uncertainty (and, therefore, confined to, and isolated in ERE). Thus, in *Ethics of Liberty*, he says at some point that: "If Crusoe had eaten the mushrooms without learning of their poisonous effects, then his decision would have been *incorrect*—a possibly tragic error based on the fact that man is scarcely automatically determined to make correct decisions at all times." (Rothbard, 1998 [1982], p. 32) And again: "The less farsighted entrepreneurs suffer losses for poor handling of decisions under uncertainty." (Rothbard, 1998 [1982], p. 39, n. 3) Passages of this sort can also be found in *Man, Economy, and State*: "In addition to the capital-supplying function, the corporate capitalists also assume the *entrepreneurial* function: the crucial directing element in guiding the processes of production toward meeting the desires of the consumers. In the real world of uncertainty, it takes sound judgment to decide how the market is operating, so that present investment will lead to future profits, and not future losses." (Rothbard, 2009 [1977], p. 434)

On the other hand, if we were to suppose that decision-making rents can be negative, it becomes very difficult to understand what the difference would be between them and profits/losses. They both vary; they can both be positive or negative. Moreover, they must both pertain to ownership, as otherwise the question arises: if decision-making pertains to ownership, to what does uncertainty bearing pertain? (If the answer were again "entrepreneurship", what would this concept still mean?)

One route has been left in suspension above, when we discussed Rothbard's inclusion of the decision-making function under labor factors (and of the decision-making rents under "wages"). That is, the implied suggestion that it might be fruitful to separate within the broader category of labor, a special subcategory, special enough so that it deserves a separate and dedicated catallactic function, together with a form of income. While not without merits, this idea falls under heavy fire by Rothbard himself elsewhere:

> Catallactically, labor is hired by entrepreneur-capitalists. It is grossly unscientific to separate laborers into arbitrary categories and to refer to one group as "labor" and "workers," while the other group receives various other names. To give them other names implies a difference in *kind* between their contribution and the contribution of others, but this difference does not exist. (Rothbard, 2009 [1977], p. 565)

WHAT'S AT STAKE?

Succinctly put, the problem is the following: will the Austrian theory of the firm be an *entrepreneurial theory of the firm*, or a *decision-making ability theory of the firm*? Which one is the fundamental/essential aspect, and provides for *the nature* of the economic phenomenon of the firm?

An element of appeal in this perspective (the one accepting the decision-making rents concept) could be the idea of *specificity* induced into the activity of the businessmen. Some affinities with the resource-based theories of the firm are immediate[10] (even though the Rothbardian theoretical edifice in its entirety permits

[10] See, *e.g.*, Nelson (1991).

a quite thorough criticism of such theories). Professor Joseph Salerno, for instance, builds up the concept of the "real/integral entrepreneur" by means of the integration of the ownership, capitalist and entrepreneurial functions:

> An important sidelight of this integration of the ownership function with the capitalist and uncertainty-bearing functions is a new perspective on the nature and organization of the firm. The firm appears now as the projection of the owner's personality, with all its cognitive and temperamental idiosyncrasies, into objective reality. Each firm's organization is shaped to accommodate the unique decision-making ability of the owner and it is perpetually transformed in a dynamic world by his decisions. The firm's organization is, furthermore, the immediate source of the integral entrepreneur's decision rents. (Salerno, 2008, p. 206)

Nevertheless, in my opinion, the specificity element does not by itself justify the introduction of the above-discussed new element (decision-making rents). Seeing human action under uncertainty exactly for what it is—real world human action—at once implies that entrepreneurial judgments must be as *specific* as possible.[11] Moreover, profit and loss can account for the correctness of specific (idiosyncratic, even) entrepreneurial judgments or decisions:

> Most uncertainties are uninsurable because they are unique, single cases, and not members of a class. They are unique cases facing each individual or business; they may bear resemblances to other cases, but are not homogeneous with them […]. Estimates of future costs, demands, etc., on the part of entrepreneurs are all unique cases of uncertainty, where methods of specific understanding and individual judgment of the situation must apply, rather than objectively measurable or insurable "risk." (Rothbard, 2009 [1977], pp. 554–555)

> The entrepreneur, in making his decisions, is on the contrary confronted with unique cases about which he has some knowledge and which have only limited parallelism to other cases. (Rothbard, 1956, p. 19)

As for the "high" versus "low" cost firms in any line of business, they can be explained at least in two ways, without the need for the special (ERE) decision-making ability. On the one hand, the

[11] One could define entrepreneurial judgments, along Misesian lines, as referring to *particular* circumstances of time, place and persons from the future. See Topan (2005), for instance.

possibility of error implies the possibility of being way off target, or just a bit off the mark. This would suffice to explain differences in profit, although it is true that these would have to be of a rather ephemeral nature. As for the more lasting differences, the idea of non-monetary income (or even direct consumption) could explain the constantly low profits (high costs) of skillful entrepreneurs who (for instance) opt for poor commercial locations because they are closer to their home.

CONCLUSION

It is our conviction, therefore, that the separation of the ownership and entrepreneurship functions even at the theoretical level (therefore as catallactic functions, as opposed to real persons) remains problematic. The "residual" functions of property/ownership—isolated by the elimination of labor and waiting elements[12]—imply at once both uncertainty bearing and decision-making.

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[12] As well as implicit insurance premiums or various land rents, if such is the case.

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