THE THEORY OF BUSINESS ENTERPRISE PART 2: NEOCLASSICAL ECONOMISTS AND VEBLEN

> The material framework of modern civilization is the industrial system, and the directing force which animates this framework is business enterprise. To a greater extent than any other known phase of culture, modern Christendom takes its complexion from its economic organization. This modern economic organization is the "Capitalistic System" or "Modern Industrial System," so called. Its characteristic features, and at the same time the forces by virtue of which it dominates modern culture, are the machine process and investment for a profit.

That's the first paragraph of *The Theory of Business Enterprise* by Thorstein Veblen. The 1904 book is written in an unfamiliar style, combining words and formulations we don't use any more with a decided lack of the kinds of references we'd expect in a work of sociology or economics. It shows a kind of subversive humor as well. The reference to Christendom is funny coming from an agnostic whose rejection of religion made it difficult for him to find work. And it's blunt.

The first three chapters lay out several ideas about the way society was organized at the time he wrote. By then the industrialization of the country and the consolidation into trusts, holding companies and interlocking directorates was well underway. The dominant force in society, Veblen says, was the industrial process with its intricate workings that required coordination of workers across many plants and industries for maximum efficiency. It required standardization of processes and goods across the range of activity, from hours of operation to fine details about the items produced so that they could be used for many different purposes. That meant that a large segment of the population had to adapt the way they lived to accommodate the processes of industry. The people who controlled the great enterprises held direct or indirect control over a large part of the lives a vast number of working people.

At the beginning of the Industrial Revolution factories were owned an operated by individuals with a view to making a living. Over time the Captains of Industry (his words) built up capital and began to treat factories not as sources of livelihood but assets to be bought and sold, and operated as generators of profit from investment. As Veblen describes the activities of the businessmen, it feels like the creation of a market in plants and equipment and other rights of ownership like railroad rights-of-way and patents. The industrial processes themselves were not operated, or even necessarily understood, by the Captains. They were designed and operated by engineers, inventors and mechanics, ond operated by workers with varying degrees of skill. All of them were working to make production as simple and as useful as possible. They depended for their livelihoods on paychecks from the Captains of Industry.

As different parts of production moved from handicraft to machine process, ownership of parts of the industrial process often were not the most efficient, as with railroads and electricity. The boundaries were unstable because the Captains of Industry were constantly fighting with one another for control of different parts of the process.

Standard economics in Veblen’s time looked a lot like our neoliberal economics as taught by Mankiw. Veblen disagrees. He starts with the proposition that the sole point of investment for profit is profit, not efficiency or the good of the community.

1. Standard economics taught that businesses are efficient. The smooth working of industrial processes require constant attention and interstitial adjustments. Veblen points out that there are opportunities for profit when the smooth operation of industrial processes is disrupted. It doesn’t matter how the disruption comes about, whether there is an improvement that reduces a cost, or a spike in demand perhaps because of a war, or a drop in demand because of a depression, or whether the Captain of Industry disrupts his own operations or whether a competitor does so. Disruptions are opportunities for profit. It doesn’t matter that the workers are thrown out or the community suffers. There are profits to be made.

> The outcome of this management of industrial affairs through pecuniary transactions, therefore, has been to dissociate the interests of those men who exercise the discretion from the interests of the community. This is true in a peculiar degree and increasingly since the fuller development of the machine industry has brought about a close-knit and wide-reaching articulation of industrial processes, and has at the same time given rise to a class of pecuniary experts whose business is the strategic management of the interstitial relations of the system. Broadly, this class of business men, in so far as they have no ulterior strategic ends to serve, have an interest in making the disturbances of the system large and frequent, since it is in the conjunctures of change that their gain emerges. Qualifications of this proposition may be needed, and it will be necessary to return to this point presently.

What this means that that there are people in businesses who job is to disrupt things to make a profit. Veblen doesn’t believe in the magic invisible hand of the market; he sees the fists of the Captains of Industry.

2. Standard economics taught that one of the main values provided by the businessman is the rationalization of industrial processes. Veblen says that consolidation is done not in the interest of smoother industrial processes, but in the interest of profits. It only happens when the Captains of Industry can profit, which is always long after the need becomes obvious, and only in the way in which the Captains of Industry can profit, which may or may not be most efficient. He admits that a businessman may be motivated by ideals of workmanship and serviceability (his word) to the community, but this is “not measurable in its aggregate results”. To the extent it is measurable, it comes from the elimination of the costs of the business transactions that are eliminated by mergers and “industrially futile manoeuvring” to gain leverage for deals, so that

> … probably the largest, assuredly the securest and most unquestionable, service rendered by the great modern captains of industry is this curtailment of the business to be done, this sweeping retirement of business men as a class from the service and the definitive cancelment of opportunities for private enterprise.

3. Standard economics taught that businesses are subject to the indirect control of consumers, who decide by their purchases which businesses survive and which fail. Veblen says that businesses of his day, business owners are removed from actual contact with customers. There is plenty of money to be made cheating customers, he says, in part because industrial processes were so efficient that there was plenty of room for waste and war.

4. Standard economics taught that competition is the lifeblood of capitalism. Veblen says businessmen charge as much as they can. Competition is only a factor when the Captain doesn’t have a monopoly, and then it is only one of several factors.

> But it is very doubtful if there are any successful business ventures within the range of the modern industries from which the monopoly element is wholly absent. They are, at any rate, few and not of great magnitude. And the endeavor of all such enterprises that look to a permanent continuance of their business is to establish as much of a monopoly as may be. Fn. omitted.

5. Standard economics taught that the market pays according to the value of the work done, which is taken to be proportional to the value to the community. Veblen says there is no relationship between the profits and wages of a business and value to the community, and that money is a poor proxy for value to a community. He also says that wages bear no relation to the productive value of the work done, but rather workers are paid only enough to get them to work hard enough to make the products of their labor saleable.

Standard economics from Veblen’s day is taught in Econ 101 today. Veblen is an astringent antidote.