

# **Thorstein Veblen on the Nature of the Firm and Income Distribution**

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# **Thorstein Veblen on the Nature of the Firm and Income Distribution**

**Abstract:** The aim of this paper is to provide a theoretical model inspired by Veblen's theory of the firm, and to derive some implications of firms' behaviour for the process of income distribution. It will be shown that the firm is a locus of conflict, involving technicians – interested in expanding production – and “businessmen” – interested in gaining money profits via the management of the “pecuniary side” of the firm. The outcome of the bargaining within the firm defines the ‘workmanship-type’ or ‘non-workmanship-type’ nature of the firm, and affects the level of real wages and employment, insofar as the greater the power of technicians, the higher the real wages are. Moreover, since the expansion of production is associated with the minimum degree of underutilization of capital, technical improvements have a positive effect on the level of employment. Finally, it is argued that a wage increase can have a positive effect on the degree of capital utilization and the level of employment, via the increase in total demand and in the degree of capital utilization.

**Keywords:** Veblen, theory of firm, wages, income distribution

**JEL classifications:** B15, B31, D21, D30

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## 1 - Introduction

Veblen's contribution to economic theory has been the object of a renewed interest (see, among others, Tilman, ed., 2003), with particular reference to two distinct aspects. First, his approach to institutions – defined as “special method of life and of human relations” (Veblen, 1975 [1889], p.188) – has been re-proposed within the so-called new Institutionalism, with the aim of presenting a theory of economic behaviour (where instincts, habits, customs and transaction costs play a pivotal role) opposed to the mainstream ‘rational choice’ view (see Hodgson, 1988). Second, attention has been devoted to his arguments on “conspicuous consumption” and imitation phenomena, and the relation between consumption on the part of the “leisure class” and the process of income distribution. Within this line of research, the recent contribution by Bowles and Park (2005) is worth noting. They show that – assuming that emulative processes are in operation also *between* classes (i.e. the working class emulates the leisure class) – working hours increase in proportion to the inequality of income distribution. Their model is based on some arguments put forward by Veblen in *The theory of the leisure class*: technological aspects – which are extremely significant in Veblen's theoretical framework - are not taken into consideration, and psychological factors alone are used to analyse the dynamics of the labour market and income distribution.

The aim of this paper is to provide a theoretical framework where, starting from the analysis of the behaviour of the firm in a Veblenian perspective, income distribution is primarily determined by technological factors, and where distributive conflicts (involving technicians vs. businessmen and workers vs. the leisure class) play a crucial role. The schema is intended to connect the works of Thorstein Veblen in the belief that the picture he presents in *The theory of the leisure class* is the “general case” with respect to the topics dealt with in his subsequent works (cf. O'Hara, 2000, p.70). The argument runs as follows. Given the Veblenian picture in *The theory of business enterprise* (Veblen, 1904), the firm is described as a locus of conflict, involving the “technicians” (engineers and industrial experts) - driven by the “instinct of workmanship” and whose aim is to apply new scientific knowledge in the production process – and “businessmen” driven by “predatory” attitudes and only interested in money profits via the management of the financial structure of the firm<sup>1,2</sup>. While

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<sup>1</sup> With regards to the “instinct of workmanship”, Veblen (1975 [1899a], p.15) writes: “As a matter of selective necessity, man is an agent [...]. He has a sense of the merit of serviceability or efficiency and of the demerit of futility, waste, or incapacity. This aptitude or propensity may be called the instinct of workmanship”, and “idle curiosity” ultimately supports it. The instinct of workmanship involves the pleasure in useful work, the dislike

technicians are interested in expanding production, thus reducing prices, businessmen aim at gaining money profits by increasing prices. At the same time, businessmen are also interested in technical improvement since it allows a more rapid turnover of capital and, as a result, more profits. In this theoretical context, it will be shown that income distribution is primarily affected by the prevalence of technicians *or* businessmen in setting firms' targets: the more the firm is of a 'workmanship-type' (i.e. the greater the technicians' power), the higher the real wages and level of employment, and the lower the profit/wage ratio. Moreover, it will be argued that the leisure class also affect income distribution, mainly via its control of the financial market. It is worth noting that the existence of unemployed workers – in Veblen's view – is the *normal* condition in a deregulated market economy: unemployment is "deliberate and habitual" (Veblen, 1921, p.71)<sup>3</sup>.

The exposition is organized as follows. In section 2 a theoretical model aiming at analysing firms' behaviour is presented. Section 3 deals with the effects of firms' behaviour on income distribution and section 4 concludes.

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of waste and the adoption of a way of thinking based on mechanical sequences. Instincts do not have a purely biological character. As O'Hara (1999, p.162) remarks, "Instincts, for Veblen, are not purely physiological, biological, and psychological, but are heavily conditioned by institutions". Asso and Fiorito (2004, pp.447-448) point out that "Veblen conceives instincts as universal goals or propensity inborn in the human agent and transmitted as "hereditary traits"". Moreover, they also note that "Although Veblen admitted that all instincts touch, blend, overlap, and interfere with each other, and therefore cannot be conceived as acting in isolation from others, he advanced his own taxonomy of instincts according to their 'teleological content'". Stephen Edgell (2001, p.79) argues that instincts, in Veblen's thought, are strictly linked to human intelligence: "Veblen defined instincts in an unconventional way in keeping with his assumptions that humans were active and intelligent animals". Edgell (2001, p.80) finds "two basic types" of instincts: "those of a group-regarding character and those of a self-regarding character". The "parental bent", which is also a typical Veblenian issue, defined by Anderson (1933, in Tilman, 2003, vol. II, p.8) as "the instinct of social sympathy" involving some forms of altruism, is at the basis of (i.e. "reinforce[s]") the "instinct of workmanship", according to what Edgell (2001, p.81) defines "mutually reinforcing instincts". Cordes (2005, p.7) stresses that "The psychological foundations of Veblen's approach laid out in 'The Instinct of Workmanship' refer to the state of the cognitive sciences at that time. Since then, the concept of, for example, 'instincts' has changed considerably. In contrast to the modern ethological understanding of 'instincts', Veblen's notion of them does not involve more or less fixed behaviors but a bundle of flexible dispositions or propensities that can be suppressed or diverted". On this topic, see also Wolozin (2005).

<sup>2</sup> In *The theory of the leisure class* (Veblen, 1975 [1899a], p.8), a "predatory attitude" – referring to a primitive culture, which is still surviving – is defined as the tendency to "the infliction of injury by force and stratagem".

<sup>3</sup> And: "The recurrence of hard times, unemployment, and the rest of that familiar range of phenomena, goes to show how effectual is the inhibition of industry exercised by the ownership of capital under the price system" (Veblen, 1908, p.108).

## 2 – The microeconomic plane: the firm as a locus of conflict

The basic idea underlying Veblen's theory of the firm is that the management of its financial structure is separated from the control of the production process. This functional separation, which can be identified with the dichotomy between "business" and "industry", is the result of a historical process, where larger sized firms required specific attention to their financial aspects, hence enhancing the division of labour within the firm:

"The pecuniary side of the enterprise came to require more unremitting attention, as the change for gain or loss through business relations simply, aside from mere industrial efficiency, grew greater in number and magnitude. The same circumstances also provoked a spirit of business enterprise, and brought on a systematic investment for gains" (Veblen, 1904, ch.III).

In contemporary economies, according to Veblen, the functional separation between business and industry results in the potential conflict between those who manage the "pecuniary side" of the firm ("businessmen"<sup>4</sup>) and those who control the production process ("technicians" or "engineers")<sup>5,6</sup>. This conflict is described in these terms:

"In the normal course of business touching this matter of industrial consolidation [...] the captain of industry works against, as well as for, a new and more efficient organization. He inhibits as well as furthers the higher organization of industry" (Veblen, 1904, ch.III).

Businessmen need technicians for two main reasons. First, given the division of labour within the firm, businessmen are unable to directly contribute to the production process, in an institutional context where technical knowledge plays a pivotal role. In this sense, the employment of technicians is a precondition for the production itself. As Donald A. Walker (1977, in Tilman, 2003, vol.II p.67) stresses: "Technicians are important because [...] they keep the industrial machinery in operation"<sup>7</sup>. Second, technical improvements can positively affect profits insofar as they reduce the turnover of capital. This issue will now be explored.

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<sup>4</sup> On the terminological distinctions between businessmen, entrepreneurs and captains of industry see, in particular, Veblen (2001 [1921], pp.20-21).

<sup>5</sup> This point is particularly stressed by Rutherford (1984) and more recently by O'Hara (2000).

<sup>6</sup> In the same vein, Anderson (1933, in Tilman 2003, vol. II, p.20) writes: "The purpose of industry is goods for the subsistence and comfort of men. The purpose of business, on the other hand, is to make money profits. So long as markets are expanding, as was the case in the handicraft period, this duality of purpose need cause no harm; but in the modern industrial age markets do not expand at a sufficiently rapid rate. The result is that the duality becomes a conflict".

<sup>7</sup> "The processes of production were continually growing more intensive, diversified, complicated, and more difficult for any layman in technology to comprehend" (Veblen, 2001 [1925], p.28).

Veblen maintains that “there are two chief means of shortening the interval of the turnover, currently resorted to in industrial business”, and that they are “the adoption of more efficient, time-saving industrial processes” and advertising<sup>8</sup>. In a long footnote (n.5, ch.V) of *The theory of business enterprise*, he clarifies:

“The turnover will count for more in gross earnings at current rates if instead of his own capital alone the business man also engages whatever funds he can borrow by using his capital as collateral. The turnover counted on capital (value of the industrial equipment) plus credit, at current rates, will be greater than that counted on the capital alone used without credit extension. The turnover may be expressed as the product of the mass of values employed multiplied by the velocity. Hence, if credit be taken as indeterminate fraction (capital/n) of the capital used as collateral, we may say that

Turnover=(1/time)(capital+capital/n), i.e.  $T=(1/t)(c+c/n)=(c+c/n)/t$ ;  $t=(c+c/n)/T$ .

The algebraic statement serves to bring out the equivalence between an acceleration of the rate of turnover and an increase of the volume of business capital”<sup>9</sup>.

In this formulation,  $T$  is revenue per unit of time, i.e. what firms obtain by selling their product via the use of time-saving techniques, while  $c$  is money capital obtained via self-financing and  $c/n$  is the amount of bank credit. By setting an exogenous length of the production process ( $L$ ), expressed in terms of money revenue per unit of time and given by “the time ordinarily allowed in the line of industry in which he is engaged”, extra-total revenues ( $\Delta R$ ) for the individual firm (with respect to its competitors) become:

$$\Delta R = T - L = [(1/t)(c+c/n)] - L \quad [1].$$

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<sup>8</sup> “Improvements of industrial plant and industrial processes” – Veblen adds – “having this in view are gaining in importance in the later developments of business, since a closer attention is now given to the time element in investments, and great advances have been made in this direction”.

<sup>9</sup> The author recalls Jevons’s *Theory of political economy* on this point and criticizes Sombart’s view, in *Kapitalismus*, that “the use of credit lengthens the time of turnover of capital”. He underlines the difference between his approach and that of Böhm-Bawerk and Fisher in these terms: “Technological (industrial) procedure, being of the nature of physical causation, is subject to the time relation under which causal sequence runs. This is the basis of such discussions of capital and interest as those of Böhm-Bawerk, and of Fisher. But business traffic, as distinguished from the processes of industry, being not immediately concerned with the technological process, is also not immediately or uniformly subject to the time relation involved in the causal sequence of the technological process. Business traffic is subject to the time relation because and in so far as it depends upon and follows up the processes of production” (Veblen, 1908, p.124). This is to say that the *time* element is not only involved in the production process but also in the market process, where the latter (i.e. the time spent in *selling* goods) is likely to affect the former (i.e. the time spent in *producing* goods) and *viceversa*. It could be useful to recall that, in *Capital* (book II, section 2), Marx maintains that the overall length of the cycle of a given capital results from the *sum* of its time of circulation and its time of production: in this sense, Veblen’s view appears similar to that of Marx, on this specific point, insofar as capital turnover also includes the time of circulation.  $R$  being one year (as the unit of measurement of the turnover),  $r$  the turnover time of a given capital and  $n$  the number of its turnovers, the following formula gives Marx’s theory of capital turnover, as presented in *Capital*:  $n=R/r$ .

Note that in this theoretical framework, competition is conceived as a *process* devoted to gain differential advantages, in particular aimed at obtaining extra-profits with respect to the competitors; a different notion from neoclassical (static) competition, where the individual firm's decisions are independent of the others' decisions<sup>10</sup>.

As a result, on the microeconomic plane, revenues for the individual firm *A* are higher (and higher than those of its competitors) as is its differential advantage *i*) the longer the 'ordinary' duration of the production process (i.e. the lower the revenue per unit of time on the part of its competitors, *L*); *ii*) the less time required for the production of its goods, i.e. the more efficient (i.e. time-saving) the production process; *iii*) the higher the money capital supplied to the firm by banks. Revenues (*R*) increase profits (*P*) under the condition that total costs remain unchanged.

The first condition presupposes that a "normal time" of production exists and is known to the entrepreneur. Furthermore, insofar as the "normal time" of production is determined by the technical choices of the competitors, s/he is forced by the competitive pressure to use time-saving techniques. In other words, the higher the intensity of competition, the lower the resulting value of *L*, and the more the individual firm is forced to increase the degree of efficiency in the production process.

The second condition is linked to the possibility, and the advantageousness, for firms to exploit the technical knowledge they possess<sup>11</sup>. Although Veblen does not expand this

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<sup>10</sup> In *The theory of business enterprise* (ch. 5, italics added), Veblen writes: "The business man's object is to get the largest aggregate gain from his business. It is manifestly for his interest, as far as may be, to shorten the process out of which his earnings are drawn, or, in other words, to shorten the period in which he turns over his capital. If the turnover consumes less than the time ordinarily allowed in the line of industry in which he is engaged, he gains *more than the current rate of profits in that line of business*, other things equal; whereas he loses if the turnover takes more than the normal time". Otherwise, he often refers to the aim of obtaining "differential advantage as against other competitors". Cutrona (2005, pp.269-274) convincingly remarks that Veblen's theory of the firm overcomes the conceptual problems of the neoclassical approach: "One of the weaknesses of orthodox theory is the lack of connection between the firm and the macroeconomic setting in which it operates. This connection is established here as a consequence of the assumption that the firm is an institution for the attainment of pecuniary gains". She adds that the Veblenian firm is engaged in "obstructing competitors' strategies", acting in view of the "movements of competitors". Thus, "the entrepreneur behaves strategically" and this view "anticipates" the theories of "administrated prices in oligopolistic markets". See also Viano (2005), who explores the relationships between Veblen's reading of Kant and his theory of instincts, with particular reference to businessmen's behaviour.

<sup>11</sup> In dealing with Veblen's view of technology, it seems necessary to distinguish between the *genesis* of technological knowledge and its (capitalistic) *use*. While the problem addressed here only regards this latter question, it is important to stress that – according to Veblen – *technology is a social construct* (see Lawson, 2006). As Hodgson (2004, p.183) writes "The individual and the social aspects of knowledge are connected, because the social environment and its 'common stock' of experience provide the means and stimulus to

argument, which would lead to the idea that the maximum technical improvements ( $t$ ) determine the maximum revenues, via  $T$ , one can argue that the opposite result can occur. This is because technical improvements imply an increase in output ( $Q$ ) and the consequent decline in prices ( $p$ ), so that  $R=pQ$  and the increase in  $t$  may have a *negative* effect on  $T$  under the condition that the elasticity of demand is low enough. In formal terms, since  $dQ/dt > 0$  and  $dp/dt < 0$ ,  $t$  negatively affects  $T$  if, in absolute terms,  $dp/dt > dQ/dt$ . It may happen that,  $t^o$  being the maximum degree of technical improvement generated by technicians, its actual value is  $t^* < t^o$ : underutilization of capital being the consequence. This issue – which establishes that the minimum  $t$  does not necessarily imply the maximum  $T$  - will be further discussed below.

The third condition derives from Veblen's view of the division of labour within the firm, in the sense that the typical function of the businessmen is to manage the "pecuniary side" of the firm and, hence, to deal with the banking system. This condition establishes a positive relation between investments and revenues, which can be limited by the value of the interest rate. The rationale for this relation, according to Veblen (1904, ch.V), is to be traced in the "trite commonplace that the earnings of any industrial business [is] a function [of] the volume of business"<sup>12</sup>. Veblen adds that high interest rate can disincentive entrepreneurs' demand for credit, hence reducing the turnover of capital: "on funds obtained on credit the debtor has to pay interest" and "This sets a somewhat elastic limit to the advantageous use of loan credit in business". This argument leads to the following result: for a given technology, the increase (decrease) in the interest rate determines a reduction (increase) of  $T$ . Thus "earnings" increase as the interest rate declines.

As we have seen, Veblen also refers to advertising as a means of increasing  $T$ . This occurs because the rate of turnover can be dependent on the "competitive pushing of sales", by selling before the competitors and accelerating the sales. In this sense, *rapidity* (in producing and selling) can be a relevant variable in the competitive struggle. Advertising also plays a significant role in modifying the elasticity of the demand. As a result, given the argument

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individual learning". Mouhammed (2003, p.151) remarks that "Technology (the industrial arts or the joint stock of knowledge) is a social ownership of the community and is accumulated over time. However, by private ownership of the means of production capitalists invariably manage to appropriate the benefits of the technological advantages, which should have been imputed to the community. Thus, for Veblen, the neoclassical marginal productivity theory cannot be applied either to the tangible (or the durable part of the capital) or to the intangible part". Note also that technology affects uncertainty, since "agents cannot know in advance which alternatives will ultimately be selected in future because selection processes are outside of their control" (Van der Steen, 1999, ch.2).

<sup>12</sup> Veblen attributes this "trite commonplace" to Alfred Marshall (*Principles of economics*).



above, advertising affects the relationship between  $dQ/dt > 0$  and  $dp/dt < 0$ , thus affecting  $t$ . The more effective the advertising, the higher the difference between  $dp/dt$  and  $dQ/dt$ , and the higher the difference between  $t^*$  and  $t_0$ . In this sense, advertising contributes to the underutilization of capital. Moreover, advertising is *waste*, since “competitive advertising is an unavoidable item in the aggregate costs of industry. It does not add to the serviceability of the output [...]. What it aims at is the sale of the output, and it is for this purpose that it is useful. It gives vendibility, which is useful to the seller, but has no utility to the last buyer”. As Kenneth J. Arrow (1975, in Tilman 2003, vol.II., p. 48) emphasises: “These expenditures [...] can be regarded as wastes; they yield indeed a competitive advantage but no social advantage”.

In view of the arguments above, the potential conflict between technicians and businessmen manifests itself in the underutilization of capital, or, in Veblen’s words, in “perversion”.

“The ownership of the capital goods affords a discretionary power of misdirecting in the industrial process and *perverting industrial efficiency*, as well as inhibiting or curtailing industrial processes and their output, while the outcome may still be profitable to the owner of the capital goods” (Veblen, 1908, p.108, italics added).

Veblen (1908, p.107) adds that “The most comprehensive principle involved in [...] business management is that of rising prices, and so increasing the net gains of business, by limiting the supply”<sup>13</sup>. In analytical terms, as will be shown, the elasticity of demand is a key variable in determining the potential conflict between businessmen and technicians. The following assumptions are made.

#### *ASSUMPTIONS*

1) Firms operate in an imperfect competition environment (see Arrow, 1975, in Tilman ed., vol.II, 2003). Businessmen are interested in money profits ( $P$ ), to gain differential advantages over their competitors (what Mayhev (2000) calls “cut-throat” competition), while technicians aim at producing and selling the maximum amount of goods ( $Q^o$ )<sup>14</sup>, given their technical knowledge and their maximum effort in applying it to the production process. If the

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<sup>13</sup> In interpreting Veblen’s theory of the firm, Arrow (1975, in Tilman, 2003, vol.II, p.48) maintains that “the rise in price may have a psychological effect on entrepreneurs and lead to a higher utilization of the existing stock of physical capital”. This can be a counterbalancing effect with respect of that described here, and it will not be taken into consideration for the purpose of our argument.

<sup>14</sup> The mere application of knowledge – without its actual use at the benefit of the community as a whole – would be ineffective for the purpose of the full realization of the “instinct of workmanship” (*to make goods not as an end in itself but as a means of increasing the social availability of goods*).

interests of technicians prevail over the interests of businessmen, the firm is of a ‘workmanship-type’, while it is ‘non-workmanship-type’ in the opposite case.

2) in view of equation 1], the individual firm is in a position of advantage over its competitors if  $T > L$ .  $T$  increases if  $t$  decreases and advertising ( $A$ ) increases;

3) profits are given by  $T - [c + c/n]$ , or, by replacing  $T$  with the revenue per unit of time ( $R$ ), by  $R - [c + c/n]$ , where  $c + c/n$  is the money capital invested by the firm for acquiring inputs<sup>15</sup>. Firms are assumed to be profit-maximizers<sup>16</sup>;

4) The production function is assumed to show constant returns, i.e.  $Q = a(\gamma)N$ , where  $a$  is average labour productivity  $\gamma$  is technology and  $N$  is the number of workers employed.

### THE MODEL

Assumption 2 leads to the following result. Since  $T$  equals revenues ( $R$ ) per unit of time, and since the individual firm faces a downward sloped demand curve, revenue increases in output ( $Q$ ) and decreases in price ( $p$ ). Hence, total revenues are at a maximum when marginal revenues are zero, i.e.  $dR/dQ = p + (dp/dQ)Q = 0$ . This condition sets the level of production which maximizes profits ( $q^*$ ), for any given investment  $[c + c/n]$ <sup>17</sup>. Assuming that technicians aim at expanding production at the level  $q^o$ <sup>18</sup>, a conflict between businessmen and technicians arises when  $q^o > q^*$ , and the higher this difference, the more intense will the conflict become.

Figure 1 – where both panels are assumed to give positive values - describes this mechanism. In panel 2 the turnover of capital is represented: since the product  $tT$  gives rise to a constant value (i.e.  $c + c/n$ ), the capital turnover curve is a rectangular hyperbole. Panel 1 describes the revenue curve, under the condition that revenues increase in output and decrease in price. Corresponding to the zero marginal revenue, the firm obtains the maximum  $R$  and, hence, (the advanced money costs being given) the maximum level of profits<sup>19</sup>: therefore  $q^*$  is the optimum amount of production from the point of view of the businessman. If  $q^o$  is the optimum amount of production from the point of view of technicians, which, in turn, depends

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<sup>15</sup>  $c$  derives from a firm’s self-financing, in view of the fact that “the wealth so drawn by the [...] entrepreneurs is nearly all held as capital, very little of it being consumed in current expenses of living” (Veblen, 1904, ch.6, footnote n.29).

<sup>16</sup> In order to emphasise the time element in the profits function, it can be written as  $P = (c + c/n)[(tf - t)/t]$ , where  $tf$  is the productive length of the investment.

<sup>17</sup> Note that the value of  $t$  affects the relation between  $T$  and money capital, in the sense that if  $t > 1$   $T$  is lower than firm’s investments (the opposite holds if  $t < 1$ ). This latter assumption is held here.

<sup>18</sup> The case where  $q^o < q^*$ , although theoretically admissible, will not taken into consideration, in view of the fact that Veblen constantly maintains that the opposite case – *as a matter of fact* – holds. *The engineers and the price system* (Veblen 2001 [1921], p.4), in particular, is entirely devoted to exploring industrial sabotage, conceived as the “conscientious withdrawal of efficiency”.

<sup>19</sup> Note that, in view of this reconstruction, Veblen seems to maintain that technical improvements only affect revenues, not even money costs which are advanced with respect to the production process.

on the intensity of the “instinct of workmanship”, and the firm sells  $q^*$ , then  $q^o - q^*$  is the degree of capital under-utilization and, at the same time, a potential ‘bargaining space’ between technicians and businessmen<sup>20,21</sup>. Furthermore, the capital turnover curve shifts upwards if  $c+c/n$  increases, while the revenue curve – for the individual firm – may shift upwards if (successful) advertising increases. The level of employment is  $N=Q/a(\gamma)$  and  $N$  falls as capital underutilization rises, i.e. as firms are more ‘non-workmanship-type’.

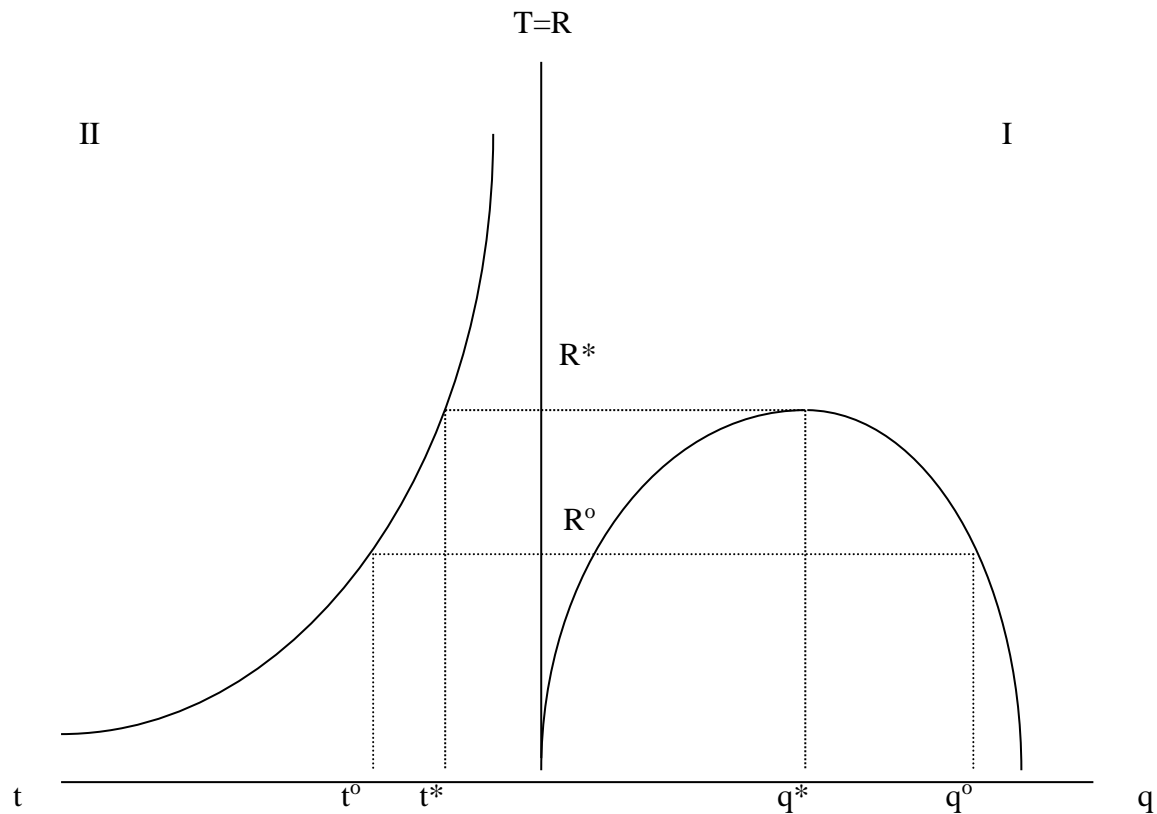


Figure 1: capital turnover and production

The elasticity of the revenue curve – which, in turn, depends on the elasticity of the demand curve - affects the potential conflict between businessmen and technicians, insofar as it increases the difference between  $q^o$  and  $q^*$ . Given an exogenous value of  $q^o$ , the lower the  $q^*$  resulting from zero marginal revenues, the higher the area where businessmen and

<sup>20</sup>  $q^o$  also indicates overproduction, i.e. “production in excess of what the market will carry off at a sufficient profitable price” (Veblen, 2001 [1921], p.8).

<sup>21</sup> Note that the high levels of  $t$  are associated with high or low levels of  $q$ . This is because  $t$  affects  $q$  indirectly, via pricing on the part of businessmen.

technicians exert their conflict and the possible degree of capital underutilization<sup>22</sup>. The lower the elasticity of the demand curve, the more the revenue curve lies on the left in panel I, and the higher the demand for the goods produced by the firm, the more the revenue curve lies on the right side of panel I: that is, *the more competitive the market for goods, and/or the higher the demand for the firm's goods, the higher the resulting  $q^*$* . Thus, the degree of competition in the market for goods affects the intensity of conflict between businessmen and technicians, in the sense that in competitive markets, since  $q^*$  is higher than in non-competitive markets, the difference  $q_0 - q^*$  (i.e. the degree of under-utilization of capital) should be lower than in non-competitive markets. Moreover, insofar as firm size is normally larger in non-competitive markets, and  $q^*$  smaller in non-competitive markets, one reaches the conclusion that the larger the firm, the higher the degree of capital under-utilization.

The difference between  $q^o$  and  $q^*$  is the 'bargaining space' where businessmen and technicians can negotiate over their own interests. Veblen does not provide a definite rationale for the determinants of the relative bargaining powers<sup>23</sup>. For the purpose of this argument, two sets of variables can be taken into consideration:

I) *On the institutional ground*, following Donald A. Walker (1977 in Tilman, 2003, vol.II, pp.68-70), although technicians are *prima facie* in the position to oppose price policies on the part of businessmen, "they do not experience the additional element of economic deprivation that would bring them into opposition with the wealthy class". In this respect, they are inclined to "cooperate [...] with the businessmen" ("capitalist lackeys")<sup>24</sup>. It is the emergence of unions, which, in turn, depends on the acceptance of new habits of thought on the part of workers via their employment in the mechanical production process (i.e. habits of thought which are based on "causal sequences" opposing the institutions of the natural rights system), which drives social changes, leading to a system where 'workmanship-type' firms prevail. Veblen (2001[1921], pp.45-50, italics added) maintains that "right lately these technologists have become '*class conscious*' and to reflect that they together constitute the General Staff of

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<sup>22</sup> It is assumed here that technicians' aim (in terms of  $q^o$ ) is not indifferent to the possibility of selling the product, so that – for every value of the elasticity of the revenue curve –  $q_0$  is not higher than the maximum quantity of goods consumers can buy. Otherwise, although Veblen is unclear on this point, it is also assumed that technicians are interested in respecting the 'non-bankrupt condition', i.e. they fix  $q_0$  so that profits cannot be negative.

<sup>23</sup> Veblen refers solely to the fact that capital under-utilization is normally at about twenty-five percent.

<sup>24</sup> "All the civilized people are suffering privation together because their general staff of industrial experts are in this way required to take orders and submit to sabotage at the hands of the statesmen and the vested interests" (Veblen, 2001 [1921], p.35). In *The engineers and the price system*, he refers to the "docility" of technicians in these terms: "By settled habit the technicians, the engineers and the industrial experts, are a harmless and docile sort, well fed on the whole, and somewhat placidly content with the 'full dinner pail' which the lieutenants of the Vested Interests habitually allow them".

the industrial system. Their class consciousness has taken the immediate form of a growing sense of waste and confusion in the management of industry by the financial agents of the absentee ownership”, and that – although few in numbers – “they are the leaders of the industrial personnel, the workmen, of the officers of the line and the ranks and file, and these are coming into a frame of mind to follow their leaders in any adventure that holds a promise of advancing the common good”<sup>25</sup>.

II) *On the economic plane*, the degree of replaceability of technicians affects their bargaining power, in the sense that the greater their numbers and the more homogeneous they are, the more the individual businessman can use the threat of dismissal to increase her/his bargaining power, thus making the technicians s/he employs more “docile”. There is a direct correlation – in Veblen’s view – between technicians’ “docility” and their salaries, and as a rule they act cooperatively with businessmen when their salaries are high enough. Moreover, the size of the firm can also play an important role in setting the aims of the firm itself and, as a result, the outcome of bargaining between businessmen and technicians. It is reasonable to expect – following Veblen’s argument - that the larger the firms is, the more businessmen tend to be profit-maximizers, given their willingness to collect and process information (on costs and revenues) and to *calculate*. In this sense, the size of the firm has a positive effect on the degree of division of labour within the firm and enables businessmen to specialize in profit-making activity<sup>26</sup>.

The outcome of the conflict between technicians and businessmen within the ‘bargaining space’ defined above – and in the conviction that “there must *always* be a certain variable

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<sup>25</sup> See, among others, Edgell (2001) for an extensive discussion on the debate on the determinants of institutional change in Veblen’s thought.

<sup>26</sup> Otherwise, in Veblen’s thought, two different aims of firms can be traced. On the one hand, he refers to the purpose of obtaining normal profits. They are defined as follows: “The precise meaning of ‘ordinary profits’ need not detain the argument [...]. The phrase is sufficiently intellegible to the business community to permit the business men to use it without definition and to rest their reasoning about business affairs on it as a secure and stable concept; and it is this commonplace resort to the term that is the point of interest here” (Veblen, 1904, ch. IV). On the other hand, according to Arrow’s interpretation (1975, in Tilman, 2003, vol.II p.47), firms “are profit-making” in Veblen’s schema. In view of the interpretation provided here, large firm size is associated with the goal of profit maximization, while small firm size is connected with the aim of normal profits. This distinction is likely to depend also on historical factors. Veblen (1904, ch.IV) appears to propose this argument in writing: “the rate of profits or earnings on investment has in the nineteenth century come to take the central and dominant place in the economic system [...] At the same time the ‘ordinary rate of profits’ has become a more elusive idea. The phenomenon of a uniform rate of profits determined by competition has fallen into the background and lost something of its matter-of-fact character since competition in the large industry has begun to shift from the position of a stable and continuous equilibration to that of an intermittent, convulsive strain in the service of the larger business men’s strategy”.

margin of unemployment of plant and manpower” (Veblen, 2001 [1921], p.9, italics added)<sup>27</sup> — affects income distribution, and it is this issue that will now be explored.

### 3 – The macroeconomic plane: institutions and income distribution

The schema above includes three macro-agents: banks, firms and workers. Setting aside the factors determining technicians’ wages (which can be considered salaries for highly skilled workers), interest, profit and wages can now be determined in the light of Veblen’s conflictual view of the firm and his arguments on bank-firm relationships.

a) *Credit, production and the interest rate.* As we have seen, Veblen maintains that firms need finance from the banking system in order to increase their money capital and, hence, by increasing the volume of investments, to obtain higher profits<sup>28</sup>. Veblen refers to  $c+c/n$  as an “indeterminate fraction (capital/n) of the capital used as collateral”. The relation between credit and production is analysed in two distinct ways.

i) Due to competitive pressure, the individual firm is forced to expand its capital via the use of credit, but “since the advantage to be derived from this expedient is a competitive advantage only, the universality of the practice results in but a slight, if any, increase of the aggregate earnings of the business community” (Veblen, 1904, ch.V).

ii) Insofar as firms are not homogenous, the credit system tends spontaneously to contribute to the increase in the size of the biggest firms: “since an advance of credit rests on the collateral as expressed in terms of value”, firms with a higher amount of collateral obtain a higher amount of credit and, hence, can expand, thus gaining further advantages over their (smaller) competitors. As a result, an ‘imperfect’ credit market is likely to spontaneously generate a selection of firms on the basis of their collateral, thus allowing the expansion of the bigger firms and the possible bankruptcy of the smaller firms. As Rutherford (1980, p.437) stresses, the distinction “between large corporations with market power and small undertakings such as independent farmers” is a key feature of Veblen’s picture of capitalist economies.

Note that, in both cases, bank-firm relationships do not affect the volume of aggregate production, but simply redistribute aggregate profits among firms. While bank decisions on

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<sup>27</sup> This is because “unemployment is deliberate and habitual”, insofar as “reasonable earnings’ could not be assured without it” (Veblen, 2001 [1921], p.71)

<sup>28</sup> He maintains that what counts for the purpose of making profits is “not the capital alone, but [...] the capital plus such borrowed funds as this capital will support”.

the *amount* of finance to extend to firms does not modify the aggregate value of the production, variations of the interest rate do so: an interest rate rise, in fact, “diminishes the *aggregate* net profits [...] in that it requires them to pay interest” (Veblen, 1904, ch.V, italics added). The inverse relation between interest rate and investments holds in contexts where uncertainty does not exist, or, in other words, an increase in the interest rate reduces investments only insofar as entrepreneurs’ expectations are not significantly optimistic. “The market fluctuations in the amount of capital” – Veblen (1904, ch.6) remarks – “proceed on variations of confidence on the part of investors, on current belief as to the probable policy or tactics of the guild of politicians, and of the indeterminable, largely instinctive, shifting movements of public sentiment and apprehension. So that under modern conditions the magnitude of the business capital and its mutation from day to day are in great measure a question of folk psychology rather than of material fact”.

A further consideration can be made. In his essay *On the nature of capital*, Veblen (1908, pp.132 ff.) refers to “great financiers” as the individuals who operate in the financial market, gaining “a tax on commonplace business enterprise”. He also maintains that the leisure class is composed, among others, by those who supply firms with money capital without directly contributing to the production process (in this sense, members of the leisure class can be seen as “absentee owners”<sup>29</sup>). In this picture, the ultimate source of the firm’s finance is the banking system, controlled by the leisure class, and the capacity of the banking system to produce money appears to be the key issue<sup>30</sup>: “Broadly speaking” – Veblen (1905, p.470)

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<sup>29</sup> Absentee ownership is regarded as “the dominant institution” via “the use of credit” (Veblen, 1923, ch.1), and “accountants, advertisers, public servants, members of parliament, owners of land and capital, banks and sales workers” are the representative members of the leisure class. Moreover, he adds that members of the leisure class can control firms also by means of the ownership of company stocks (as a part of its intangible assets): “The free income which is capitalized in the intangible assets of the vested interests goes to support the well-to-do investors, who are for this reason called the kept classes, and whose keep consists in an indefinitely extensible consumption of superfluities” (Veblen, 1919, ch.5).

<sup>30</sup> Dillard (1987) emphasises that Veblen’s dichotomy between industrial and pecuniary employment is a key issue of the so-called monetary theory of production, where money supply is endogenous, the interest rate is a purely monetary phenomenon and the production process starts with the demand for ‘initial finance’ on the part of firms. In so doing, the author finds significant analogies between Veblen’s and Keynes’s views of the functioning of monetary economies: “Money is a form of private property that wealth holders in business enterprise economy at times treasure more than income itself. It is a device for limiting losses in a profit-and-loss economy. The moral of Veblen’s teaching is that in a pecuniary economy, monetary values dominate industrial values” (Dillard, 1987, p.1646). In a similar vein, Parker Foster and Ranson (1987, p.228) maintain that “The conclusion reached by both Veblen and Keynes is that the traditional theory of production is flawed. Production is governed not by real exchanges but by the institution of money. Production continues only as permitted by the creation of new credit to finance new investment”. In comparing Veblen’s and Keynes’s thought, Mouhammed (2003, p.268) stresses that “Veblen believes (as Keynes does) that the interest rate and the money supply are used to control the economy by the vested interests”. He also attributes to Veblen the Keynesian principle of effective demand, arguing that a ‘vent for surplus’ argument via imperialism is relevant in Veblen’s thought (pp.273 ff.). In line with Dillard and Parker Foster and Ranson, Mouhammed (2003, p.279)

emphasises – “banking is profitable chiefly because the banker lends more than that he has or borrows”, and “the banker [can] create a new volume of credit”<sup>31</sup>. This occurs in cases where “in making a loan on collateral, which is not of the nature of a bill of sale, *the banker*, or any similar concern doing a credit business of this kind, *creates a new volume of credit*” (Veblen, 1905, p.470, italics added). As a result, the interest bill (as a “tax on profits”) is what the leisure class gain via its unproductive activities, devoting it to “conspicuous” and competitive consumption<sup>32</sup>.

b) *Profits, wages and unemployment*. In view of the schema above, while profits depend on the size of the firm and on the “docility” of technicians, wages are assumed to be fixed at the subsistence level. In reviewing Böhm-Bawerk’s *The Positive Theory of Capital*, Veblen (1892) remarks that “the laborer, from the point of view of consumption of products, is no longer a ‘laborer’: he is a member of society simply, and his share of the product of industry is the share of an individual member of society”. This means that wages enter the total demand for consumption goods, and that high wages imply high demand<sup>33</sup>. In view of this point, the effects of an exogenous increase in wages are described in the following sequences, under the assumption of fixed technical coefficients (i.e.  $K/N=\lambda$ , where  $\lambda$  is an exogenous given):

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concludes that Veblen developed a model of the monetary theory of production, where although “a lucid explanation for the interest rate determination” is not provided, markup pricing can be used to determine it within the Veblenian theoretical framework. See Graziani (2003) for a general description of the monetary theory of production. Rutherford (1980, p.439) expands this argument by arguing that “No firm can survive in the ‘credit economy’ of the New Order that fails to fully extend its credit; and so become dependent on the banker”. Phillips (in Blaug, 1992) develops a Veblenian model of financial instability where the dynamics of the credit market significantly affect the path of production. In particular, he shows that “a rise in price of capital will have two effects: one will be to lower the demand for capital and the other will be to induce banks to increase loans since from their point of view there is an apparent increase in net wealth”. As a result, due to the functioning of the credit market, economies are intrinsically unstable.

<sup>31</sup> Cutrona (2005, p.270, footnote n.18) stresses that – in Veblen’s view – “credit consists in the creation of new purchasing power; that is, it is a pecuniary phenomenon”. Note also that Veblen (1906 [1901], p 310) maintains that the nature of the interest rate does not rest on clearly defined economic grounds, insofar as “productivity theories of interest should be as difficult to maintain as productivity theories of the gains of the pecuniary employments, the two resting on the same grounds”.

<sup>32</sup> Note also that Veblen (1905, p.461) explicitly rejects the quantity theory of money, stressing that “[credit and prices] stand in a casual relation to one another, possibly as being the effect of the same causes”, and that the increase in the price level can produce – in some circumstances - an increase in the quantity of money; and this particularly happens in periods of prosperity. This happens because as prices increase, the money value of collaterals increases too and “if this market value of the collateral advances, then the amount of the credit which it will support will likewise increase”. Moreover, prices affect credit insofar as “the incentive to credit extensions [...] is a prospective gain in terms of price” (Veblen, 1905, p.466).

<sup>33</sup> *It should be noted that also the increase in wasteful expenditure – according to Veblen – can produce increases in the level of employment: “The wasteful expenditures enhance demand [...] increase profits and raise capitalization” (Veblen, 1904, p.252; italics added). This ‘Malthusian’ element in Veblen theoretical framework has recently been studied by Pacella (2006). See also O’Hara (2000), who refers to a ‘Keynesian’ effect.*



*Sequence 1: wages and total demand.*

$$\begin{array}{ccccccc} \uparrow w & \rightarrow & \uparrow D & \rightarrow & \uparrow K & \rightarrow & \uparrow K/\lambda \rightarrow \uparrow N \\ & & & & & & \downarrow \\ & & & & & & \uparrow Q \rightarrow \uparrow w/p \end{array}$$

An exogenous increase in (money) wages has a positive effect on total demand for consumption goods ( $D$ ), hence stimulating firms to produce more via the increase in the stock of used capital ( $K$ ). The increase in  $K$ , in turn, determines an increase in employment ( $N$ ) and an increase in real wages via the increase in output ( $Q$ )<sup>34</sup>.

*Sequence 2: wages and firms' capitalization.*

$$\uparrow w \rightarrow \uparrow c/n \rightarrow \uparrow F \rightarrow \uparrow Q \rightarrow \uparrow K/\lambda \rightarrow \uparrow N, w/p$$

An exogenous increase in (money) wages induces firms to increase their demand for finance from the banks ( $F$ ), thus increasing their capitalization ( $c/n$ ). Insofar as the increase in firms' capitalization has a positive effect on their production ( $Q$ ), it also generates an increase in the degree of utilization of capital and, as a result, an increase in real wages and employment.

Accordingly, *wage increases determine the increase in firm size and in the level of employment*. Note also that *money wage pressures generate a reduction in the price level*: the main cause of inflation is, in view of the discussion above, a reduction in the degree of capital utilization<sup>35</sup>. Moreover, a possible counterbalancing effect can be traced in the increase in the money interest bill due to the increase in finance, which could produce a decline in investments and, hence, in employment and real wages<sup>36</sup>.

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<sup>34</sup> This effect recalls the 'acceleration principle' which was to be elaborated, within early 20<sup>th</sup> century American Institutionalism, by John Maurice Clark. See Schute (1997).

<sup>35</sup> With regard to the causes of inflation, in his essay on *Credit and prices*, Veblen (1905, p.462) writes: "Movements of general credit and general prices have apparently a mutual accelerating effect upon one another, both in case of advance and in case of decline, giving rise to the well-known cumulative process of expansion or of contraction that marks a period of prosperity or of crisis or depression". The idea that the expansion of credit produces price increases is clearly stated by Veblen (1905, pp.470 ff.) in the following terms: "In making a loan on collateral which is not of the nature of a bill of sale, but represents property not intended to be sold, the banker, or any similar concern doing a credit business of this kind, creates a new volume of credit. The remuneration of this service also is called interest or discount. Such a transaction creates credit, and so adds to the borrower's fund available for the purchase, and therefore increases the effective demand for goods, and by so doing helps to enhance prices. In such a transaction the banker lends funds which he does not possess". Mouhammed (2003, p.163) stresses that three causes of inflation can be traced in Veblen's thought: *i*) price increases can derive from the exercise of *power*, i.e. "they are created by large corporations through restricting the output of the machine industry in order to generate required rates of profits; *ii*) they can depend on the increased money supply; *iii*) they can be generated via social conflict within the firm, since "unionised workers can slow down productivity and thus increase the per unit costs of output, a condition that forces producers to raise relative prices in order to defend their rate of profits".

<sup>36</sup> Although the issue is not directly addressed by Veblen, it may occur that firms react to wage increases by firing workers. However, insofar as wage increases are driven by social conflict, and considering that social conflict requires solidarity among workers (see below), one can assume that wage claims are associated with

If wage increases drive economic growth, the ultimate cause of wage increases must be traced. In *The engineers and the price system*, Veblen refers to a “limit of tolerance” in order to set the minimum level of wage consistent with no social conflict. The limit of tolerance has two dimensions: an economic dimension, i.e. the impossibility to survive in a ‘decent’ way in the event the current wage is systematically lower than the subsistence wage (depending on the institutional and social setting); a moral dimension, i.e. a non purely rational reaction to the violation of the prevailing canon of equity. This latter dimension derives from Veblen’s idea that workers react to a decrease in their wages when, due to the violation of their “limit of tolerance” (Veblen, 1921, p.76)<sup>37</sup>, they feel they do not have “*anything to lose* by such an overturn of the established order as would cancel the vested rights of privilege and property” (Veblen, 1921, p.61; italics added). This means that the opportunity-cost of conflict resulting from the violation of the limit of tolerance is not the money income (since, if so, workers would not rationally react by risking the loss of a wage level higher than zero), but conflict is driven by their ‘perception of social injustice’<sup>38</sup>. In more general terms, in the final analysis Veblen’s view of income distribution is based precisely on moral variables<sup>39</sup>:

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workers’ demand for increasing regulation of labour contracts, namely for reducing the firm’s freedom to fire. Moreover, solidarity also implies a lack of competition among workers, so that firms are not in the position to fire employees in order to hire workers at low wages.

<sup>37</sup> The “limit of tolerance” should be conceived as the *minimum* level of the long-term real wage consistent with no reaction on the part of workers. Its determination, according to Veblen (1921, p.76), “would be a hazardous topic of speculation”.

<sup>38</sup> Veblen clearly remarks that the principles of *solidarity* must precede the genesis of social conflict, so that ‘free-riding’ problems cannot arise. For social conflict (eg. “general strikes”) to be in operation and potentially successful “two main lines of subsidiary preparation” are to be considered: “(a) an extensive campaign of inquiry and publicity [...]; and (b) the working-out of a common understanding and a solidarity of sentiment between the technicians and the working force” (Veblen, 1921, p.103). This remark serves to emphasise that social conflict is strictly connected with institutional change (i.e. changes in habits of thought and, above all, in the moral canons underlying individuals’ behaviour), involving at least two dimensions: *a*) the critique of the natural-rights doctrine and *b*) the critique of the principles of individualism. With particular relation to the natural rights doctrine, Veblen (1910, p.184) maintains that it cannot be defended in the present day since “with the revolutionary changes that have supervened in technology and in pecuniary relations, there is no longer such a close and visible touch between the workman and his product as would persuade men that the product belongs to him by force of an extension of his personality; nor is there a visible relation between serviceability and acquisition; nor between the discretionary use of wealth and the common welfare”. Hence, critical attitudes connected with social conflict ultimately derive from the *moral judgement* based on “the impulsive approval of whatever conduct is serviceable to the common good and [...] the disapproval of disserviceable conduct even within the limits of legality and natural right” (Veblen, 1910, p.183). Otherwise, the natural-rights doctrine is seen by Veblen (1899b, p.111), as a “dogma” stating that “property rests on production”. But “this relation between production and property rights is a moral, not a casual relation, if it is assumed to subsist at all”.

<sup>39</sup> A more detailed inquiry on Veblen’s ethics is provided by Forges Davanzati (2006). It is useful to recall here that Veblen (1904, ch.3) clearly rejects the idea that “honesty is the best policy”. He convincingly argues that this view applies in contexts (“olden days”) where the search of reputation on the part of the seller is profitable insofar as buyers are not anonymous. When, as “under modern circumstances”, market exchanges rest on “impersonal character”, reputational factors lose their strength, and it is no more convenient to behave honestly. More generally, as Tilman (2006) emphasises, “moral agnosticism” typical of the neoclassical approach is outside Veblen’s view. Moral judgements can legitimately enter economic analysis insofar as they are addressed

“The principles and practice of the distribution of wealth vary with the changes in technology and with the other cultural changes that are going forward; but it is probably safe to assume that *the principles of apportionment* – that is to say, *the consensus of habitual opinion as to what is right and good in the distribution of product* – [...] have always been such as to give one person or class something of a settled preference above another”. And (ib., p.113, italics added): “Principles (habits of thought) countenancing some forms of class or personal preference in the distribution of income are to be found incorporated in the *moral code* of all known civilizations and embodied in some form of institution” (Veblen, 1908, pp.112-113, italics added).

If the limit of tolerance is violated, “popular discontent” and the consequent social conflict occurs (Veblen, 1921, pp.12 ff.). In view of the arguments above, the following conclusion can be drawn: *the lower the ‘limit of tolerance’, the higher the wage claims and the higher the degree of capital utilization and employment*. Furthermore, by assuming the limit of tolerance as an exogenous given, the possible causes of its violation are to be traced. Although Veblen is unclear on this issue, it can be argued that the violation of the limit of tolerance ultimately depends on the ‘rapacity’ of the leisure class<sup>40</sup>. Even if the leisure class *as a whole* is interested in preserving the existing social order, *on the microeconomic plane* the competition in consumption can lead the individuals belonging to the leisure class to ‘exploit’ the industrial system to a degree so as to produce a decline in real wages. Suppose *A* and *B* are two individuals involved in a competition over consumption, both interested in *i*) obtaining a level of consumption higher than the others and *ii*) preserving the existing social order. Let *C\** be the level of aggregate consumption on the part of the leisure class consistent with a wage level so as to not violate the limit of tolerance (say *w\**). The desire on the part of *A* to obtain  $C_A > C_B$  can lead both *A* and *B* to subtract resources from the industrial system (indirectly via the reduction of profits due to the increase in the interest rate) so as to determine a decrease in profits and the possible reaction – on the part of businessmen – to cut wages. Unintentionally, the members of the leisure class behave in such a way as to produce social conflict, and this is a *spontaneous* outcome of a deregulated market economy. Hence: *the higher the bargaining power of the leisure class with respect to businessmen, the higher the intensity of competition to consume within the leisure class, and the more probable it is*

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to exploring problems related to “human existence” (so one can define those institutions which do not promote human well-being as “imbecile institutions”). On these premises, Peukert (2005) finds a theory of “unhappiness” – or some “paradoxes of happiness” - in *The theory of the leisure class*, due to insatiability of *relative* wants and the impossibility of satisfying them mainly because of the existence of power relationships.

<sup>40</sup> This is to say that – apart from the conflict within the firm, involving technicians and businessmen – a conflict in the socio-political arena – involving the leisure class and the workers – is also in operation, and deeply affect income distribution, the level of employment and the path of economic growth: “The effectual division of interest and sentiment” – Veblen (1923, ch.1) clarifies – “is beginning visibly to run on class lines, between the absentee owners and the underlying population”.

that the “limit of tolerance” will be violated and that social conflict will occur. Social conflict, in turn, is more likely to occur the higher the degree of solidarity there is among workers<sup>41</sup>. The stability of the system – i.e. “institutional inertia” – is thus guaranteed only in the event that the members of the leisure class are in a position to co-ordinate their action, thus maintaining their level of consumptions at values consistent with no reactions on the part of workers<sup>42</sup>.

#### 4 – Concluding remarks

This paper dealt with Veblen’s theory of the firm and income distribution. The re-reading of Veblen’s contribution proposed here leads to the following main results. First, the firm is conceived as a locus of conflict, involving businessmen – interested in money profits – and technicians – interested in expanding production. The outcome of the bargaining within the firm determines the level of output and the level of real wages: the more firms are of a ‘workmanship-type’ (i.e. the less docile the technicians are), the higher the resulting level of output and real wages. Second, at the macroeconomic level, it is argued that an exogenous wage increase can have a positive effect on the degree of capital utilization, both because of the positive effect of wage increases on the total demand for consumer goods and because of their effects on the degree of firms’ capitalization. Accordingly, high wages can be associated with high level of employment. Third, it is shown that institutional change, driven by social conflict, is likely to occur in cases where the members of the leisure class – competing in consumption – drive an ‘excessive’ amount of resources from the productive sector, so as to produce systematic violations of workers’ “limit of tolerance” and hence enhancing their reaction.

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<sup>41</sup> Moreover, solidarity among workers and technicians can increase the intensity of conflict and the probability of its success. This particularly applies in the cases of revolution (see Veblen, 1921, ch. VI).

<sup>42</sup> Social order, in Veblen’s thought, can also be guaranteed by the Government, mainly via the claim for “national integrity” and the consequent social cohesion, in the form of what Bush (1987) calls “regressive institutional changes”. As Tsuru (1993) clearly emphasises: “Veblen [...] differs from Marx and Engels in thinking that the state does not exclude the underlying population from the governing process for the reason that the business leadership would not be able to govern without ‘the advice and consent of the common run’ [...] Veblen was aware of a possible crisis [and] he developed a theory regarding the counter instruments to which the business leadership was expected to resort. Thus came his theory of ‘national integrity’ (or plain nationalism) into the picture. It had two aspects, namely: (1) equating the interests of business leadership with those of the nation as a whole; and (2) adopting aggressive policies towards the outside world, accompanied by the militarization of society”. O’Hara (2004, p.979, italics added) convincingly supports the idea that “Veblen recognized that politics and economics were two aspects of a unified social whole to be understood together. The state is the guarantor of the existing social order and protects existing property rights and the interest of the leisure class [...] Veblen made it very clear that the interests of the capitalist absentee owners are the *primary concern* of the government”.

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