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The non-productive entrepreneurial process

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Abstract A large literature explores the importance of entrepreneurship as the catalyst of economic progress. In contrast, this paper argues that entrepreneurs are the driver of economic stagnation. We analyze the non-productive entrepreneurial process and discuss three channels through which non-productive activities have a multiplier effect culminating in economic decline and stagnation. Drawing on examples of non-productive entrepreneurship from both underdeveloped and developed countries, we provide insight into why economic stagnation persists in the former and why economic decline can occur in the latter.

Keywords Economic development · Entrepreneurship · Institutions

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1 Introduction

Could entrepreneurship be the catalyst of economic stagnation? Typically, entrepreneurship is viewed in the positive context of increased efficiency and

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economic growth (see, for example, Audretsch 2006; Audretsch et al. 2006; Harper 2003; Holcombe 1998; Kreft and Sobel 2005). Along similar lines, the market process literature emphasizes the dual role of the entrepreneur as an arbitrageur and as an innovator (see Kirzner 1973, 1992, 1997). As an arbitrageur, the entrepreneur continually reallocates resources in a more efficient manner which pushes the economy closer to a given production possibilities frontier. As an innovator, the entrepreneur shifts the entire production possibilities outward, allowing for higher levels of output for a given level of inputs. This real increase in output, due to a real increase in productivity, is the essence of economic growth.

A related literature explores different 'types' of entrepreneurship. Baumol (1990) differentiates between productive, unproductive, and destructive entrepreneurship.[1] Productive entrepreneurship refers to the aforementioned, positive-sum acts of arbitrage and innovation resulting in economic growth. In contrast, unproductive and destructive (i.e., non-productive) entrepreneurship is inherently predatory in nature because non-productive entrepreneurs seek transfers from those who are productive. Such acts benefit the non-productive entrepreneur while reducing social welfare.[2] Examples would include rent-seeking and crime.

There are two implications of recognizing the different types of entrepreneurship. First, institutions are central because they influence the payoffs associated with the various types of entrepreneurship. Second, while entrepreneurship can be beneficial (i.e., productive entrepreneurship) in terms of increased efficiency and growth, it can also be a determinant (i.e., non-productive entrepreneurship) to the allocation of resources and economic development. While the existing market process literature provides insight into the process through which productive entrepreneurship takes place, there is no equivalent for non-productive entrepreneurship. The purpose of this paper is to fill this gap.

Our core thesis is that entrepreneurs are the driver of economic stagnation. While entrepreneurs can be a source of increased efficiency and growth, they can also be a catalyst of economic decline and underdevelopment. We explore the non-productive entrepreneurial process, and in doing so, illuminate the various channels through which one non-productive activity can generate subsequent non-productive opportunities culminating in economic decline and stagnation. Drawing on examples of non-productive entrepreneurship from both underdeveloped and developed counties, we provide insight into why economic stagnation persists in the former

[1] For an empirical test of Baumol, see Sobel (2008). Using a variety of measures for institutional quality, productive entrepreneurship and unproductive entrepreneurship, Sobel finds that Baumol's theory holds. Where the payoff to engaging in unproductive activities is relatively high, entrepreneurs will tend to exploit those opportunities at the expense of productive opportunities which contribute to economic growth. Also relevant is Murphy et al. (1991) who analyze the proportion of engineers to lawyers. They conclude that a high level of engineers has a positive impact on growth and a large number of lawyers have a negative effect because of a high level of rent-seeking. The underlying idea is that lawyers can be productive in enforcing existing laws and rules. However, lawyers can also be unproductive because they play a key role in the rent-seeking process.

[2] Coyne and Leeson (2004) build on Baumol by adding an additional category for evasive entrepreneurship. Evasive activities include the expenditure of resources and efforts in evading the legal system or in avoiding the unproductive activities of others. Examples of evasive activities include tax evasion and bribes paid to avoid burdensome regulations. Like unproductive and destructive activities, evasive activities involve the creation of deadweight losses.

and why economic decline can occur in the latter. While a situation where all entrepreneurship is productive is a 'first best' outcome, real-world economies are characterized by a mix of productive and non-productive activities. As such, we need to understand not only the process of productive entrepreneurship, but also the non-productive entrepreneurial process.

The importance of the non-productive entrepreneurial process can be traced back to Adam Smith's discussion of "publick debts." Smith (1776: 930) noted that "it [the public debt] occasions a general and most pernicious subversion of the fortunes of private people; enriching in most cases the idle and profuse debtor at the expence of the industrious and frugal creditor, and transporting a great part of the national capital from the hands which were likely to increase it and improve it, to those which are likely to dissipate and destroy it." Smith's point is that public debt often transfers resources from productive to non-productive activities. Our goal is to explore and generalize the implications of this insight by understanding how non-productive activities emerge and create subsequent non-productive opportunities.

Our analysis contributes to several strands of literature, the first of which is the existing market process literature discussed above. Within this literature, our analysis is closest to Holcombe (1998) who explores the connection between entrepreneurship and economic growth, and specifically how economic growth occurs in a market setting. He concludes that the actions of entrepreneurs "…create an environment within which innovations build on themselves, leading to continually increasing productivity" (1998: 47). Although not explicitly stated, Holcombe's main focus is clearly on the activities of productive entrepreneurs.

The current paper can be seen as the flipside of Holcombe's analysis. We argue that, like economic growth, economic stagnation is the result of previous entrepreneurial activities. While Holcombe is correct to conclude that one productive activity generates subsequent entrepreneurial activities, it is also the case that one non-productive activity generates subsequent non-productive activities. Ultimately, the ability to experience and sustain development is a function of whether the benefits of productive entrepreneurial activities trump the negative effects of non-productive entrepreneurial activities. This helps to explain why some countries can become mired in economic underdevelopment. Where institutions encourage non-productive activities, entrepreneurs will tend to exploit those opportunities. In doing so, they create subsequent non-productive opportunities. Each non-productive activity has a multiplier effect contributing to further decline. From this standpoint, non-productive entrepreneurial activity is the catalyst of economic decline and stagnation.

Our analysis also contributes to the literature on the rise and decline of nations. Olson (1982) argued that distributional coalitions could lead to economic decline through rent-seeking. Further, he claimed that stable democracies, without some form of substantial upheaval or shock (e.g., war, revolution, natural disaster, etc.) would tend to accumulate an increasing number of distributional coalitions. Our analysis provides insight into how distributional coalitions can accumulate and how wealthy countries can experience economic decline. One non-productive activity generates several others and this process continues resulting in economic stagnation.

We proceed as follows: the next section provides an overview of the institutional view of economic development, which emphasizes that alternative institutional

environments generate different payoffs to productive and non-productive activities. The dominance of productive or non-productive activities, in turn, determines economic growth or the lack thereof. Section 3 provides insight into the non-productive entrepreneurial process. We explain how the cause of economic stagnation is non-productive entrepreneurship and, more specifically, the subsequent opportunities created by non-productive activities. In doing so, we identify three main channels through which one non-productive activity creates subsequent non-productive opportunities. Section 4 reviews the implications of our analysis while Section 5 concludes.

2 The institutional view of economic development and stagnation

Institutions are the formal and informal rules governing human behavior (see North 1990, 1991).[3] Examples of formal rules include codified legal and political structures, as well as written rules such as constitutions. Informal rules include culture, norms, and conventions not backed by formal law, but by social custom. Institutions provide the general rules of the game which facilitate economic, social and political interactions. In providing the rules of the game, institutions establish or alter incentives by influencing the costs and benefits associated with certain types of activities. Boettke and Coyne (2003), Coyne and Leeson (2004) and Sautet (2005) make the connection between institutions and the type of entrepreneurship that emerges in different societies. Where the net payoff to productive entrepreneurship is high relative to that associated with non-productive entrepreneurship, productive activities will dominate and vice versa.

All existing economies are characterized by a mix of productive and non-productive activities. The central issue is which type of activity is dominant. Where the beneficial effects of productive entrepreneurship trump the negative effects of non-productive activities, development and growth are possible. However, where the negative effects of non-productive activities are the dominant force, economic decline and stagnation will result. The dominant type of entrepreneurship, and hence development or the lack thereof, is a result of the existing institutional constraints. Development ultimately requires effective constraints on non-productive activities. Absent such constraints, productive activities will provide an incentive for increased non-productive activity which will, in turn, weaken the incentive for subsequent productive activities.

The institutional view has important implications for development. Many discussions of development center on the level of certain inputs into growth—e.g., monetary aid, human capital, physical capital, etc. (see Easterly 2001). However, the main implication of the institutional view of development is that while inputs clearly matter for economic outcomes, they will only contribute to growth when formal and informal institutions are conducive to productive entrepreneurship. In contrast, where institutions attach a relatively high payoff to non-productive entrepreneurship, economic decline and underdevelopment will persist, no matter what the level of inputs.

One example of this logic is the failure of foreign aid to lift the poorest countries out of poverty. An existing literature ties the failure of aid to the absence of institutions

[3] For a history of institutions in Austrian economics, see Garrouste (2008).

which provide the proper incentives and information for assistance to be used in a way which contributes to economic development (see Easterly 2001, 2006; Moyo 2009; Williamson 2010). Even a high level of inputs—in this case foreign aid—will fail to have the desired effect without certain institutional arrangements to provide an incentive for those inputs to be transformed into value-added outputs.

The institutional view emphasizes that economic development involves an increasingly complex structure of production employing heterogeneous capital (see von Bohm-Bawerk 1884; Hayek 1941; Kirzner 1986). At the center of the production process is the productive entrepreneur who is alert to previously unseen profit opportunities (Kirzner 1973, 1997). In exploiting these opportunities through arbitrage and innovation, entrepreneurs contribute to increased efficiency. In addition to increasing efficiency, productive activities also generate positive externalities. Along these lines, Holcombe (1998) emphasizes that in exploiting profit opportunities, productive entrepreneurs "…create new entrepreneurial opportunities that others can act upon. Entrepreneurship creates an environment that makes more entrepreneurship possible" (Holcombe 1998: 51). This explains why countries experience economic development and growth. Productive entrepreneurs not only increase efficiency, but also create an array of subsequent productive opportunities for other entrepreneurs. In other words, productive entrepreneurial activities have a multiplier effect resulting in increases in the extent of the market which is critical for economic development.

How then do we explain economic stagnation? The institutional view attributes underdevelopment not to a lack of inputs, but rather to a lack of incentive for productive activities. Holcombe (1998: 56) notes that, "…a stagnant economy blunts the incentives for entrepreneurial activity, and can remain stagnant because of the lack of entrepreneurial activities." This, however, misses the point. Economic stagnation, like economic growth, is not the result of a lack of entrepreneurial opportunities, but rather a result of previous non-productive activities which created subsequent non-productive opportunities. The issue is not the absence of entrepreneurial activity, but rather the type of opportunities which are dominant. While the institutional view explains why entrepreneurs engage in productive or unproductive activities, it does not, by itself, explain where entrepreneurial opportunities come from. Holcombe (1998) concludes that productive entrepreneurial opportunities come from prior productive activities. However, an equivalent understanding of where non-productive entrepreneurial opportunities come from is currently lacking. The purpose of the next section is to fill this gap.

3 The non-productive entrepreneurial process

Where do non-productive opportunities come from? They come from previous non-productive opportunities. Similar to productive entrepreneurship, non-productive entrepreneurship benefits the individual entrepreneur, at the expense of productive entrepreneurs, but also has externality effects in terms of creating subsequent non-productive opportunities. In non-static economies characterized by constant change, new entrepreneurial opportunities are continually being created. "When entrepreneurs take advantage of some opportunities, the economic environment changes, creating with it additional opportunities. Thus, entrepreneurship leads to more

entrepreneurship" (Holcombe 1998: 54). As noted, much of the existing literature focuses on this process in the context of productive activities. However, the same logic can be applied to non-productive activities with a drastically different outcome. Just as one productive activity creates several other productive opportunities, so too does each non-productive activity lead to several other non-productive activities. While the multiplier effect associated with productive entrepreneurship contributes to development and growth, the multiplier effect associated with non-productive entrepreneurship contributes to economic decline and stagnation.

There are three main channels through which the multiplier effect associated with unproductive entrepreneurship operates. First, as noted above, a non-productive activity leads to changes in the status quo. This is the process of 'creative destruction' whereby the existing economic environment is disrupted due to an act of entrepreneurship.[4] The disruption of the existing equilibrium results in new profit opportunities. Typically, creative destruction is discussed in the context of productive entrepreneurship. However, there is no reason that this same logic cannot be extended to acts of non-productive entrepreneurship. As Olson (1982: 42) notes, in diverting resources to secure more income for their members, special-interest groups not only reduce social output directly, but also shift the "pattern of incentives in the society…in ways that can vastly reduce the level of production."

The second channel, which is closely related to the first, is that non-productive entrepreneurship leads to new non-productive niches for profit. While the first channel focuses on the change to the status quo, the second channel recognizes that those changes create entirely new market niches for other non-productive entrepreneurs. These new market niches create an array of subsequent non-productive activities and the process continues in a similar fashion.

To provide an example of these two channels, consider the analysis by Holcombe (1999) of the growth of government during the Progressive era in the twentieth century. He identifies the Civil War veterans as the first large-scale interest group to secure monetary transfers from the U.S. Treasury. Veterans were effective in securing rents for two reasons. First, they were a well-organized interest group. Second, they were able to justify their actions in terms of their patriotic service to their country which legitimized their claim for redistribution.

In the context of our analysis, the lobbying efforts of the veterans, which began around 1870, had two important effects. First, the veterans themselves benefited from trading votes for monetary transfers. As Holcombe notes, "As the history of the period shows, benefits were viewed as payments to an interest group rather than an activity furthering the common good. There was substantial political debate on the subject, and political campaigns consciously considered the payment of veterans benefits as a way to buy the support of that voting bloc" (Holcombe 1999: 321). Second, the transfers "opened the door for others to petition the federal government to protect their economic interest, and the federal government was transformed, in the period from the Civil War to World War I, from a protector of individual freedoms to a promoter of economic interests" (Holcombe 1999: 324). In other words, the non-productive activities of the Civil War veterans disturbed the existing equilibrium and, in the

[4] For a discussion of the differences between Kirznerian entrepreneurship and Schumpeterian entrepreneurship, see Kirzner 1973: 72-75, 1999.

process, created opportunities for subsequent non-productive entrepreneurs to seek transfers. The success of the veterans created new market niches in lobbying by well-organized interest groups. As Holcombe indicates, the cumulative effect of this process was to change the very nature of the government and political apparatus.

As another example, numerous studies have explored the impact of political interest groups and their effects on the passage of state antitrust legislation, which culminated in the federal passage of the Sherman Antitrust Act of 1890 (DiLorenzo 1985; DiLorenzo and High 1988; Toresken 2002; Boudreaux and DiLorenzo 1993). These studies show how early lobbying by agrarian and other small business groups in Southern and Western States led initially to various states passing antitrust and anti-monopoly laws, and eventually to the emergence of more centralized interest groups supporting the Federally mandated Sherman Antitrust Act.

Consider that Maryland became the first state to pass antitrust legislation in 1867 and that by 1893 there were 24 states which had followed suit. Of these, 15 states passed their own antitrust laws between 1889 (the year before the Sherman Act) and 1890 (the year of the Sherman Act). It has been noted that much of this legislation came in direct response to growing agrarian movements, which had historically wielded political power in southern and western states. Some of the earliest and strongest movements came from cotton farmers in Georgia, Mississippi, and Tennessee who were increasingly seeing their cotton replaced with more cost effective jute for various materials (DiLorenzo 1985). These groups became increasingly influential as their central goal became the promotion and protection of smaller farmers from the competitive pressures created by the emergence of more efficient, large-scale, farms.[5]

Over time, these groups were able to slowly make inroads within the political process of their respective state legislatures (the first channel discussed above). As this success became more visible many other groups followed suit within their states (the second channel discussed above). Eventually, these efforts led the Western agrarian societies and interest groups, along with small business counterparts of numerous northern states, to directly petition the Federal government for antitrust legislation.

In his comprehensive study of the letters of John Sherman, Toresken (2002) notes that although no agrarian groups directly lobbied Senator Sherman for protection from more efficient and large-scale firms, numerous small business and small manufacturing groups did. The most ardent of these groups were small oil refiners who were constantly encroached upon by Rockefeller and Standard Oil. Further, although it would seem that Sherman received no direct petitions from organized agrarian groups, DiLorenzo (1985) finds that members of the 51st Congress (which passed the Sherman Act) received no less than 64 petitions from national and Midwestern agrarian interests, many of whom had built momentum and capital within their respective state legislatures.

As this would all suggest, American antitrust policy was initially driven by profit seeking interest groups at the state level who sought to insulate themselves from competitive pressures. The success of these groups created subsequent opportunities

[5] The fact that antitrust laws were used by non-productive entrepreneurs to insulate themselves from competitive market forces is supported by DiLorenzo (1985) who finds that of the 17 industries accused of forming trusts and acting monopolistically in the 1880–1900 period, all of them actually increased output and reduced price; the exact opposite of what the theory of monopoly would suggest should happen and in complete contradiction to the intent of antitrust legislation.

at the local and federal levels culminating in the passage of the Sherman Antitrust Act of 1890. The Sherman Act created subsequent opportunities for non-productive entrepreneurial activity which are evident today (see Armentano 1990). One consequence of the Sherman Antitrust Act is that firms are now able to avoid direct lobbying and may simply accuse competitors of anticompetitive behavior and bring suit within the court of law through the process of treble damages. One recent and notable example of this behavior is the numerous lawsuits brought against Microsoft by AOL, Sun Microsystems, and other competitors (see McAfee and Vakkur 2005).

A connection can be made here with the existing literature on 'political entrepreneurship,' which refers to the use of the political apparatus to secure rents at the expense of broader social well being (see Wagner 1966; DiLorenzo 1988). Political entrepreneurs include political actors (elected or non-elected) who seek to maximize utility through the political process, as well as private citizens who use the political apparatus to secure rents through subsidies, protectionism, and other arrangements between business and government. The existing literature in this area focuses on the damaging effects of political entrepreneurship. Our analysis complements this literature by emphasizing the externality aspects of political entrepreneurship. The Civil War veterans, small farmers, and related business associations were all political entrepreneurs and illustrate how political entrepreneurship can erode existing wealth by creating subsequent opportunities for further non-productive activities creating market niches for lobbying and redistribution.

The third channel through which non-productive activities multiply is through their effect on social networks and the structure of social capital which, in turn, influences the extent of the market for other non-productive opportunities. In the broadest sense, social capital refers to "the investments we make in relationships…and the social norms (such as trust, reciprocity, social sanctions, and authority) that emerge out of such investments help us to 'get things done' both in the market and in the wider social realm" (Chamlee-Wright 2008: 41). Chamlee-Wright (2008) interprets the concept of social capital through an Austrian lens and concludes that social capital, like physical capital, consists of heterogeneous elements with specific uses. This has important implications for understanding the process of non-productive entrepreneurship. Like productive activities, many non-productive activities rely on well-formed social networks. Once in place, these networks yield benefits which make changes to the structure of social capital costly. This has implications for the creation of new non-productive opportunities as well as the transferability of social capital between industries, occupations, and institutional arrangements.[6]

[6] Non-productive activities also influence mental models regarding perceptions of profitable entrepreneurial opportunities. North (2005) emphasizes that norms and culture determine the performance of a society over time by framing the perceptions of individuals regarding opportunities and alternatives. Further, a growing economics literature drawing on psychology finds that a society's culture, in the form of values, beliefs, and norms, influences interactions through individual's perceptions of their 'locus of control' and 'self-efficacy' (see Lane 1991; Harper 2003). In the context of our analysis, this implies that as an increasing number of entrepreneurs engage in non-productive activities, their actions can influence broader perceptions regarding what profitable entrepreneurial activities entail. Where non-productive activities dominate, they will contribute to the perception that engaging in non-productive activities is what entrepreneurs do to profit. As more and more people frame entrepreneurial activity in this manner, it further contributes to the perpetuation of non-productive activities and the associated negative effects.

Keeping in mind that social capital is heterogeneous and therefore has specific uses, in cases where social capital supports productive activities, it will tend to be transferable to others productive activities. To understand this logic, consider a case where an industry which was previously productive in nature becomes obsolete due to innovation. During the time that the industry operated, social networks were developed which supported its productive activities. With the end of the industry, that social capital can be transferred to other productive activities. Likewise, in industries where social capital specific to non-productive activities exists, it will tend to be transferrable to other non-productive activities. For example, consider a 2005 report by Public Citizen (2005) which studied the number of former members of U. S. Congress who transitioned to the lobbying industry following their time in public office. The report found that 43% of the 198 members eligible to lobby, who left Congress since 1998, have become registered lobbyists. Similarly, 50% of eligible departing senators and 42% of eligible departing House members became registered lobbyists.

The logic behind this finding is straightforward in the context of our analysis. During their time in elected office, politicians build social capital within the context of the political process. When they leave office they enter industries, such as lobbying, where they can profit from their existing social capital. Further, as they transition to lobbying, these former politicians create new opportunities for unproductive activities by serving as a liaison between paying clients and their existing social networks in Washington, D.C. In the role of a middleman between private citizens and politicians, the lobbyists reduce the cost of lobbying and rent-seeking.

Foreign aid provides another example of how transfers create context-specific social capital that is not easily transferable to productive activities. In providing aid, a central issue is the 'Samaritan's Dilemma,' which emphasizes that the provision of aid shifts the incentives facing recipients (see Buchanan 1975). In providing aid, the Samaritan creates a disincentive for recipients to save and invest leading to a dependency on the continued provision of aid. Moreover, aid recipients invest resources in establishing networks and relationships which maximize the amount of aid received. For example, an existing literature on foreign aid shows how corrupt governments shift resources to capture the rents from foreign aid (see Maren 1997; Easterly 2001, 2006; Moyo 2009). Once these networks are in place, they can have the counterproductive effect of making change toward liberal market and political institutions that much more difficult given the rent-seeking nature of the status quo.

4 Implications

Our analysis yields five implications. First, entrepreneurial opportunities are endogenous to the process of economic and political activity. Both productive and non-productive opportunities continually arise from the previous actions of entrepreneurs. Economic growth is a result of productive activities which generate numerous other productive activities, which in turn contribute to increased economic efficiency. On the flipside, economic decline and stagnation is the result of non-productive activities which create an array of other non-productive activities. Where

adequate constraints are present, political institutions can support and encourage productive economic activity. However, when political constraints are weakened or absent, the possibility of increased non-productive entrepreneurship is a real threat to economic growth due to rent-seeking and the rise of distributional coalitions (Olson 1982). More specifically, absent constraints on non-productive entrepreneurship, productive activities will provide an increased incentive for non-productive entrepreneurs to engage in predatory behavior. The predatory behavior of non-productive entrepreneurs will weaken the incentive for subsequent productive activities. The implication is that economic decline and underdevelopment should not be viewed as a lack of entrepreneurial opportunities, but instead as a result of the dominance of certain types of entrepreneurial opportunities. Entrepreneurs exist in all societies and it is the institutional environment and resulting constraints that direct their alertness to profit opportunities whether they are linked to productive or non-productive activities (Boettke and Coyne 2003).

Second, the realization that non-productive entrepreneurial activities, like productive activities, have a multiplier effect provides new insight into how we think about 'poverty traps' in the context of economic development. The standard view of poverty traps is captured by Sachs (2005: 56–57) who notes that "when people are…utterly destitute, they need their entire income, or more, just to survive. There is no margin of income above survival that can be invested for the future. This is the main reason why the poor are becoming trapped with low or negative economic growth rates." The poverty trap view holds that a lack of savings and investment in capital is the reason that countries remain mired in poverty.[7] Indeed, Sachs concludes that a 'big push' through foreign aid and assistance (i.e., greater inputs) is needed to break out of the poverty trap.

However, the standard logic of the poverty trap neglects how the existing institutional environment impacts the process of transforming inputs into outputs. In other words, it assumes that increased inputs (i.e., savings and investment) will automatically be transformed into increased outputs that solve the economic problem of allocating scarce resources among competing ends.[8] In this regard, the main implication of our analysis is that poverty traps are not due to a lack of inputs, but instead to an institutional environment that discourages productive activities while typically rewarding non-productive actives. To the extent that inputs are lacking it is because of the incentive, or lack thereof, to save and invest. Further, where inputs are not being transformed into outputs, it is because the payoff associated with the process of transformation is not sufficient to induce productive entrepreneurs to undertake production.

Furthermore, in encouraging non-productive entrepreneurial activities, the institutional environment in impoverished countries also facilitates the creation of subsequent non-productive opportunities through the channels discussed in the previous section. As these subsequent opportunities emerge and are exploited, they reinforce economic stagnation, further trapping citizens in a state of poverty. Within this context, policies aimed at breaking the poverty trap should not focus on more

[7] For a review of the empirical evidence regarding poverty traps, see Easterly 2006: 38-51.
[8] Skarbek and Leeson (2009) discuss what foreign aid "can do." They conclude that while aid can increase output in a specific area, it cannot solve the fundamental economic problem.

inputs as called for by Sachs and other advocates of a big push, but instead on changing the institutions which reward the catalyst of economic stagnation—non-productive entrepreneurship. Because non-productive social networks are often deeply embedded, this can be a difficult task.

Third, our analysis implies that the costs of non-productive entrepreneurial activities are typically underestimated. In analyzing the costs of non-productive entrepreneurship, it is standard to consider the deadweight loss and destruction of resources which harm economic well being. However, our analysis indicates that there is also an externality aspect to non-productive activities. Existing literature recognizes the positive externalities associated with productive entrepreneurship. For example, endogenous growth models recognize that knowledge has increasing returns and spillover effects which can contribute to economic growth. The market process literature also recognizes the externality aspect of knowledge although it is mainly concerned with the process through which new knowledge emerges. Along these lines, Holcombe (1998: 58) indicates that "knowledge externalities occur when the entrepreneurial insights of some produce entrepreneurial opportunities for others. Increasing returns occur because the more entrepreneurial activity an economy exhibits, the more new entrepreneurial opportunities it creates." Similar logic can be applied to non-productive entrepreneurial activities. Knowledge externalities are present in the case of non-productive activities because each activity creates subsequent entrepreneurial opportunities. However, instead of contributing to growth, these opportunities contribute to further economic decline and stagnation. The main implication is that the true costs of non-productive activities are typically underestimated because they neglect the costs associated with the spillovers leading to numerous new non-productive activities. Because of these spillover effects, the destruction of wealth through non-productive activities is larger than the damage of any one single non-productive act.

Fourth, the type of social capital that exists within specific industries will affect how an economy reacts to economic fluctuations and shocks. Social capital is heterogeneous and specific meaning that capital which supports non-productive activities may not be conducive to supporting productive activities. This implies that when an economy faces a shock, the nature of existing social capital will influence how those involved (i.e., citizens, businesspeople, politicians, etc.) respond and how the economy recovers. Consider, for example, the agricultural and automobile industries in the United States. Both have a long history of political favors and protections including subsidies, tax breaks, price supports, quotas, and tariffs to insulate producers in these industries from competition. Further, both industries invest heavily in lobbying efforts to sustain political connections. For example, during the 'Great Recession,' both industries have relied on these political connections to remain economically viable instead of reallocating resources to other productive activities as dictated by market signals.

Recognizing the heterogeneity and specificity of social capital also has implications for understanding the process of institutional change and the transition between institutions. Institutional change requires that we "start from the here and now" (Buchanan 2004: 136). The status quo includes the existing array of informal institutions, such as social capital, which facilitate specific types of relationships and organizational forms while constraining others. Institutional changes are more likely

to 'stick' if they are grounded in local custom and practice (see Boettke et al. 2008), which makes understanding the status quo all the more important. Where formal institutions align with informal institutions the latter will serve as a foundation to support the former. However, where there is a disconnect between formal and informal institutions the formal institutions will be dysfunctional or altogether collapse because the everyday practices and customs will fail to support their operation. This is important because economic growth requires institutions which encourage productive entrepreneurship. Obtaining these institutions is limited by the array of informal constraints that exist at any point in time. This has real implications for institutional reform in countries characterized by high levels of non-productive entrepreneurship. Reforms that fail to appreciate the existing informal institutions will fail to operate in the desired manner.

Fifth, our analysis reveals that overcoming the economic decline and stagnation requires identifying mechanisms for reducing the payoff to non-productive entrepreneurial activities relative to productive activities. The productive entrepreneurial process includes inherent feedback mechanisms—prices and profit and loss—which continually prod markets toward efficiency. These mechanisms do not exist in the context of the non-productive entrepreneurial process meaning that the inefficiencies associated with non-productive activities are not self-correcting. Absent the price and profit and loss feedback mechanisms, how can the inefficiencies of non-productive entrepreneurship be corrected? Several potential explanations exist in the literature.

As noted in "Section 1", Olson (1982) concludes that exogenous shocks, such as natural disasters and war, are one means of eroding entrenched interests in a society. Along these lines, another possibility is that a system dominated by non-productive entrepreneurship will eventually self-implode. Unlike productive entrepreneurship, non-productive entrepreneurship has an upper bound defined by the surplus created by productive activities. In the limit, once the surplus is eroded the system runs the risk of collapse as there is no incentive for productive entrepreneurs to create additional wealth and non-productive entrepreneurs are left to predate other non-productive entrepreneurs. Where such cases of drastic upheaval do occur, a situation emerges where vested interests lose their privileged positions and the status quo is once again 'up for grabs.'

Other research emphasizes the importance of productive entrepreneurship as a mechanism for changing institutions which encourage non-productive activities. For example, in his analysis of the Soviet transition from communism to capitalism, Boettke (1993: 84–86) emphasizes the importance of low barriers to entry so that exogenous entrepreneurs can overcome the problems posed by entrenched interested groups. Thomas (2010) analyzes how innovation and technological change can serve to overcome the transitional gains trap which typically serves to constrain deregulation and reform. In short, certain monopoly positions may lose their value as new innovations make those positions irrelevant. In such cases productive entrepreneurship is an indirect means of changing the payoff to non-productive entrepreneurship. While the initial innovation takes place to exploit a profit opportunity, it has the indirect effect of reducing the payoff to unproductive activities by making the existing monopoly privilege irrelevant.

5 Conclusion

A large literature explores the various aspects of the market process. A smaller literature differentiates between the different types of entrepreneurship. The market process literature implicitly focuses on productive entrepreneurship while neglecting the non-productive aspect of entrepreneurial activity. We have begun to fill this gap by exploring the link between institutions and non-productive entrepreneurial activity. In doing so, we have provided insight into the process through which non-productive entrepreneurial opportunities emerge. Similar to productive entrepreneurship, non-productive entrepreneurial opportunities have a multiplier effect whereby one non-productive activity leads to subsequent non-productive activities. We identified three main channels through which this multiplier effect operates. Incorporating our analysis into the broader market process literature will contribute to our understanding of the wealth of nations or the lack thereof.

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