On the Validity of Veblen's Criticisms of Economic Orthodoxy:

An Analysis of His Positions in the Light of Current Conditions and Economic Thought

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ABSTRACT. *Thorstein Veblen* has received his share of brickbats and bouquets over the years. Rather than add to them, this study examines the validity of some of his criticisms of *economic orthodoxy* in the light of contemporary *economic conditions* and currents of *economic thought.* Attempt is made to understand the ways in which orthodox theorists have viewed this heterodox thinker and to delineate the influence Veblen has exerted on us in modifying our approach to *economic analysis.*

I

Veblen as Economic Iconoclast

LIKE OTHER HETERODOX theorists, Thorstein Bunde Veblen has had his share of brickbats and bouquets, of praise and blame. During his lifetime (1857–1929), his ideas were greeted by stiff resistance from his professional colleagues. But his writings have lived on and as Roll has rightly pointed out:

> By all the criteria of originality, range and profundity of thought there are few others who have such a high claim to be included in the extremely select company of those who during the last 250 years have added to the yeast in the thinking on economic and social problems.[1]

Though it is admittedly true that Veblen did not leave a conspicuous school of Veblenians in the same way Keynes lives on among the Keynesians or Marx among the Marxists, the influence exercised by his ideas has indeed been profound.

In this study, Veblen's criticisms of the economic orthodoxy of his day will be examined. An attempt will be made to assess the validity of these criticisms with respect to the situation obtaining now. While Junker and Seckler have engaged in a heated debate on the definition of "behaviorism" and on the philosophic rift between individualists, collectivists and so on,[2] this paper does not seek to throw any light on the controversies shrouding the study of Veblen and institutionalism. Instead, the purpose here is to examine Veblen's criticisms and to assess how these have been addressed.

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behavior of the upper classes—the elite in the society. Men may seek to give vent to "pecuniary canons of taste."

Veblen also criticized orthodox theorists' taxonomy—a pre-Darwinian, non-evolutionary classification of society for the purposes of economic analysis. He has pointed out that such a taxonomy has resulted in a denial of the pattern of evolution of human society, the birth and gradual evolution and modification of institutions and their influence on human behavior. The fact that the "normal" economic situation implied a taxonomy based on "natural rights, utilitarianism and administrative expediency" intrigued Veblen.

III

The Validity of Veblen's Criticisms

THE ISSUE between Veblen and the theorists of his time can be discussed only in the context of the controversy between orthodox and heterodox theorists. Orthodox theorists have considered institutions as "givens" in their model. They have not probed into the reasons why the institutions came into being or how they came into being or to what extent changes in the institutions have been affecting economic life.

Conventional economic theory views a consumer, an individual or a household (where the household constitutes the decision-making unit) as allocating money income exhaustively among goods and services so as to maximize utility, subject to income or budget constraint. The consumer is assumed to be capable of ranking commodity combinations consistently in order of preference.

Utility functions are considered ordinal:

$$\text{maximize } u = u(x_i) \qquad i = 1 \cdots n$$

$$\text{subject to } I = \sum P_i x_i$$

where x_i stands for goods and services or commodities and P_i stands for prices of these goods and services and I stands for money income. Constrained optimization implies first order conditions:

$$\frac{\partial u_i}{\partial x_i} \bigg/ \frac{\partial u_j}{\partial x_j} = P_i/P_j \qquad 1 \neq j$$

Second order conditions imply indifference curves convex from below for a maximization of utility.

A consumer's demand curve for a commodity can be derived from the first order conditions. Demand curves are single valued and homogeneous of degree zero in prices and income.

An individual's work-leisure decisions are also analyzed in this rational decision format. Work performed leads to disutility, leisure contributes to utility while income earned, being a proxy for consumption, also leads to utility:

$$u = Q(R, I)$$

where R = Leisure = 24 hours per day − L;
L = hours per day of labor;
C = Consumption and I = Income.

This may be expressed as:

$$\text{Utility function: } u = G(C) + H(L)$$

$$\text{Production function: } C = \emptyset(L)$$

with

$$\frac{dG}{dC} > 0, \qquad \frac{d^2G}{dC^2} < 0, \qquad \frac{dH}{dL} < 0, \qquad \frac{d^2H}{dL^2} < 0, \qquad \frac{d^2u}{dCdL} = 0;$$

the trade-off boils down to:

$$-\frac{dH}{dL} = \frac{dG}{dC} \cdot \frac{dC}{dL}.$$

In other words the individual would work till the point where his marginal disutility from working equalled his marginal utility from consumption. The conventional treatment does indeed make room for analysis of a consumer's reaction to price and income changes in terms of substitution and income effects and is generalized, and the utility theoretic approach and the approach via revealed preference theory lead us to the same basic conclusions regarding consumer behavior.

As far as producer behavior is concerned we assume convex (to the origin) isoquants and view the producer as engaged in constrained optimization once again, given his production function relationship and his cost equation. The producer is seeking to maximize output subject to the cost constraint or seeking to minimize cost given the output level, as follows:

Given the production function: $Q = Q(q_i)$ $i = 1 \cdots n$,

Where Q = output and q_i = input, $i = 1 \cdots n$,

$$\text{(a) maximize } Q = Q(q_i), \qquad i = 1 \cdots n$$

$$\text{subject to } C = \sum r_i q_i + b$$

Where C stands for total cost, r_i for input prices and b for fixed cost, or,

(b) minimize $C = \sum r_i q_i + b$

given $Q = Q^0$, where Q^0 = specified output level.

This constrained optimization implies the first order conditions.

$$\frac{\partial Q}{\partial q_i} \Big/ \frac{\partial Q}{\partial q_j} = r_i/r_j, \qquad i \neq j$$

The second order conditions require that marginal physical productivity be positive and be decreasing for all i's.

The output decision obtained via the output maximization or cost minimization processes is linked to the profit maximizing solution. Indeed, conventional theory underlines the role of profit maximization in producer behavior: when data are available on the production function, the cost equation and the expansion path function, it is possible to express total cost as a function of output level. The first order conditions for profit maximization require that the producer turn out that quantum of output for which the marginal cost equals the price and the second order conditions require that the marginal cost curve be rising.

Where the production function under consideration is homogeneous of degree one, Euler's theorem can be used to demonstrate that total output is just exhausted if each input is paid its marginal physical productivity. It has, however, been recognized that assumptions of competitive profit maximization break down if the producer's long run production function is homogeneous of degree one. The condition of product exhaustion can be likened to the condition that maximum long run profit equals zero.

According to conventional theory the first order conditions for profit maximization require that, where more than one output is produced, the rate of product transformation between every pair of outputs equals their price ratios; where more than one input is used, the value of the marginal productivity of each input with respect to each output equals the input price, and the rate of technical substitution between every pair of inputs equals their price ratio.

The aggregate demand function is derived from the demand functions of individual consumers and the aggregate supply function is derived from individual supply functions. Market equilibrium is attained when demand equals supply and implies consistency of buyers' desires and sellers' desires. Equilibrium in a factor market would imply that the price of the factor equals the value of its marginal product.

Competitive market conditions are assumed for analytical purposes and the accepted theory has been extended to the analysis of problems of externalities in production and/or consumption, public goods, imperfect competition and market failure in general.

The competitive model allows us to demonstrate readily the existence of multi-market equilibrium. Long run equilibrium requires that every market is cleared and that profit of the representative firm in each industry equals zero.

Conventional theory has focussed heavily on welfare economics, which, nevertheless is still plagued with several thorny issues. Since elaborate value judgments regarding the desirability or otherwise of alternative income distributions are frequently not available, economists have focussed their attention on the Pareto criterion.

A reallocation is considered to be an improvement in welfare if it makes at least one person better off without making anybody worse off. Pareto optimality requires that the corresponding rates of commodity substitution of all consumers are equal, the corresponding rates of transformation of all producers are equal and the rates of substitution equal the corresponding rates of transformation and that the second order conditions are duly fulfilled.

A competitive model makes room for the fulfillment of the first order conditions for Pareto optimality.[5]

In "The Limitations of Marginal Utility" Veblen had chastised the orthodox theorists of his day, asserting that:

> To any modern scientist interested in economic phenomena, the chain of cause and effect in which any given phase of human culture is involved, as well as the cumulative changes wrought in the fabric of human conduct itself by the habitual activity of mankind, are matters of more engrossing and more abiding interest than the method of inference by which an individual is presumed invariably to balance pleasure and pain under given conditions that are presumed to be normal and invariable. The former are questions of the life-history of the race or the community, questions of cultural growth and of the fortunes of generations, while the latter is a question of individual casuistry in the face of a given situation that may arise in the course of this cultural growth. The former bear on the continuity and mutations of that scheme of conduct whereby mankind deals with its material means of life; the latter, if it is conceived in hedonistic terms, concerns a disconnected episode in the sensuous experience of an individual member of such a community. . . .
>
> Evidently an economic enquiry which occupies itself exclusively with the movements of this consistent, *elemental* human nature under given, stable institutional conditions—such as is the case with the current hedonistic economics—can reach statical results alone; since it makes abstraction from those elements that make for anything but a statical result. On the other hand an adequate theory of economic conduct, even for statical purposes, cannot be drawn in terms of the individual simply—as is the case in the marginal-utility economics—because it cannot be drawn in terms of the underlying traits of human nature simply; since the response that goes to make up human conduct takes place under institutional norms and only under stimuli that have an institutional bearing, for the situation that provokes and inhibits action in any given case is itself in great part of institutional, cultural derivation. . . .

It is, of course, on individuals that the system of institutions imposes those conventional standards, ideals and canons of conduct that make up the community's scheme of life. . . .

The exigencies of modern life are commonly pecuniary exigencies. That is to say they are exigencies of the ownership of property. Productive efficiency and distributive gain are both rated in terms of price. . . . The current economic situation is a price system. Economic institutions in the modern civilized scheme of life are (prevailingly) institutions of the price system. . . . Indeed, so great and pervading a force has this habit (institution) of pecuniary accountancy become that it extends, often as a matter of course to many facts which properly have no pecuniary bearing and no pecuniary magnitude as, *e.g.*, works of art, science, scholarship, religion. More or less freely and fully, the price system dominates the current commonsense in its appreciation and rating of these non-pecuniary ramifications of modern culture; and this in spite of the fact that, on reflection, all men of normal intelligence will freely admit that these matters lie outside the scope of pecuniary valuation. . . . The pecuniary tests and standards so applied outside of business transactions and relations are not reducible to sensuous terms of pleasure and pain. . . . Indeed, it may, *e.g.* be true that (such) a wealthy neighbor is, on the whole, more highly regarded and more considerately treated than another neighbor who differs from the former only in being less enviable in respect of wealth.

It is the institution of property that gives rise to these habitual grounds of discriminations, and in modern times, when wealth is counted in terms of money, it is in terms of value, that these tests and standards of pecuniary excellence are applied. This much will be admitted[6].

While the avowed institutionalists have, in a way, toed the Veblenian line, we would concentrate in this paper on the reactions of non-institutionalists primarily.

IV

Veblen's Influence

SOME SOCIAL SCIENTISTS have dismissed Veblen's criticism of economics as a dismal science (since it assumes man to be selfish and money-grabbing) as being largely beside the point.[7] Some have also pointed out that Veblen was in a state of confusion with respect to the differences in the strands of thought presented by classicists and by the neoclassicists or marginalists.[8] But, on the whole, Veblen's ideas have influenced the course of our thought very definitely.

In the 1930s Keynes questioned the full employment equilibrium upheld by the classicists. In the subjective and objective factors listed by Keynes as influencing consumer behavior, he implicitly recognized the importance of institutions. He recognized the importance of contingencies, of expected future income in relation to current income and so on.[9] These factors have their roots in the prevalent institutions.

James Duesenberry's Relative Income Hypothesis as an explanation of consumer behavior appears Veblenian.[10] He underscored the importance of the perceived relative position of the individual, the desire to keep up with the Joneses, and habit persistence in influencing consumer behavior. One could even argue that the Life Cycle hypothesis[11] and the Permanent Income hypothesis[12] are also somewhat influenced by Veblenian thought though the tenor is hedonistic in both cases. Lifetime earnings or permanent income can be arguments in the consumption function, only when we recognize the institution of private property or ownership. Since the individual knows, accepts and relies on rights to his income, this can influence his consumption. Yet others have more candidly recognized the importance of institutions in fashioning individual behavior.[13] Economic theory today has clearly accepted some of the Veblenian interpretations of the economic orthodoxy of his day as unquestionable.[14] Theorists engaged in the study of the phenomena of economic growth and development have also, in some cases indirectly, emphasized the role of institutions,[15] of conspicuous production and of the demonstration effect.[16,17] There is no denying that the unquestioning acceptance of some institutions did not allow conventional theory to reach out for a fuller explanation of the psychosocial behavior of human beings.

Veblen, through his theory of history, which in some respects resembles the Marxian theory of history, pointed out how honorific roles were born, how the 'leisure class' evolved and how they helped develop habits of thought. In his theory of the leisure class he succeeded in demonstrating how demand was really influenced by habits of thought and not by hedonism alone. For instance, when people seek to emulate the life styles of the upper classes—the elite, the leisure class—they are not strictly hedonistic in their approach. In his theory of the business enterprise, Veblen showed that long run competitive equilibrium was not a certain outcome and in fact, a business crisis was imminent. This insight into business crises singularly ranks his heterodox approach in an "outstanding" classification.[18] In his criticism of orthodoxy he was flamboyantly pungent, but not altogether wrong. He did not see harmony of interests, nor did he see a trend toward long run equilibrium. Empirical evidence bears witness to the grain of truth in some of his assertions.

As Hahn and Hollis have pointed out, purity in what is frequently labelled as neo-classical theories is a matter of

> conceiving *homo economicus* in abstraction from his social setting, and, more excusably, of forswearing the attempt to make economics part (or all) of a general theory of society. By contrast, political economy as the term is now used is just such an attempt and its champions insist that no economic theory can be as pure as neoclassicals pretend. Marxian economics is a leading example but has no monopoly and there are heretics within the temple too.[19]

Indeed, our attempt to interpret economic activity in terms of the calculus of pleasure and pain has not been greeted by success, largely because we have, unlike Veblen, failed to make economics part (or all) of a general theory of society. Hahn and Hollis have further pointed out (and I, for one, quite agree with them) that "In macro- no less than in micro-economics, pure theory rests on propositions about individual action. To generalize, it needs to take the individual agent as typical or representative of others. Generality is achieved by conceiving the individual as a rational economic man and asserting that mankind at large is as rational as he." They have cited the example of the Keynesian analysis of investment, saving and liquidity preference, and it is certainly possible to think of many more post-Keynesian theorists who have resorted to this kind of abstraction. But in most of these abstractions we have not paid any heed to the distinction between people as rational egoists and people obedient to norms. [As has been pointed out earlier in this paper, there have been some attempts to incorporate the importance of societal norms (keeping up with the Joneses, habit persistence and the like) even within the framework of a basically neo-classical analysis]. We have implicitly believed that utility functions of a bunch of despots, a military junta or a dictator are about the same as those of the others in the society and we have disregarded the role of culture, tradition and institutions as affecting the utility function. To this extent, Veblen's criticisms seem to remain valid even now.

As Hollis and Nell have rightly observed, in spite of efforts at promoting generalizations, orthodox theory presents us with a law of demand which is as "riddled with exceptions as it is well-confirmed".[20] Probably a multi-disciplinary approach, as was pursued by Veblen, would someday allow us to understand the economic behavior of homo sapiens in greater detail.

V

Conclusions

THE DEFENSE of laissez faire or free enterprise and of the status quo was questionable in the context of the social, economic and cultural life in Veblen's day. Though the achievements of the U.S. economy between the Civil War and World War I were impressive, hours of labor were long, housing facilities were inadequate, scope for education was limited, job security was virtually absent, wage rates were low and the distribution of income and wealth was skewed. Weak-kneed unionism and large-scale conservatism in social and economic life made room for the concentration of power in the hands of big business. From a relativist point of view one can, therefore, readily see the reasons for and relevance of Veblen's criticism of economic orthodoxy.

The situation prevalent today also warrants a rethinking of accepted economic theory. For instance, wage rates depend on a variety of factors including the strength of the trade union movement and that of the employers' lobby, as well as the political-social backdrop, and it would be incongruous to say labor is paid according to its marginal productivity alone. In spite of governmental intervention in various forms, market imperfections and market failures persist. Organized planning in the market economies has not yet answered the riddles of welfare economics. Harmony of interests is conspicuous by its absence. There is enough room for developing an awareness of the need for an integration of theory, methods and data across the various social sciences. The need for empirical investigation into the various facets of human behavior is now almost universally recognized.

Veblen's criticism of the teleology in economics is valid. As Schumpeter has observed: "Teleology, or the attempt to explain institutions and forms of behavior causally by the social need or purpose they are supposed to serve, is obviously not always erroneous: many things in society can be, of course, not only understood in terms of their purpose but also causally explained by it. In all sciences that deal with purposive human actions, teleology must always play some role."[21] Veblen felt that orthodox theory of his day failed to emphasize the role of institutions in economic life. Down to our day the institutions (like private property, and others born of social, economic, cultural, moral, religious and aesthetic value judgments by the community) together with customs, social habits, laws, beliefs, mode of thinking and ways of living influence human behavior. Though all the causal relationships have not yet been analyzed and interpreted satisfactorily, interdisciplinary and empirical investigations during our times have been seeking to address Veblen's criticism on this count.[22] Keynesian and post-Keynesian economics has not placed much reliance on the ultimate certainty of pre-ordained ends.

Veblen felt that some theorists had clung to a pre-Darwinian classification. Since society and institutions are constantly changing, he argued, an evolutionary approach should be used. During our times this criticism is also being addressed, especially via multi-disciplinary research into social indicators and quality of life. For instance, if a time series of social accounts is developed on the basis of behavior settings concepts developed in the area of ecological psychology, one would be in a position to grasp the evolutionary process.[23]

The tenor of economic theory is still hedonistic and this is because of the lack of a better and more consistent theory. However, Veblen's criticism on this count has also been partially addressed. Tremendous strides have been and are being made in the analysis of market imperfections, of conditions of market failure and of conditions that vitiate the attainment of long run equilibrium. Over the years a conscious effort has been made to link economic concepts to findings in other disciplines.[24] Contemporary theory and empirical investigations are seeking to uncover human behavior as affected by risk, uncertainty, etc., and are keen on analyzing the differences in motives (risk neutrality, risk-preference and risk-aversion) as influencing economic behavior.

Veblen's genius from its Olympian height has forewarned us of the dangers of economic analysis divorced from the realities of life. We have taken lessons from his criticisms.

Notes

1. Eric Roll, *A History of Economic Thought* (1938) (London: Faber and Faber, 1973), p. 439.
2. Louis Junker, "Genuine or Spurious Institutionalism," *American Journal of Economics and Sociology,* Vol. 38, No. 2 (April, 1979); David Seckler, "Individualism, Collectivism and the Latter-day Institutionalists—a Raving Review by Professor Junker," *ibid.,* Vol. 39, No. 1 (January, 1980), see especially pp. 105–06; Seckler, *Thorstein Veblen and the Institutionalists: A Study in the Social Philosophy of Economics* (Boulder, Colo.: Associated Universities Press, 1975).
3. Thorstein Veblen, "Professor Clark's Economics," in E. K. Hunt and Jesse G. Schwartz, eds., *A Critique of Economic Theory* (Middlesex, England: Penguin Books, 1972), pp. 175–76. (Excerpted from Veblen's article in the *Quarterly Journal of Economics,* 22(1908), pp. 147–95, afterward reprinted in *The Place of Science in Modern Civilization* (1919) (New York: Russell and Russell, 1961), pp. 180–230.
4. Thorstein Veblen, "Why is Economics Not an Evolutionary Science?" (1898), reprinted in *The Place of Science in Modern Civilization, op. cit.,* p. 73.
5. S. K. Ghosh, "Designing a Pilot Set of Social Accounts Based on the Fox-Van Moeseke Total Income Approach," unpublished doctoral dissertation, Iowa State University, Ames, Ia., February, 1979, pp. 54–59.
6. Thorstein Veblen, "The Limitations of Marginal Utility," *Journal of Political Economy,* 17(1909), reprinted in K. William Kapp and Lore L. Kapp, eds., *History of Economic Thought: A Book of Readings* (New York: Barnes & Noble, 1949), pp. 337–48.
7. Milton Friedman, "The Methodology of Positive Economics," in *Essays in Positive Economics* (Chicago: Univ. of Chicago Press, 1935), reprinted in William Breit and Harold M. Hochman, eds., *Readings in Microeconomics,* 2nd ed. (Hinsdale, Ill.: Dryden Press, 1971), p. 40.
8. See, *e.g.,* Sir Eric Roll, *op. cit.,* p. 443.
9. John Maynard (Lord) Keynes, *General Theory of Employment, Interest and Money* (New York: Harcourt, Brace and World, Inc., 1935). pp. 89–112; Kenneth K. Kurihara, *Introduction to Keynesian Dynamics* (London: George Allen and Unwin, 1964), p. 42.
10. James S. Duesenberry, *Income, Saving and the Theory of Consumer Behavior* (Cambridge, MA: Harvard Univ. Press, 1940), p. 1.
11. Albert Ando and Franco Modigliani, "The 'Life Cycle' Hypothesis of Saving," *American Economic Review,* March, 1963, pp. 55–84.
12. Milton Friedman, *A Theory of the Consumption Function* (Princeton, N.J.: Princeton Univ. Press, 1957), pp. 9–11, 25, 26.

13. Blaine Roberts and Bob Holdren, *Theory of Social Process: An Economic Analysis* (Ames, Ia.: Iowa State Univ. Press, 1972), p. 198.

14. See for example: Harvey Leibenstein. "Bandwagon, Snob and Veblen Effects in the Theory of Consumers' Demand." in William Breit and Harold M. Hochman. *Readings in Microeconomics.* Dryden Press. Hinsdale, Illinois, 1971, pp. 111–127 (Reprinted from *Quarterly Journal of Economics,* May, 1950).

15. Celso Furtado. "Capital Formation and Economic Development" in *The Economics of Underdevelopment,* A. N. Agarwala and S. P. Singh, eds. (New York: Oxford Univ. Press, 1963), pp. 309–37 (reprinted from *International Economic Papers* No. 4, 1954). See p. 326: "behavior of coefficient of investment strongly influenced by institutional and other factors having an affect on the propensity to consume."

16. H. Myint "An Interpretation of Economic Backwardness" in Agarwala & Singh, *op. cit.,* pp. 93–132 (reprinted from *Oxford Economic Papers,* June, 1954). See p. 114: conspicuous production in underdeveloped countries.

17. W. A. Lewis. *The Theory of Economic Growth.* ELBS Edition (London: George Allen & Unwin, 6th Impression, 1963); see, p. 162, institutional change.

18. Thorstein Veblen. *The Theory of the Leisure Class* (New York: Macmillan, 1899); Veblen, *The Theory of the Business Enterprise* (New York: Charles Scribner's Sons, 1904).

19. Frank Hahn and Martin Hollis, eds., *Philosophy and Economic Theory* (Oxford, England: Oxford Univ. Press, 1979), intro., pp. 1–17.

20. Martin Hollis and Edward J. Nell, "Two Economists," *ibid.,* pp. 45–46.

21. Joseph A. Schumpeter, *History of Economic Analysis* (1954) (London: Allen and Unwin, 4th printing, 1961), p. 58n.

22. Herbert A. Simon. *Models of Man: Social and Rational* (New York: John Wiley. 1957); Karl A. Fox: *Social Indicators and Social Theory: Elements of An Operational System.* (New York: John Wiley, 1974).

23. David Seckler (1975), *op. cit.;* Karl A. Fox and Syamal K. Ghosh, "Social Accounts for Urban Centered Regions," *International Regional Science Review.* November, 1980; Karl A. Fox, and Syamal K. Ghosh, "A Behavior-setting Approach to Social Accounts Combining Concepts and Data from Ecological Psychology, Economics and Studies of Time Use," in *Social Accounting Systems: Essays on State of the Art,* F. Thomas Juster and Kenneth C. Land, eds., (New York: Academic Press, 1981).

24. *E.g.,* Hahn and Hollis, *op. cit.;* also the 42 earlier volumes of this *Journal.* See especially John Dewey, "Foreword to a Venture in Scientific Synthesis," *Am. J. Econ. Sociol.,* Vol. 1, No. 1 (October, 1941).

Man's Strongest Impulse

MAN'S STRONGEST IMPULSE is not to destroy the empirical world; rather it is to transform it into the mythical world, to regain Eden in this life and to synchronize, once and for all, mythical and empirical reality. [From *The Nature of Narrative.*]

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