

[Lawrence Nabers]

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*Veblen's Critique of the  
Orthodox Economic Tradition*

VEBLEN appeared in a number of roles with more or less success: historian, ethnologist, sociologist, political scientist, philosopher, professional cynic, seer, and social reformer, the last in spite of numerous disclaimers. But he was pre-eminently an economist by training and inclination, as the biographical details make clear. A large share of his work, which for purposes of academic administration is catalogued under other headings, Veblen regarded as an integral part of his economic analysis. These classificatory subtleties, he felt, are a largely useless and generally misleading heritage of the past. In speaking of the last and most complete statement of his economic thought, Veblen indicates that "it makes little use of the received theories of Political Economy; not as departing from the received theories or discrediting them, but because the inquiry is concerned chiefly with economic forces and phenomena which are of later date than the received doctrines."<sup>1</sup> His attitude by this time was one of unconcern with and disregard for conventional analysis.

This unconcern with conventional economic categories had its origin

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in a general philosophical position, as we shall presently see. But more important it sprang from a critical analysis of "received doctrine" during the formative period of his own work. Regardless of the central topic under discussion, he sooner or later asks the question: "What are the implications of this for the accepted body of economic analysis?" It is possible, therefore, without too much distortion to reconstruct Veblen's version of the orthodox economic analysis of his day and his alternatives to that analysis.

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<sup>1</sup> T. Veblen, *Absentee Ownership and Business Enterprise in Recent Times* (New York: Viking, 1954), pref. The references to Veblen's writing are only to representative passages. He was enormously repetitive and more than occasionally contradictory. One of Veblen's favorite authorities in the later work was the earlier Veblen.

Veblen's critique was developed during the period when the formal, if not greatly substantive, changes in economic doctrine after the deceptively named "marginalist revolution" were being integrated into economic thought. The decline of the classical modes of analysis following John Stuart Mill had occurred for two principal reasons: first, the labor theory of value was inadequate in providing a consistent basis for the problems of pricing, allocation, and efficiency, which were becoming increasingly important once the end of the period of rapid economic growth was in sight; and second, the radical implications of a theory of distribution based on the labor theory of value were clear by this time even to those who had not read Marx.

The new orthodoxy<sup>2</sup> accepted in large measure the existing state of affairs; nor did any significantly new policies or attitudes toward business, the state, the position of individuals in the economy, or the apodictic certainty of progress emerge. Its innovations were the development of a theory of distribution, which for a while seemed to give more logical support to the existing status than was possible before, and a method of demonstrating that under certain circumstances, which were in large measure thought to obtain in the real world, the economy would operate with the greatest attainable efficiency.

Veblen saw with clarity the continuity of the body of received doctrine with the past. His central thesis is that though it may have had some operational significance (in his own term, serviceability) in the eighteenth and early nineteenth centuries, economic conditions had changed so radically that it had little meaning by his time. That

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is to say, orthodox economics was not serviceable either as an explanation of the operation of the economic mechanism or as a guide for policies conducive to the welfare of the population. Its function, he felt, was to provide a rationale for current business practices, even though those practices were seldom of the kind contemplated by the prevailing economic doctrines.

The purpose of this essay, then, is to examine Veblen's reconstruction of orthodox economic analysis and to set forth his alternatives. If we take the corpus of contemporary economic analysis in its entirety, it would be possible to find largely consistent positions on the major theoretical and practical issues. But most of the issues can be grouped around the

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<sup>2</sup> The term neoclassical is generally used. Both terms will, however, be used here interchangeably, although the "neo" should be underemphasized, for the changes, as mentioned, are largely formal or, to err on the side of caution, were largely formal in the period of the development of Veblen's critique.

analysis of value, distribution, and price-allocation. We shall confine ourselves to these problems.

## I

Veblen remarks that “Adam Smith was a creature of his own time, and what he has to say applies to the state of things *as he saw them*.”<sup>3</sup> The remark is universally true of all economists, or for that matter of everyone who must look outside himself for some part of the “stimulus to action.” Without becoming entangled in the problems of *Wissenssoziologie*, let us say that individuals see different things in the same ostensible fact situation. Those differences, Veblen argues, can be explained in terms of the intellectual and cultural heritage of the observers. In the social sciences this heritage leads most honest workers to come up with traditional answers “due to the fact that their intellectual horizon is bounded by the same limits of commonplace insight and preconceptions as are the prevailing opinions of the conservative middle class.”<sup>4</sup> In other words, the limitations lead to seeing some facts and not others, and those facts seen are interpreted or given meaning in a context acquired independently of the facts. It is not necessary to argue that Veblen somehow escaped, that he was the aloof, freely poised intellect. His vision was simply different, and we may use his own test for the adequacy of the vision, its service-

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ability. It is to these visions of what Josiah Royce has called “the world of the outside order” that we must turn in understanding the source of the differences between Veblen and the orthodox tradition.

The dominant attitude toward the individual was developed during the formative period of modern capitalism. The intellectual origins of these ideas are to be found in the Protestant Reformation and were incorporated into economic thought through the work of the Philosophical Radicals. Their program was based on Utilitarianism and its applications to psychology and logic, plus a program for reform emphasizing free trade, legal changes strengthening property and individual rights, decreased individual supervision by the state in both personal and economic matters, and in general the program of *laissez faire*.<sup>5</sup> The corpus

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<sup>3</sup> T. Veblen, *The Vested Interests and the Common Man* (New York: Viking, 1946), p. 27 (italics mine).

<sup>4</sup> T. Veblen, *The Higher Learning in America* (Stanford, Calif.: Academic Reprints, 1954), p. 186.

<sup>5</sup> Elie Halevy, *The Growth of Philosophical Radicalism*, trans. Mary Morris (London: Faber and Faber, 1934), ch. i.

of orthodox economic thought had not by Veblen's time progressed far from the Philosophical Radicals either in terms of policy or philosophy.

Talcott Parsons has characterized the philosophical system of utilitarianism as involving the fourfold tenets of empiricism, atomism, rationality, and the randomness of ends.<sup>6</sup> The last three are important for our purposes. Each individual is conceived of as an independent atom pursuing in a rational fashion ends which have meaning only in terms of himself. There is a presumed lack of necessary uniformity in the distribution of those ends. The rules of rational behavior are given by Bentham's hedonistic calculus. This approach in its purest Benthamite trappings was taken without qualification as late as the last quarter of the nineteenth century. W. Stanley Jevons, after stating that his own theory "is entirely based on a calculus of pleasure and pain," continued to define that calculus, quoting Bentham, in terms of its intensity, duration, certainty, propinquity, fecundity, and so on.<sup>7</sup> Few of Jevons' contemporaries were so unqualified in their use of the language of utilitarianism, but the attitude remained the same, for ultimately the most consistent justification of individualistic *laissez faire* rests on such grounds.

In the economic theory of the nineteenth century the exchange problem took logical priority over production. That is, individuals

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were thought to be engaged in the production of services or commodities involving physical pain-costs up to the point where the last unit of pain-cost was equal to the pleasure-return from exchange. These pleasures and pains were evaluated in terms of the hedonistic calculus.

Since all this was very abstract, it required empirical content. The pain of the last unit of labor was equated to the pleasure equivalent of the wage, thus securing the maximum net pleasure-return; this principle served as the point of departure for the discussion of wages and the labor market. Businessmen were thought of as incurring costs (not suffering pains except in the sense of foregoing pleasures) in acquiring or producing commodities for sale up to the point where the last unit of foregone-pleasure-cost is equated to pleasure-returns, thus securing the maximum net returns. After much theoretical investigation the theory of cost and production and, in time, a theory of distribution was derived from this principle. Throughout it was assumed that individuals continue to act in a rational fashion, that is, in a manner resulting in the greatest amount of pleasure (net wage or profit).

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<sup>6</sup> *The Structure of Social Action* (Glencoe, Ill.: Free Press, 1949), pp. 58 ff.

<sup>7</sup> *The Theory of Political Economy* (4th ed.; London: Macmillan, 1911), pp. 23 ff.

The strategic individual in the process was the businessman—in this matter alone Veblen would not have disagreed.<sup>8</sup> The facts of business enterprise made this inevitably so, and the neoclassical theorists were willing in large measure to accept it as given without inquiring too far into the reasons. The attitude generally expressed is that the businessman is no different in the rationale of self-seeking than anyone else. He is differentiated from other individuals simply because of his greater skill and ability in the complex calculations involving maximum pleasure-profit positions. These calculations lead simply to a recognition of the maximization conditions already inherent in the data. Alfred Marshall, Veblen's great orthodox contemporary, has put the matter thus:

There is no breach of continuity as we ascend from the unskilled labourer to the skilled, thence to the foreman to the head of a department, to the general manager of a large business paid partly by a share of the profits, to the junior partner, and lastly to the head partner of a large private business: and in a joint-stock company there is even somewhat of an anti-climax when we pass from the directors to the ordinary shareholders, who undertake the

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chief ultimate risks of the business. Nevertheless business undertakers are to a certain extent a class apart.

For while it is through their conscious agency that the principle of substitution chiefly works in balancing one factor of production against another; with regard to them it has no other agency than the indirect influence of their own competition.<sup>9</sup>

The businessman was conceived of as the organizer of the industrial process, as the investor and innovator, whose constant concern was with the rational process of profit-pleasure maximization. The firm was an extension of the businessman. Like him it was an independent, self-sustaining unit producing commodities the same as those produced by a large number of other firms, each completely independent just as every other individual in the utilitarian universe. The relationship among those independent atoms (individuals and firms) was designated with considerable looseness as competitive. "A man competes freely when he is pursuing a course, which without entering into any combination with others he

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<sup>8</sup> T. Veblen, *The Theory of Business Enterprise* (New York: Scribner, 1904), p. 4.

<sup>9</sup> Alfred Marshall, *Principles of Economics* (8th ed.; London: Macmillan, 1946), p. 663. It is perhaps unfair to refer to Marshall in the context of the stereotype of neoclassical economics being developed. He was, as is well known, cautious and not at all given to the unqualified simplifications typical of the orthodox epigoni. However, the passage is typical.

has deliberately selected as that which is likely to be of greatest material advantage to himself.”<sup>10</sup> Under these rules it becomes possible to demonstrate with fairly rigorous logic, given large numbers of individuals and firms and the homogeneous product implied by the atomistic preconceptions, that everyone will obtain the greatest possible amount of net utility or profit. The belief in the attainment of the greatest possible benefit for all by the simple and obvious system of natural liberty was lifted from the realm of faith and enshrined with due qualifications as a scientific *quod erat demonstrandum*. This vision of a competitive economy is used in a number of different ways by the neoclassical economists: First, competition was held to be the normal case, that is, the one most frequently encountered in the real world; departures were treated as temporary aberrations. Second, since competition was the normative case, departures were socially undesirable and should be dealt with by legal or legislative means. Third, competition defined

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the general direction in which the economy tended as an historical generalization.<sup>11</sup> With whatever particular qualification necessary in the case of an individual writer, this characterization of the operation of the economy would probably have been accepted as fair by the orthodox economists of Veblen’s time. In any event this is the vision of the world attributed to them by Veblen.

Veblen would have none of the orthodox view except their attitude toward the strategic importance of the businessman (but with a different emphasis). Their treatment of the individual and his behavior evoked some of Veblen’s finest satire. The view of man as a “lightning calculator of pleasures and pains, who oscillates like a homogeneous globule of desire of happiness under the impulse of stimuli that shift him about the area but leave him intact”<sup>12</sup> was far from what Veblen held to be the case; nor could a society survive in which decisions were so made, for in the lack of development of patterns of “conventional relations . . . it is not conceivable that the institutional fabric would last over night.”<sup>13</sup>

For our purposes it is unnecessary to reconstruct in any detail the complex social psychology that Veblen developed with varying emphasis throughout his writings. Briefly, man may be taken as a cultural phenomenon. All he knows, his patterns of life and belief, are

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<sup>10</sup> Alfred Marshall, *Economics of Industry* (2nd ed.; London: Macmillan, 1881), p. vi.

<sup>11</sup> Cf. Joseph A. Schumpeter, *History of Economic Analysis* (New York: Oxford University Press, 1954), pp. 927 ff.

<sup>12</sup> T. Veblen, *The Place of Science in Modern Civilization* (New York: Viking, 1942), p. 73.

<sup>13</sup> *Ibid.*, p. 251.

aspects of his cultural heritage. "Each move . . . is necessarily made by individuals immersed in the community and exposed to the discipline of group life as it runs in the community, since all life is necessarily group life. The phenomena of human life occur only in this form."<sup>14</sup> But Veblen was no cultural determinist in the strict sense. The individual was an active, creative element in his environment. "He is in an eminent sense an intelligent agent. By selective necessity he is endowed with a proclivity for purposeful action."<sup>15</sup> The source of the purposeful action is to be found in Veblen's well-known "instinctual" theory. Veblen makes use of four instincts: idle curiosity, the parental

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bent, the instinct of workmanship and the predatory bent.<sup>16</sup> The purposes of instinctual behavior are formed, limited, or retarded by the institutional environment. Veblen at times sets the traditional patterns of "use and wont" against the instinctual drives. He speaks of the instincts as being "overborne by cumulative habituations to the rule of the self-regarding proclivities that triumphed in the culture of predation, and whose dominion has subsequently suffered some impairment in the later substitution of property rights for tenure by prowess."<sup>17</sup>

These remarks should be sufficient to indicate that there is no point of contact between Veblen's approach and that of the orthodox tradition. To oppose the notion that labor, or foregone pleasure, is painful with motive power given by the desire to avoid pain, Veblen takes individual behavior as determined by the working out of instinctual drives in a particular cultural context; nor can any utilitarian counterpart be found for idle curiosity, which in conjunction with the instinct of workmanship is responsible for social progress in Veblen's analysis. It would be a mistake to view Veblen's attitude toward the individual simply as a response to the neoclassical formulation. His view of human nature is the rationale for his exploration of the institutional environment in which the instinctual proclivities assume significance. If the economic man of the orthodox tradition is a valid point of departure, then these investigations become pointless.

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<sup>14</sup> T. Veblen, *The Instinct of Workmanship and the State of the Industrial Arts* (New York: Viking, 1946), pp. 103-104.

<sup>15</sup> T. Veblen, *Essays in Our Changing Order* (New York: Viking, 1945), p. 80.

<sup>16</sup> Too much has been made of Veblen's use of the term, instinct. It is enough, as he says, to take the expression "to signify a concurrence of several instinctive aptitudes, each of which might or might not prove simple or irreducible when subjected to psychological or physiological analysis" (*Instinct of Workmanship*, p. 27).

<sup>17</sup> *Ibid.*, p. 182.

The same considerations apply in Veblen's view of the businessman and his environment. He sees a different business world than did his orthodox contemporaries. The prevailing attitude was that the economy was composed of a large number of small firms purchasing factors in a competitive factor market and accepting the prevailing prices in their product markets. The premium was on achieving profits through better management and by innovation that would permit an increased margin at given prices. The profits are short-run because any advantage will be copied by competitors. Thus the full advantages will accrue

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to the consumer in the form of a greater quantity of the product at a lower price.

Veblen's economic world was completely different from this. His world was that of the *United States Industrial Commission Reports*—the story of business intrigue and high finance put together in thirteen massive volumes by a joint committee at the turn of the century. It tells the unpleasant tale of the sugar trust, the whisky combination, the steel combination, the oil pools, the railway pools, and the rest. The characteristic results of the Industrial Revolution were the giant corporation and the trust movement as a device for ending the destructive power struggle among the corporate giants. In manufacturing alone the number of wage earners increased from 1,311,246 in 1860 to 6,615,046 by 1910, bringing about a complete social transformation.<sup>18</sup> As Beard points out, the “great pecuniary accumulations were thenceforth made largely in business enterprise—including the work of the entrepreneur, financier, speculator, and manipulator under that general term. Inevitably the most energetic and keenest minds were attracted by the dominant mode of money-making.”<sup>19</sup> Much confusion has arisen in interpreting Veblen's remarks on business enterprise because of a failure to realize that his unit of analysis is always the giant corporation, not the atomistic firm of the neoclassical economists. His “representative firm” has a large number of stockholders with direct management control; it has been reorganized a number of times and has made extensive use of debenture financing.<sup>20</sup>

The neoclassical version of the businessman's activities as coordinator of the industrial process, like the neoclassical view of the individual, called forth Veblen's typical satire:

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<sup>18</sup> Cf. Charles A. Beard, *Contemporary American History* (New York: Macmillan, 1923), ch. ii, esp. pp. 33 ff.

<sup>19</sup> *Ibid.*, p. 33.

<sup>20</sup> Esp. *Theory of Business Enterprise*, pp. 114 ff., 143 ff.



[This view] has a great sentimental value and is useful in many ways. There is also a modicum of truth in it as an account of facts. In common with other men, the businessman is moved by ideals of serviceability and an aspiration to make the way of life easier for his fellows. . . . Instances are perhaps not frequent, but they are also not altogether exceptional, where a prosperous captain of industry will go out of his way to heighten the

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serviceability of his industry even to a degree that is of doubtful pecuniary expediency for himself. Such aberrations are, of course, not large; and if they are persisted in to any very appreciable extent the result is, of course, disastrous to the enterprise. The enterprise in such a case falls out of the category of business management and falls under the imputation of philanthropy.<sup>21</sup>

The motivation of Veblen's businessman is on the face of it similar to that of Smith's, J. S. Mill's, or Marshall's businessman: pecuniary gain and the accumulation of wealth. For an explanation of this motivation, Veblen appeals to the analysis of behavior in *The Theory of the Leisure Class*. That is, in a society in which pecuniary canons determine social relationships, which in turn involve invidious comparisons of status, the accumulation of wealth is essentially a mark of success. This is another example where much of Veblen's work was concerned with an explanation of a concept which his orthodox contemporaries are willing to postulate.<sup>22</sup> However, the method by which wealth is accumulated or profits are maximized is quite different in Veblen's analysis. If the primary interest of the businessman is pecuniary gain in an environment where the manipulations by large corporations of their markets give the widest range to business discretion, then he will be preoccupied with "an alert redistribution of investments from less to more gainful ventures, and to a strategic control of the conjunctures of business through shrewd investments and coalitions with other businessmen."<sup>23</sup>

The implications of this argument turn on a particular conception of the industrial process. The organization of the economy as a whole is thought of as continually approaching that of one single, integrated, balanced establishment:

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<sup>21</sup> *Ibid.*, pp. 41, 42n.

<sup>22</sup> *Ibid.*, p. 20.

<sup>23</sup> *Ibid.*, p. 24.

It is eminently a system, self-balanced and comprehensive; and it is a system of interlocking mechanical processes, rather than of skilful manipulation. It is mechanical rather than manual. . . . It runs to “quantity production” of specialized and standardized goods and services. . . . This industrial system runs on as an inclusive organization of many and diverse interlocking mechanical processes, interdependent and balanced among themselves in such a way that the due working of any part of it is conditioned on the due working of all the rest.<sup>24</sup>

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Then only fortuitously, according to Veblen, will the ends of pecuniary gain coincide with efficiency requirements of the industrial process. This point is central to an understanding of his theory of distribution and allocation, so we shall return to it later.

It is clear that the “representative firm” of the neoclassical economists as a business unit had no significance in Veblen’s view of the economy; nor could it have significance as a productive or industrial unit. Veblen at one point chides Marx for “continuing to speak of industry as an affair of detachable factors and independent segments of work going on in severalty.”<sup>25</sup> Neither is Veblen’s businessman like his orthodox counterpart. During the period of modern capitalism a series of developments occurred in the status of the representative businessman. Prior to the Industrial Revolution at the end of the eighteenth century, he was the shopkeeper and trader who slowly developed with the tide of technological innovations into the “Captain of Industry” engaged in the direct management and development of the industrial process, albeit for pecuniary gain. As business became more complex and markets larger, the Captain of Industry developed into the Captain of Corporation Finance who resigned his position as the overseer of the industrial process to the technicians and engineers.<sup>26</sup> The principal tasks of the businessman became the maintenance of the credit structure and the returns on invested capital through the manipulation of prices and market conditions.<sup>27</sup> The last stage in the development was the coming of The Captain of Solvency as the representative businessman; the investment banker and his financial interests were constituted into a general staff of financial strategy commanding the

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<sup>24</sup> T. Veblen, *The Engineers and the Price System* (New York: Viking, 1947), pp. 52-53.

<sup>25</sup> *Absentee Ownership*, p. 271n.

<sup>26</sup> *Engineers and the Price System*, ch. ii, *passim*.

<sup>27</sup> *Absentee Ownership*, pp. 110 ff.

country's financial resources,<sup>28</sup> thus assuming the strategic role in business. In this new situation beginning around the turn of the century, the Captains of Corporate Finance became simple Lieutenants of Solvency.<sup>29</sup> We are here far removed from the neoclassical vision of the entrepreneur as the technological innovator and the shrewd manager of affairs engaged in the game of searching out the minimum points of constantly downward shifting cost functions.

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## II

The discussion of the conflicting views of Veblen and his orthodox contemporaries has brought us to the point where we must examine certain philosophical and methodological issues which play a major role in Veblen's critique. The movement of events, institutional change, technological development—those aspects of culture that are found in all except the very likely nonexistent static societies—proceed on a different level from thought, belief, and ritual. The result is that systems of law and custom are superimposed on a working order to which they may bear little, if any, relation, having been formulated in terms of an earlier order.<sup>30</sup> This leads to the customary stresses occurring when man's beliefs are inconsistent with the requirements of day-to-day living. The one way in which the cultural stresses arising out of the disparate relation between customs and the underlying matter-of-fact solutions of environmental problems may be lessened is through borrowing the matter-of-fact solutions from some other society without at the same time taking over their ritual and custom. Veblen explained the industrial pre-eminence of imperial Germany in these terms; and in one of his last writings he argues that the economists of the new generation (1920's) have a significant advantage over their predecessors because "the experience which has given its bias to these latter-day economists is of a later date than that to which their predecessors were exposed; it is of the twentieth century, rather than the nineteenth,"<sup>31</sup> and presumably more relevant. The advantages of the latecomer and the borrower are, of course, much the same.

One way in which the body of beliefs is transmitted is through the media of economic doctrines. The formative period of modern economic thought was during the eighteenth

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<sup>28</sup> *Ibid.*, pp. 338 ff.

<sup>29</sup> *Engineers and the Price System*, pp. 66 f.

<sup>30</sup> *Vested Interests*, pp. 7 ff.

<sup>31</sup> *Essays in Our Changing Order*, p. 4. Also cf. the reasons for the superiority of the dolicho blonde group in northern Europe, *Instinct of Workmanship*, pp. 34 ff.

century, the important exemplars being the physiocrats and Adam Smith. The generations of economists following Smith took over in large measure the preconceptions implicit in the early classical analysis. Four of these preconceptions, which are closely related, will concern us here: the belief in a natural law or order; the belief in teleological meliorism; the taxonomic interpre-

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tation of economic theory; and the attitude towards private property.

It is possible and logically consistent to interpret the physiocratic system as a working out of the law of nature,<sup>32</sup> though this scarcely does the physiocrats justice in Veblen's own terms because of their essential concern with matter-of-fact problems.<sup>33</sup> We may, however, take Veblen's point heuristically. If we interpret the *Tableau* as a model of the natural order, recognizing the fact that it is simultaneously the model of the theoretical economic system of the physiocrats, the preconceptions inherent in the natural law doctrines a fortiori inhere in the economic theory. Economic theory then becomes an exploration of how the natural order works. It also serves as a bench mark for the development of policies directed against deviations from the natural order.<sup>34</sup>

Veblen further identifies the natural law doctrine with a "propensity to the accomplishment of a given end."<sup>35</sup> It is this end that must be defined by economic theory. The same considerations apply to all the disciplines. For example, the purpose of astronomy is to define nature's organization of the heavenly bodies. The issue is simpler here because there is no possibility of interfering with nature's work. But whenever man is involved, there is the possibility of deviation from the natural order. Thus we have a natural law ethics, though man through his selfishness, or more important through his ignorance, may deviate. His goal or purpose, however, is the attainment of the natural, ethical life.

If, then, the economy is conceived of as possessing a natural design, teleological considerations ( in the sense of a propensity to reach a particular goal) must be dealt with at two levels: First, all deviations will tend to disappear; it is thus possible to define the direction and meaning of short-run tendencies. Second, the natural organization of the

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<sup>32</sup> *Place of Science*, p. 87.

<sup>33</sup> Cf. Leo Rogin, *The Meaning and Validity of Economic Theory* (New York: Harper, 1956), p. 16. But see *Place of Science*, pp. 86-87.

<sup>34</sup> *Place of Science*, pp. 89-90.

<sup>35</sup> *Ibid.*, p. 92.

economy is itself directed toward the fulfillment of some long-run end; in this case the end is progress. Economic progress in turn is defined in terms of the increasing accumulation of goods, more specifically the accumulation of capital. "Every increase . . . of capital, therefore, naturally tends to increase . . . the real quantity of

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industry, the number of productive hands, and consequently the exchangeable value of the annual produce of the land and labour of the country, the real wealth and revenue of its inhabitants."<sup>36</sup> In the physiocratic system, Veblen argues, the teleological preconceptions have reached their highest point. Essentially any belief in a natural order which is inner directed is not far removed from primitive animism which attributed to inanimate objects a direction and force like that of living objects. The animism of the physiocratic natural order, however, is of a high level. It is conceived in a large way, unified and harmonized as a comprehensive order of nature as a whole.<sup>37</sup>

The translation of economic doctrines from France to England brought a change in emphasis. The prevailing impersonal, mechanistic philosophical and social thought in England gave greater weight to the analysis of causal relations proceeding through time with the motive force given by the prior event. This mechanistic, as contrasted to teleological, interpretation was self-sufficient without the natural order assumptions, and Hobbes' reconciliation is extraordinarily obscure. The doctrine of natural law is explicitly abandoned by Locke and, more important for the development of the orthodox tradition, by Bentham. Nevertheless, Veblen argues that animistic (used in this connection in the special sense of end-directed) elements remain important in the "higher synthesis" of political economy. It has, however, become "colorless" and has degenerated "to the tamer levels of normality and causal uniformities."<sup>38</sup> Thus the development of such parts of the theoretical system as the theory of normal price, natural wages, and so on is held by Veblen to reveal the essentially animistic tendencies characteristic of classical thought.<sup>39</sup> Above all, the animistic preconceptions, although they had lost their loftier formulation as the doctrine of the harmony of interests, remained in the preoccupation of economists with the definition of the conditions of economic welfare and the predisposition toward essentially normative

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<sup>36</sup> Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (New York: Modern Library, 1937), p. 321. Also *Place of Science*, pp. 115, 127 ff.

<sup>37</sup> *Place of Science*, p. 32.

<sup>38</sup> *Ibid.*, p. 93

<sup>39</sup> *Ibid.*, pp. 116 ff.

models.<sup>40</sup> Reference has already been made to the way in which the concept of competition has been used by the neoclassical economists.

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The teleological mechanism implicit in the orthodox tradition has had, according to Veblen, another important methodological result: it has led economic theory to be constructed in terms of “normal cases” on the one hand and deviations from those normal cases on the other; or to cataloguing results in terms of their *differentia specifica*. Once the *differentiae specifica*e are listed, it becomes possible to ignore them and confine attention to the nature of the genus. Veblen’s discussion of this point is endlessly repetitive and obscure. His arguments are to be taken in the context of the discussion of the implications of evolution for science and society at the turn of the century. To a generation concerned with the application of the principles of atomic physics to scientific methodology, the discussion has become jejune. Nevertheless, insofar as it comes to an important methodological criticism of his contemporaries, it is relevant for our purposes.

In discussing Irving Fisher’s *The Nature of Capital and Income* Veblen points out that the bias inherent in reasoning from normal cases has led to some unacceptable results:

Taxonomy for taxonomy’s sake, definition and classification for the sake of definition and classification meets no need of modern science. . . . It is on this head, as regards the serviceability of the taxonomic results that Mr. Fisher’s work falls short. *A modern science has to do with the facts as they come to hand*, not with putative phenomena warily led out from a primordial metaphysical postulate, such as the “hedonic principle.”<sup>41</sup>

The essence of Veblen’s criticism, then, is that all the facts must be considered in the development of explanatory principles—and they must be considered in terms of their changes through time, including qualitative as well as quantitative changes.

More specifically, in speaking of Marshall’s great work, Veblen acknowledges the wideness of range and the willingness to include all available factual information; however, Marshall conceives of the economic system as a “self balancing mechanism, not . . . a cumulatively unfolding process or an institutional adaptation to cumulatively unfolding exigencies.”<sup>42</sup> A system so conceived clearly derives from the “normal or natural” types,

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<sup>40</sup> *Ibid.*, p. 145.

<sup>41</sup> *Essays in Our Changing Order*, pp. 149-150 (italics mine).

<sup>42</sup> *Place of Science*, p. 173.

ultimately based on a “colorless” teleology. It further is subject to criticism because the system becomes the

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basis for a taxonomy of events in which it is possible to abstract from facts not fitting neatly into the general framework, particularly facts concerned with quantitative, temporal change.<sup>43</sup>

What do these rather complex methodological and philosophical considerations signify? Current doctrines are circumscribed by the preconceptions inherent in the prevailing beliefs of the time. These beliefs are a heritage of past thought which may not be relevant to the problems of the current age and may involve beliefs which are unscientific in the sense of (a) no longer being serviceable or (b) failing to correspond with the matter-of-fact knowledge of the society. The lack of serviceability of these preconceptions in the case of economic theory is attested by the fact that a large number of details, which would be dealt with if the approach were oriented toward an explanation of development, process, and change, are excluded. Further, taking over philosophical beliefs from an earlier generation, the orthodox economic tradition developed with an almost unrecognized, but built-in, bias toward economic progress. This does not mean that progress has not occurred; Veblen recognized that the rate of economic development has been high and continuous under capitalism. But the inherent bias in economic theory leads to a distortion of analysis, results that have little meaning in terms of current developments, and a natural predilection for the *status quo*; for if progress is inevitable in the current state of things, pressure for change of the institutional arrangements becomes if not dangerous at least mischievous.

The orthodox tradition took as its basic model the stage of economic development characteristic of an earlier period—the entrepreneur-manager, the small firm, competitively organized markets and so on—in conjunction with the bias toward private property current during that period. As Veblen says:

The standard theories of economic science have assumed the rights of property and contract as axiomatic premises . . . and their theories are commonly drawn in such form as would fit the circumstances of the handicraft industry and petty trade. . . . These theories . . . appear tenable on the

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<sup>43</sup> Further mention might be made of Veblen’s polemics against the static-dynamic dichotomy, which caused its share of confusion among orthodox economists at the turn of the century. But the bearing on the foregoing discussion is obvious. Cf. *ibid.*, pp. 189 ff.

whole, when taken to apply to the economic situation of that earlier time. . . . It is when these standard theories are sought to be applied to the later situation, which has outgrown the conditions of handicraft, that they appear nugatory or meretricious.<sup>44</sup>

Veblen's extensive discussions of the origins of private property need not detain us here.<sup>45</sup> The accumulation of wealth requisite for the development of the modern market system made inevitable the development of property and contract rights just as it made inevitable that complex of psychological predispositions which may be loosely designated as the Protestant ethic. These property rights became, as might be expected, an integral part of the natural order. The presumed<sup>46</sup> basis in the orthodox tradition for property is in individual workmanship, which is responsible for the creation of a valuable article. This right of private property vests the owner with the power to sell or dispose of the product of his labor by whatever method he desires. By extension of the principle even natural resources are included as objects amenable to the rules of ownership.<sup>47</sup> We shall return to the analysis of the importance of private property in Veblen's critique of the orthodox tradition, for it becomes crucial in an analysis of the distribution problem.

### III

Given the attitude toward the individual, the analysis of the structure and operation of the economy, and the preconceptions underlying traditional thought, we must turn our attention to the unifying principle behind any systematic economic speculation, namely, the theory of value. The essential requirements of any theory of value are (1) its postulates must be consistent with the vision of the data which is held; (2) it must be serviceable in that it facilitates further

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<sup>44</sup> T. Veblen, *An Inquiry into the Nature of Peace and the Terms of Its Perpetuation* (New York: Viking, 1945), pp. 317-318.

<sup>45</sup> *Inter al. cf. Essays in Our Changing Order*, pp. 32 ff., and *Absentee Ownership*, ch. iii.

<sup>46</sup> Presumed, for Veblen points out that property is a cultural phenomenon. It has its origins in the "invidious distinction between drudgery and exploit" (*Essays in Our Changing Order*, pp. 42, 44). He states characteristically that "the origins of property are to be found in priestly fraud and royal force" (*Instinct of Workmanship*, p. 159).

<sup>47</sup> *Absentee Ownership*, p. 50.



analysis; (3) the results obtained from further analysis must in turn be consistent with observation if the results are of a descriptive nature, or with the rest of the system of thought if the results are of an analytical nature, or with the wider view of the “good society” if the results are normative.

In modern discussions of the value problem so consistently is value taken to refer to relative prices that the ultimate meaning of the term has been lost sight of. The term was borrowed from philosophy, where its meaning, if not its determination, is clear: simply, value stands for worth. The criteria of worth have been variously defined: conduciveness to the greater honor and glory of God, the survival of the race, an increase in pleasure, and so on. In economics the implications of value are the same, but because of the limitation of analysis to “economic goods” the criteria can be defined with less generality.

If society is thought of in terms of congeries of independent (human) atoms, each seeking its own individual end, which is presumed to be inner satisfaction, then all services or commodities conducive to that inner satisfaction have value. As Veblen points out in describing the position of the classical economists, when the determination of legitimate activity is defined by law and custom, “all normal, legitimate economic activities carried on in a well-regulated community serve a materially useful end”<sup>48</sup> and presumably their value will be proportioned to the degree of usefulness to the individual. This conception of value could only have arisen in a society in which the judgments were subjective, individualistic, and, as Veblen suggests, determined by the “self-regarding sentiments of cumulous rivalry.”<sup>49</sup> When we contrast the medieval conception of the just return defined vis-à-vis the requirements of equitable, material livelihood for the participants in the economic process, the individualistic nature of the orthodox analysis of value becomes even clearer.<sup>50</sup>

The utilitarian view of the psychology of individuals was taken over by the orthodox economic tradition. The process of valuation, that is, the determination of the worth of a commodity, is judged in terms of the pain experienced in the creation of the commodity (the labor-cost) or the pleasure derived from the attainment, or both as in the full articulated system of analysis following Marshall and his work.

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<sup>48</sup> *Place of Science*, p. 287.

<sup>49</sup> *Instinct of Workmanship*, p. 199.

<sup>50</sup> *Ibid.*, p. 233.

In any event the goal of the individual is to make himself better off. Benefit to the community is irrelevant as far as the individual is concerned. Discussing the traditional approach in another place, Veblen remarks: "Whatever form of expenditure the consumer chooses, or whatever end he seeks in making his choice, has utility to him by virtue of his preference. . . . The question of wastefulness does not arise within the scope of economic theory proper."<sup>51</sup>

The foregoing implies that the economists of the orthodox tradition would be solely concerned with phenomena which could be quantified in a pecuniary sense, or in terms of physical units which are proportioned to pecuniary units. The causal relations in the pecuniary sequences making up economic activity become the center of analysis, subject to the preconceptions imposed by the acceptance of private property and individualistic valuation.<sup>52</sup> Two aspects of the pecuniary sequence constitute the central problems of analysis: distribution and exchange with an implicit analysis of progress and allocation. The purpose of the orthodox theory of value was to facilitate the solution of these two problems. The specific analysis of their solutions will be developed in the following two sections.

Veblen's critique of orthodox value theory proceeds on two levels. First, as we have already indicated, Veblen would have none of the traditional analysis of the behavior of individuals. The process of individual valuation is a purely cultural phenomenon except insofar as a relative constancy of instinctual behavior gives a degree of continuity to valuation over time. Second, accepting distribution and exchange as the central problems for analysis, the point of departure of the orthodox tradition is not serviceable as far as Veblen is concerned.

This lack of serviceability is attributed even more to the failure to take into account the actual operation of the economy than the failure to understand the cultural basis of behavior. If we want to analyze the problems of distribution and exchange in terms of their relation to such considerations as progress and efficiency, then to assume, as is customary in the orthodox analysis, the identity of real magnitudes with pecuniary magnitudes is more than misleading:

But great as may be the due of courtesy to that conception [of hedonism] for the long season of placid content which economic theory has spent be-

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<sup>51</sup> T. Veblen, *The Theory of the Leisure Class* (New York: Viking, 1943), p. 98.

<sup>52</sup> *Place of Science*, p. 138.

neath its spreading chestnut tree, yet the fact is not to be overlooked that its scheme of accountancy is not that of the modern business community. The logic of economic life in a modern community runs in terms of pecuniary, not of hedonistic magnitudes.<sup>53</sup>

The pecuniary magnitudes must be seen in the light of business rivalries, a complex credit system, irrationalities in both business and individual behavior rather than the “‘refined system of barter’ culminating in a net aggregate maximum of pleasurable sensations of consumption”<sup>54</sup> posited by the orthodox tradition:

But since it is in just this unhedonistic, unrationalistic pecuniary traffic that the tissue of business life consists; since it is this peculiar conventionalism of aims and standards that differentiates the life of the modern business community from any conceivable earlier or cruder phase of economic life; since it is in this tissue of pecuniary intercourse and pecuniary concepts, ideals, expedients, and aspirations that the conjunctures of business life arise and run their course of felicity and devastation; since it is here that those institutional changes take place which distinguish one phase or era of the business community’s life from any other; since the growth and change of these habitual, conventional elements make the growth and character of any business era or business community; any theory of business which sets these elements aside or explains them away misses the main facts which it has gone out to seek.<sup>55</sup>

Veblen nowhere spells out an explicit alternative value theory to serve as a point of departure for his analysis of distribution and allocation. This has had the result of obscuring the consistency of his observations and has exposed him to the charge of eclecticism, which is not necessarily bad, but which is certainly not as impressive as an integrated performance. However, implicit in Veblen’s arguments is a consistent basis of analysis which, it can be argued, constitutes a theory of value. Value simply implies serviceability to the community. The point becomes clearer when we see it in contrast to the orthodox position where value involves serviceability to a single individual. In the latter case the measure of serviceability is in the degree of satisfaction-gain to the individual. For Veblen the proper measure of value is the degree to which a commodity contributes to the ability of the economy seen as an interrelated and inseparable concat-

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<sup>53</sup> *Essays in Our Changing Order*, p. 160.

<sup>54</sup> *Place of Science*, p. 250.

<sup>55</sup> *Idem*.

enation of industrial processes, to produce required goods and services. For the time being, we shall allow the circularity of the argument to stand, namely, the fact that the goods and services are required because they contribute to the ability of the economy to produce.

This definition of value implies that there are two kinds of activities, industrial—those activities necessary to produce required goods and services—and pecuniary or business—those activities which are not strictly necessary.<sup>56</sup> Here again is the dichotomy which we have mentioned before as being essential to an understanding of Veblen's work. This definition of value is strongly normative, for if a service is not of use to the community or if it acts in large measure to interfere with the industrial efficiency of the community, then it would be to the advantage of the community to eliminate it. However, the distinction between the industrial and the pecuniary employments is tied so inseparably to the institutional fabric constituting the modern western capitalist community that little could be done without the complete and total alteration of the economic system. Veblen was not overly sanguine about this possibility.<sup>57</sup>

There are three sources of value judged in terms of serviceability to the community: the state of the industrial arts, the size of the population, and natural resources. "The state of the industrial arts is a joint stock of technological knowledge and practice worked out, accumulated, and carried forward by the industrial population which lives and moves within the sweep of this industrial system."<sup>58</sup> Veblen gives priority to the state of the technological arts, for, he argues, "the growth of the population is governed by the state of the industrial arts in such a way that the numbers of the population cannot exceed the carrying capacity of the industrial arts,"<sup>59</sup> further, the state of the arts determines what natural resources will be useful as well as how they will be made use of.<sup>60</sup>

Distribution and exchange are purely pecuniary aspects of the operation of the economic system subject to the rules of private property and free contract, which in the orthodox analysis are taken as the immutable conditions postulated by the analysis.<sup>61</sup> The standards

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<sup>56</sup> *Ibid.*, pp. 293 ff.

<sup>57</sup> *Engineers and the Price System*, chs. iv, v, *passim*.

<sup>58</sup> *Absentee Ownership*, p. 65.

<sup>59</sup> *Ibid.*, p. 62.

<sup>60</sup> *Ibid.*, p. 63.

<sup>61</sup> *Place of Science*, p. 236.

of valuation of commodities are standards of private gain in terms of price; whereas if industry were conducted in terms of benefit to the community, the price valuations would be meaningless.<sup>62</sup> In speaking of Marx's analysis in terms of the labor theory of value (and it might be added parenthetically that Veblen discusses Marx with less than his customary asperity), he points out that variations of proportions between the exchange ratios of human labor involved in commodities and their prices are attributable to the "strategy of self interest"; and then he says revealingly: "Under a socialist regime, where the labourer would get the full product of his labor, *or where the whole system of ownership, and consequently the system of distribution, would lapse, values would reach a true expression, if any.*"<sup>63</sup>

The circularity in Veblen's statement of the value problem has been mentioned, namely, the definition of value in terms of itself. The circularity of the argument becomes irrelevant when the concept of required goods and services is given empirical content. Much of Veblen's analysis of the economic system was devoted to a description of those aspects of the system which he felt to be not required or in his own term, disserviceable. In general those activities fell into four groups: First, there are those activities characterized by the invidious use of leisure and conspicuous consumption of commodities along with the cultural complexes of behavior which have been developed in furthering the pecuniary canons of taste. Second, there are those activities which result in interfering with the industrial process, involving "certain customary kinds of waste, which are unavoidable so long as industry is managed by businesslike methods and for businesslike ends." They include unemployment of resources or labor whether through design or ignorance, salesmanship, production of spurious goods for business reasons, excess capacity, duplication, and so on.<sup>64</sup> The third group of commodities disserviceable to the community in the sense of not enhancing the community's economic welfare are those "whose value lies in their turning the technological inheritance to the injury of mankind";<sup>65</sup> that is, the military establishment and the constabulary insofar as the function of the latter is to protect the predatory rights of the leisure class. Finally, there is a group of activities of most probable net detriment such as race tracks, saloons,

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gambling houses, and houses of prostitution. Then typically Veblen suggests:

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<sup>62</sup> *Engineers and the Price System*, p. 147.

<sup>63</sup> *Place of Science*, p. 421 (italics mine).

<sup>64</sup> *Engineers and the Price System*, p. 108.

<sup>65</sup> *Place of Science*, p. 356.

Some spokesmen of the “non-Christian tribes” might wish to include churches under the same category, but the consensus of opinion in modern communities inclines to look on churches as serviceable, on the whole; and it may be as well not to attempt to assign them a specific place in the scheme of serviceable and disserviceable use of invested wealth.<sup>66</sup>

The application of Veblen’s distinctions between pecuniary and nonpecuniary employments is difficult and must proceed *ad hoc*. If such categories of private property and the maintenance of national integrity are accepted as socially desirable in themselves, the catalogue of serviceability is largely reversed. The analysis, however, does provide a point of departure for a treatment of distribution and allocation which throws a completely different light on these problems than the orthodox tradition.<sup>67</sup>

#### IV

The problem of the distribution of income was central in economic analysis beginning at least with Ricardo. He posed the economic problem in terms of the distribution of income which would be most conducive to economic progress. Thus, the reason for his attack on the corn laws was their tendency to distort the distribution of income in favor of the landed classes through raising the cost of wage goods, in turn lowering profits. Under these conditions progress would be impossible. This argument required positing an inverse relationship between profits and wages resting ultimately on the notorious wages fund doctrine. It has already been indicated that the inadequacies

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of the classical analysis of distribution became increasingly obvious during the course of the nineteenth century: there was the strong implication from the labor theory of value that labor, the source of value, was exploited in the economic process through receiving only a

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<sup>66</sup> *Ibid.*, pp. 357-358.

<sup>67</sup> Frank H. Knight among others has objected that any system of analysis which rejects as a point of departure consumer sovereignty has dangerous political implications. Specifically in his review of *The Place of Science, Jour. Pol. Econ.*, XVIII (1920), 518-520, he says: “It goes without saying that there is a great deal in this distinction between real value and trumpery, but we wish to remark that it is a canon very difficult to apply in a democracy” (p. 520). Veblen would have replied: (1) consumer sovereignty is myth derived from an acceptance of the hedonistic calculus; (2) in any event the gains to be made from the application of the canons of serviceability for society as a whole would outweigh any other possible loss; and (3) to the implied question of who is to make the decisions for individuals he would ask, “Who makes them now?”

proportion of the total product. Explanations running in terms of the productivity of the other factors of production, such as abstinence, co-ordination, and so on, were not fully integrated into formal value theory. Next there were the problems of applying the wages fund doctrine when one of the most important phenomena to be analyzed was increasing productivity. Finally, there was an increasing concern with problems of efficiency, price, and allocation, which could not conveniently be dealt with in terms of the labor theory of value. The stage was thus set for the “marginalist revolution.”

The distribution problem was posed until recently in terms of a class structure presumed to be functionally meaningful. The division of society into three groups, workers, capitalists, and landlords, is as old as the beginnings of modern capitalism, when the requirements of trade and industry separated the workers from their tools and established on the basis of the ownership of the means of production the distinction between employers and employees. The origins of the landed classes are in a similar fashion to be found in private property and contract arising with the break-up of the feudal order. In the course of the nineteenth century a fourth factor of production was added to the traditional three. The “undertaker” or entrepreneur as distinct from the capitalist or owner of the means of production began to be distinguished in recognition of an increasingly obvious historical fact. His activity was usually thought of during this period as a special kind of labor, that of co-ordinating or directing the industrial processes.<sup>68</sup> The distribution of income, then, was the division of the social product among these functional economic classes—functional in the sense that each contributed its share to the creation of the product.

In the earlier scheme of analysis the relationship among the income shares was worked out in a somewhat unsatisfactory fashion. Each of the shares was from one point of view considered residual: thus rent was the residual payment between price and the other necessary payments which made up the wages fund. Profits plus interest on

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capital invested was the residual of the wages fund after the necessary (subsistence) payments to laborers. And wages were generally looked upon as the residual payment from the wages fund after profit plus interest was taken out; thus the payment could go below the subsistence level for the mass of workers until changes in population adjusted the size of the labor force. Now this analysis is unsatisfactory because it leaves unanswered the question of equity of payment as well as for formal reasons previously mentioned.

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<sup>68</sup> *Place of Science*, pp. 288-289.

The transition to the neoclassical analysis turned on defining economic classes as factors of production. Taking the firm as the central unit of analysis rather than the economic class, it is possible to argue that in the process of maximizing profits each firm will use the factors of production up to the point where the contribution to the product of the firm of the last unit of the factor of production used will be equal to the price which must be paid for that factor of production. Granting the assumption as to the relative smallness of each of the units engaged in this process, the price cannot be affected by any of the participants. For the economy as a whole (by-passing issues raised by variations in factor efficiency) all the factors of production will be rewarded in accordance with their contribution to total output, no more or no less. Thus, changing the point of view, the economic classes receive in the form of income exactly what they contribute to output. The equitable features of this arrangement were thought to be obvious. This was the state of distribution theory as it left the hands of Alfred Marshall and J. B. Clark, and it is to this analysis that Veblen addresses himself.<sup>69</sup>

To begin with, Veblen's conception of the class structure was totally different from the orthodox tradition. In the analysis of class structure he remains consistent to the categories of industrial and nonindustrial employment. In a more extended breakdown, Veblen makes the distinction between the upper, middle, and lower classes, which he identifies respectively with the aristocracy or the predatory classes proper, the business class, and the industrial class. The first two, granting the distinction previously discussed, are nonindustrial.<sup>70</sup> The

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rationale for the maintenance of this distinction is private property. It is the ownership of the means of production and natural resources which gives the nonindustrial classes the ultimate power to manipulate industry for the purpose of pecuniary gain. To put the matter somewhat differently, class distinction runs between "those who own more than they personally can use and those who have urgent use for more than they own."<sup>71</sup>

It must be remembered that Veblen's analysis is drawn in terms of large-scale, modern corporate enterprise with a considerable degree of purely financial control where "the pecuniary magnate . . . is superior to the market on which the capitalist-employer

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<sup>69</sup> The argument has been greatly simplified, although greater detail would not affect the conclusions. For a fairly complete discussion cf. George J. Stigler, *Production and Distribution Theories* (New York: Macmillan, 1941), esp. chs. iv, xi, xii.

<sup>70</sup> *Instinct of Workmanship*, p. 184.

<sup>71</sup> *Absentee Ownership*, p. 9.



depends.”<sup>72</sup> In these circumstances the class division may be looked at as “between those who own wealth invested in large holdings and who thereby control the conditions of life for the rest; and those who do not own wealth in sufficiently large holdings, and whose conditions of life are therefore controlled by these others.”<sup>73</sup> Another way of putting the proposition is that in an advanced industrial society the division is between the vested interests and the common man, a vested interest being defined characteristically as a “legitimate right to get something for nothing, usually a prescriptive right to an income which is secured by controlling the traffic.”<sup>74</sup> The prescriptive right is, of course, a property right. Ancillary to the vested interests are such groups as go to make up the “gentry,” the “crown,” and the “clergy.”<sup>75</sup> The distinction is not hard and fast in Veblen’s analysis. There is much movement back and forth between the classes, but “the great distinguishing mark of the common man is that he is helpless within the rules of the game as it is played in the twentieth century under the enlightened principles of the eighteenth century.”<sup>76</sup> The common man is with marginal exceptions the industrial class. Thus the problem of distribution for Veblen is the division of the product between these two groups, which cuts across the lines of demarcation drawn in the orthodox tradition.

To return to the neoclassical treatment of the theory of distribution, Veblen points out that the basis for ownership is alleged to be the productive labor of the owners. The institution of property itself

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is traced in the conjectural history of the orthodox tradition to the productive labor of the hunter, the fisher or the herdsman.<sup>77</sup> If it is granted that productive goods and services, which by assumption are owned, are the most important elements in modern economies, and if exchange can only occur via the mechanism of pecuniary transactions, then the society must treat pecuniary transactions as productive and by the application of the principle of exclusion, nonpecuniary transactions as nonproductive.<sup>78</sup> But since the industrial arts yield

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<sup>72</sup> *Place of Science*, p. 382.

<sup>73</sup> *Vested Interests*, p. 160.

<sup>74</sup> *Ibid.*, pp. 161-162.

<sup>75</sup> *Idem.*

<sup>76</sup> *Ibid.*, p. 163.

<sup>77</sup> *Essays in Our Changing Order*, pp. 32-33.

<sup>78</sup> *Instinct of Workmanship*, pp. 208-209.

no determinable income to any one individual, it is impossible to attribute productivity to what Veblen regarded as the most important factor in determining the level of output, namely, the prevailing technology, that is, the state of the arts. "It is the indispensable foundation of all productive industry, of course, but except for certain minute fragments covered by patent rights or trade secrets, this joint stock is no man's individual property."<sup>79</sup> If this joint stock of knowledge belongs to the community at large then the efficiency of any single individual in the industrial process is determined by the state of the arts, which is in turn a function of the level of culture attained by the community; and the imputation of efficiency to any given workman or any other factor of production is impossible.<sup>80</sup>

Thus, given the value categories with which Veblen operates, the neoclassical marginal productivity theory of distribution can have no meaning. For while the entrepreneur, for example, may be productive in the sense of increasing the pecuniary return of the firm, his activities according to Veblen should be interpreted in terms of the interruption of the industrial process, which implies, if anything, negative value productivity. In the same wise, wages paid to salesmen, buyers, accountants, and the like may only be imputed from pecuniary, not industrial, productivity. Even individuals engaged directly in the productive process are working in accordance with the instructions given by business management; so their tasks are limited by the restriction of output or the production of commodities which are less

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serviceable to the community than they might have been. Therefore their wages cannot be imputed from the utility of the product to the community:

It might, therefore, be feasible to set up a theory to the effect that wages are competitively proportioned to the vendibility of the product; but there is no cogent ground for saying that the wages in any department of industry, under a business regime, are proportioned to the utility which the output has to any one else than the employer who sells it. When it is further taken into account that the vendibility of the product in very many lines of production depends chiefly on the wastefulness of the goods . . . the divergence between the usefulness of the work and the wages paid for it seems wide

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<sup>79</sup> *Engineers and the Price System*, pp. 27-28.

<sup>80</sup> *Instinct of Workmanship*, pp. 144-145. The consideration applies with somewhat less force to the problems of short-run production where it is possible to impute the degree of productivity from engineering data. But Veblen is arguing specifically in the context of distribution theory.

enough to throw the whole question of an equivalence between work and pay out of theoretical consideration.<sup>81</sup>

Veblen's objections to the neoclassical analysis of distribution has proceeded on three grounds: First, the view of the class structure is inadequate when the facts of the modern productive processes are considered. Second, the identification of pecuniary with industrial returns is incorrect. It was developed because the acceptance of private property as an aspect of the natural order made it inevitable that the analysis should run in terms of pecuniary magnitudes. And finally, it would be impossible to impute a return to the state of the arts, which from the social point of view is the most important determinant of productivity.

Granting the existing institutional structure the neoclassical analysis did not according to Veblen provide us with an explanation of the phenomenon of distribution. Where is such an explanation properly to be found? Veblen begins with the category of capital seen as an aspect of ownership: "The state of the industrial arts continues, of course, to be held jointly in and by the community at large; but equitable title to its usufruct has, in effect passed to the owners of the indispensable material means of production."<sup>82</sup> In other words, through the ownership of the means of production, the vested interests are able to secure in the form of a proprietorial income the pecuniary returns of business activity, such returns giving them their claim on the real product of the economy.

These usufructs on the product of the technology take the form of capital. Capital in the orthodox discussions has been variously treated.

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It usually has reference to physical quantity whether fund or flow, though the definition of the immediate uses of capital have varied extensively. Veblen treats capital as a purely pecuniary magnitude. Its value is defined as the capitalized earning power of the firm as the basic unit of valuation. The same arguments apply, *mutatis mutandis*, to land. It is clear, then, why the returns to capital cannot be imputed either from the cost of the capital or from its productivity (in a real rather than a pecuniary sense). The returns to the firm are the result of peculiarly business activities, and as such the value of capital may reflect the differential advantages to the firm which appear in the corporate accounts as good will or as asset values inflated through revaluation. Even if this were not true, it still remains that the state

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<sup>81</sup> *Theory of Business Enterprise*, pp. 62-63n.

<sup>82</sup> *Vested Interests*, p. 60.

of the arts, or the common fund of industrial knowledge, cannot be sliced up into so many units each of which contributes some fraction of the total productivity.<sup>83</sup>

In an interesting application of the argument Veblen remarks on the ability of nations to make rapid recoveries from the destruction of war. Economic historians, he suggests, have been persistently surprised at this ability especially after an extensive destruction of capital values; but their surprise is due to their apprehension of capital in terms of standard economic theory where real value is identified with pecuniary assessment. If the state of the industrial arts is properly conceived of as a system of habits of thought and knowledge which would have suffered slight damage, the phenomenon would come as a lesser surprise.<sup>84</sup>

Granted the predominance of absentee ownership in Veblen's vision of the economy, the share of income received by the ownership group is determined by usufructs in the form of equities and claims on the industrial process. The income so derived is capitalized to determine the value of the claims for exchange purposes. It might be added that Veblen's analysis of cyclical fluctuations as an example of the wastes of the operation of the business system takes its point of departure from the capitalization process which in its detailed working out becomes a credit phenomenon. But the orthodox tradition could not, because of its identification of the industrial with pecuniary activities,

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develop a theory of the cycle articulated with its general theory of value and distribution. Of necessity, monetary theory and cycle theory developed as special theories.

As far as the determination of return to the industrial classes is concerned, Veblen takes the position that the amount must be determined *ad hoc*, for in the last analysis the relationship between employer, or manager as a lieutenant of the vested interests, and the workers is one of bargaining:

The two parties to the quarrel—for it is after all a quarrel—have learned to know what to count on. And the bargaining between them therefore settles down without much circumlocution into a competitive use of unemployment, privation, restriction of work and output, strikes, shutdowns and lockouts, espionage, pickets, and similar manoeuvres

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<sup>83</sup> See the extended discussion in *Theory of Business Enterprise*, ch. vi, *passim*.

<sup>84</sup> T. Veblen, *Imperial Germany and the Industrial Revolution* (New York: Viking, 1939), pp. 263-264.

of mutual derangement with a large recourse to menacing language and threats of mutual sabotage.<sup>85</sup>

In other words, the determination of the return to the industrial class is a matter of the determination of the market price of the product, labor, given the businesslike methods of market relationships. But this brings us to the next section where we shall compare specifically Veblen's analysis of the operation of the market mechanism with that of the neoclassical economists.

## V

In the course of the development of Veblen's economic thought an important change in emphasis occurred. Prior to *The Instinct of Workmanship* (1914) the emphasis is on the question of the distribution of wealth and the effects on society of the concentration of the claims on wealth in the hands of a leisure class of absentee owners. It is, of course, impossible to separate the analysis of distribution from that of allocation even in Veblen's treatment, for the way in which the vested interests extract their income from the industrial process determines the organization of industry and commerce subject only to the inherent logic of mechanical organization, which could be distorted through a considerable range. With *Imperial Germany* (1915) and especially with extensive passages in the chapter "Peace and the Price System" in *The Nature of Peace* (1917) the emphasis is increas-

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ingly on efficiency, organization, and such problems. *The Engineers and the Price System* (1921) completes the shift. No change is involved in any of Veblen's analytical categories; it is simply a change in emphasis. Thus in *The Theory of Business Enterprise* the point of departure is the nature of capital and its relation to credit, which we have treated as a distributive category. The value of capital is enhanced through the interruption of the industrial process, but the strategic element is the class structure. In the later work the analysis settles on the industrial process itself with the distributive results in the background.

Several possible reasons for the shift in emphasis are to be found: First, after the turn of the century there were a number of changes in the complexion of industrial organization, which increasingly took up Veblen's attention: the beginnings of rationalization, the development of new power sources, and the growth of industrial chemistry.

When the growth of industrial chemistry and electricity set in there also set in by insensible degrees, a new era in the articulation of industrial processes. . . . The number

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<sup>85</sup> *Absentee Ownership*, p. 406.

and interplay of technological factors engaged in any major operation in industry today are related to the corresponding facts of the middle nineteenth century somewhat as the mathematical cube is related to the square; and the increase and multiplication of these technological factors is going forward incontinently, at a constantly accelerated rate.<sup>86</sup>

The mathematical analogy is to be taken, of course, like the more famous Malthusian relation. But the change in the industrial order, with its increasing demands for management and control by technicians who understand the industrial process, concerned Veblen most immediately for the rest of his life.

Next, the higher level of prosperity for the nation as a whole with the corresponding decline in agrarian discontent lessened the popular emphasis on some of the more malodorous business activities that were personalized in the conduct of the Captains of Industry and Solvency leading to the preoccupation with the sources and uses of their wealth. Finally, in the economic writings of the day the difficulties with the theory of distribution and the fatuous nature of some of the conclusions, particularly those of J. B. Clark, were increasingly realized,

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and the attention of the profession at large was shifting to a more specific analysis of the price problem. As Joan Robinson has remarked: "Marshall turned the meaning of value into a little question: Why does an egg cost more than a cup of tea? It may be a small question but is a very difficult and complicated one. It takes a lot of time and a lot of algebra to work it out. So it kept Marshall's pupils preoccupied for fifty years."<sup>87</sup> Veblen was conscious of the center of theoretical interest, and his own shift in emphasis was partially in response to the shift in neoclassical analysis.

Joan Robinson might have added that there was a wider purpose than simply to determine the price of a cup of tea, namely, a demonstration of the conditions under which it would have been the best of all possible prices. The problem was solved in terms of the orthodox vision of the economy as discussed in section II. In justice, it should be pointed out, however, that the later theorists began to take this vision as postulate rather than reality, although in many cases the distinction is a fine one. Briefly, with the large number of firms presupposed, those firms must have minimum costs at an output small enough so that no firm may influence the market in which it sells its commodity. The same conditions hold

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<sup>86</sup> *Ibid.*, p. 271.

<sup>87</sup> *On Re-reading Marx* (Cambridge: Students' Bookshop, 1953), p. 22.

true, *mutatis mutandis*, for purchases of commodities or factors of production. The pressure of newcomers to the market will set prices at minimum cost levels, implying minimum acceptable profits but assuring that industrial establishments will be operating at optimum efficiency. Consumers will then be getting commodities at minimum attainable prices and will be maximizing the satisfaction derivable from those commodities in the manner we have already discussed. Subject to certain qualifications, the importance of which it was generally assumed were not great enough significantly to effect the result, this process would lead to the maximization of the net social return.

Many of the objections of Veblen to this argument have already been discussed. They proceeded on two levels, which are closely related: First, business enterprise cannot in the context of Veblen's statement of the value propositions be said to operate with efficiency; this point is the familiar one. Second, confining our attention to the market relationships only, the orthodox model of market behavior is highly unrealistic. In this connection Veblen anticipates a sub-

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stantial portion of present-day oligopoly and bilateral bargaining theory. In fact, he holds these models of behavior to be the only significant ones.

To recapitulate Veblen's first set of objections to the orthodox position, the requirements of profit maximization are inconsistent with the efficient operation of an articulated industrial system. "So long as the price system rules, that is to say, so long as industry is managed on investment for a profit, there is no escaping this necessity of adjusting the process of industry to the requirements of remunerative price."<sup>88</sup> In the post-World War I period Veblen began to make use of the ugly word, sabotage. Businessmen were thought of as sabotaging the industrial process through the restriction of supply, the obstruction of traffic, and meretricious publicity with a view to more profitable sales.<sup>89</sup>

The potentialities of effective sabotage can only be fully realized if the firm has some degree of control over the market. Up to the last half of the nineteenth century competition was described by Veblen as relatively free in the sense that markets were increasing faster than the productive capabilities of industry. This led to an emphasis on quantity of output with gains to be made through the spreading of overhead. Prices in this situation could not be varied because of any one firm's increase in output, so the economic order, when not

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<sup>88</sup> *Nature of Peace*, p. 325.

<sup>89</sup> *Vested Interests*, p. 100.

threatened by a cyclical downturn, offered a fair prospect of continued profit at increasing levels of output.<sup>90</sup>

This condition of free competition, which bears some resemblance to the orthodox competitive models, during the last half of the nineteenth century began “dying at the top” in what Veblen called the key industries, that is, those industries on which the rest of the industrial establishment was immediately dependent, such as coal, steel, oil, transportation, and structural work.<sup>91</sup> From the key industries the decline of free competition spread throughout the rest of the economy. The critical point was reached, Veblen argues, when these key industries had been brought under absentee ownership on a scale sufficiently large to furnish a basis of collusive management.<sup>92</sup>

Specifically, the development of improved technology during this

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period permitted firms to produce quantities far beyond the current business needs. The business need is defined as that quantity consistent with profit maximizing. In other words, the strategic firms were operating under conditions of decreasing cost in the area of profit maximizing quantities. But because of their size with respect to the market they were unable to take advantage of the situation, for any increase in output would lower the market price. On the demand side, the available markets had reached their limits or at least were not expanding as rapidly as productive capacity. These conditions led to a substitution of competitive selling in place of the competitive production of goods, for the principal gains were to be made at the expense of other firms without affecting total industry output, which would have resulted in decreases in industry prices. Thus, as Veblen remarks, “the chief expedients in this businesslike competition . . . [were] salesmanship and sabotage. Salesmanship in this connection means little else than prevarication, and sabotage means the businesslike curtailment of output.”<sup>93</sup>

The typical market situation was one in which the firms were large with respect to the market, and the recognized interdependence of pricing and production policies led to an increasing use of the devices of salesmanship (Veblen would have included the attributes of what has come to be known as product differentiation or variation under this head) for

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<sup>90</sup> *Engineers and the Price System*, pp. 35 ff. Also *Absentee Ownership*, pp. 72 ff.

<sup>91</sup> *Absentee Ownership*, p. 77.

<sup>92</sup> *Ibid.*, p. 213.

<sup>93</sup> *Ibid.*, pp. 78 ff.



purposes of increasing market shares. While these structural conditions were developing, the relationship among firms was characterized by cutthroat competition, which raised the threat of significant declines in earning capacity.<sup>94</sup> This situation would not for long be maintained because it directly militated against the position of the “vested interests,” who are increasingly responsible for business activities as the financial control begins to dominate in the strategic areas of industry.<sup>95</sup> As a result,

the country’s business concerns have entered into consolidations, coalitions, understandings and working arrangements among themselves—syndicates, trusts, pools, combinations, interlocking directorates, gentlemen’s agreements, employers’ unions—to such an extent as virtually to cover the field of that large scale business that sets the pace and governs the movements of the rest.<sup>96</sup>

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This does not imply the end of sabotage and salesmanship, for it is still the purpose of business to manipulate consumers and to limit production even though the problems arising out of competitive relations among firms have been settled.

Thus for Veblen the orthodox analysis of the allocative mechanism operating through the market-price mechanism had little meaning. The definition of efficiency vis-à-vis the ability of the system to meet the demands of the individual consumer was inconsistent with Veblen’s definition of efficiency vis-à-vis society. It further overlooked the important fact that the individual was manipulated by business through salesmanship to suit the ends of business. The consumer could scarcely be taken as the bench mark for the analysis. Next, technology was such as to make large-scale business inevitable. This led to the development of collusively oligopolistic pricing and marketing practices, for the alternatives were such as to damage the position of the “vested interests.” The only way, then, in which the mechanism of allocation could be analyzed was through a careful study of the development of business practices with full recognition of the conflict between industrial and pecuniary ends.

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<sup>94</sup> *Ibid.*, pp. 337 ff.

<sup>95</sup> *Ibid.*, pp. 339 ff.

<sup>96</sup> *Engineers and the Price System*, p. 124.