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Thorstein Veblen

And Development Economics

Abstract

Thorstein Veblen may be considered the founder of Institutionalism, but his contribution to development economics may have broader impact today. This paper outlines the Veblenian perspective on growth and development, the directions it leads analysis and exposes its pervasiveness in modern thought on the subject. Unsurprisingly, Veblen serves as a starting point for critiques of neoclassical policies; but he can also be found lurking behind extremely conservative assessments of development—whose antecedents Veblen himself attacked at length—suggesting that Veblen tapped into foundational and inescapable concepts. Taken together, these concepts represent an analytical framework that has gradually emerged over the course of a century from beneath the eroding mass of conventional wisdom on economic development.

Thorstein Veblen and Development Economics

By the 1990s, historical and cultural relativity had become foundational principles in development economics, supplanting the preceding universalist convention. The perspective shift was an adjustment to reality: development policies based on neoclassical thought were yielding mixed results (Stiglitz, 2011; see Appendix B). The ancestry of development economics is complex, but a sketch of what it would become can be found in the work of Thorstein Veblen, who constructed a view of economic development which brought out the centrality of historical and cultural relativity (Cypher, 2009). In approaching Thorstein Veblen[1] it becomes immediately clear that any meaningful discussion must be preceded by the question, *which* Veblen? At the center of what we might imagine (and what many institutionalists would have us believe) is a struggle for control of the institution of *economics* itself, extracting meaning from Veblen may seem impossible—even if the difficulty were to stem only from an urge to rubberneck and not from contradictory accounts[2]. Indeed, the case of Veblen is so fascinating from the perspective of sociology and of history that we need some concrete mechanism to prevent what should be a narrow examination from becoming a headlong plunge into a quagmire of philosophy and social commentary. Let us begin by introducing this idea: our interpretation of history is influenced by our perspective. Perspective, however, is not just a restriction but also a tool to be manipulated. So, to deliberately analyze the relationship between Veblen's perspective on growth and modern development economics we propose an explicit construction of Veblen; not as disruptor, critic,

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[1] Thorstein Bunde Veblen (1857-1929) was a second-generation immigrant from Norway; his parents settled in Minnesota. He earned his undergraduate degree at Carleton College where he studied under John B. Clark, who was at the time working on his Marginal Productivity Theory of Distribution. He earned his PhD in philosophy from Yale. An outsider, he wrote eleven books, the most famous being *The Theory of the Leisure Class* published in 1899. He is considered the founder of the Institutionalist school of economics.

[2] For a fascinating entrée into the side of Veblen we try to ignore here see Bartley, R., & Bartley, S. (2000). Stigmatizing Thorstein Veblen: A Study in the Confection of Academic Reputations. *International Journal of Politics, Culture, and Society, 14*(2), 363-400. Retrieved from http://www.jstor.org/stable/20020081

or eccentric but as the proprietor of a peculiar perspective on economics. This decidedly un-Veblenian approach to Veblen facilitates a focus on the framework he developed for the analysis of economic growth and illustration of how that framework has been simultaneously inherited and derived independently by the modern development school.

Veblen's Perspective on Growth

Veblen's critique of classical and neoclassical economics can be construed as a disagreement on *what* should be studied rather than *how* to study it: Veblen found static analysis inadequately explained the dynamic interrelationships between the economy and society (Sowell, 1967). Though he recognized its usefulness, Veblen's interest in economic change led him to criticize (neo)classical[3] economics for distorting perspectives on economics and society through reduction. Essential to his perspective was the idea that actors actively seek to affect the world, rather than being "simply a bundle of desires that are to be saturated by being placed in the path of the forces of the environment[.]" (Veblen, p.74, 1906.) Veblen's idea of agency leads to several important conclusions about the forces that drive economic development. The first is that markets and economies are cultural institutions that emerge to address economic realities (see Appendix A for a visualization of Veblen's framework). In this way, Veblen denies any pretense of economics as a natural science. If economies are social constructs, then the means of production, though underpinned by certain universal truths, are at least culturally-mediated. Thinking in this direction brought Veblen to the importance of knowledge, and the observation that technology applies to both materials and society (Sowell, 1967). Social technology[4], as we

[3] Much of Veblen's critiques were in response to classical economists, rather than his contemporaries. To add to this confusion, he habitually misattributed ideas and contradicted himself. Regardless, many of his complaints are equally valid with respect to the neoclassical school (Sowell, 1967), and even 20th century development economics.

[4] We will use this term to refer to ways of organizing societies. *Material technology* is used to denote physical means of production. Even in imagining this dichotomy, some interesting interdependences come to mind: a factory is both, for instance.

might term it, is sublimated in static analysis but becomes crucial to understanding economic development. Rather than frame development as a series of discrete stages, Veblen wants to explain the underlying logic of continuous change. In this way, ironically, he may have had more in common with Newton than his contemporaries.

If culture—an inherently qualitative variable—is a driving force in development, then economic relativity must follow. This second conclusion is particularly annoying for the study of less developed economies, because it implies that understanding cultural and historical context must precede any economic analysis. If cultural change precedes economic change, then actors benefitting from the status quo may wield their power to resist the change that development asks. These are Veblen's "vested interests"[5]. Since culture and institutions change only with great difficulty, they may be intrinsically inertial forces—even without vested interests to defend them. For economies to develop, then, society must reorganize. But institutions resist replacement. Something that must also follow: culture and institutions are perpetually obsolete, because while reality is dynamic the mechanism for adaptation is wrought with friction.

Path dependence[6] also follows from Veblen's conception of the individual, because to him, people are not just driven to do, but possess "native proclivities" expressed through technologically defined conduits (Hall & Whybrow, p.352, 2008). Social technology is interrelated to material technology: a tool may arise from economic imperative through native proclivity, but the tool soon affects social technology in turn. This process is imagined as

[5] Veblen's meaning here goes deeper than it may seem. He distinguishes between *business*, the purpose of which is to "make money", and *industry*, whose purpose is to make and do *things*. Industry, being closer to the reality of economy, is driven to change. But business, which parasitizes industry, has a vested interest in the status quo and so is concerned with preventing the advance and diffusion of technology (Veblen, 1919).

[6] Broadly, the idea that history is relevant to decision making. Energy is an example: even if more desirable (socially, economically) alternatives exist, the cost to switch from fossil fuels is enormous and must be considered. Thus, the historically-neutral ideal allocation of resources—that is, the allocation we arrive at if we ignore switching costs—may differ from the actual allocation.

"cumulative causation" (Veblen, 1906). The Veblenian framework would then reject the notion of revolutionary change; very rapid changes may indeed occur, but through the continuous complex process outlined above rather than discretely. In this way, a nation's path is dependent on social technology and history as much as material technology. Veblen's exploration of the relationship between technology and human nature over time naturally leads to the conclusion that resource endowment is only consequential insofar as it influences a nation's path—that is, resources are less than destiny and the social technology and knowledge that arise out of the interaction between a society and its resources determines directional *tendency*, not an end-state (Cypher, p.365, 2009). Veblen's consideration of institutional behavior suggests that the potential for lock-in[7] is a function of the power wielded by vested interests. The resulting view of economies as integral to society, inherently backward, and the result of cumulative change is central to modern development economics. It is also antithetic to the thinking of Veblen's contemporaries.

Interestingly, Veblen's framework predicts his own faulty analysis of "developing" economies, suggesting that blindness to our own bias is unbelievably powerful. Or, to turn Veblen on himself, even the most dedicated critic is intellectually confined by culture. Even so, Veblen opened a door to understanding the process by which less developed economies catch up—a door that Gershenkron[8] eventually stepped through: knowledge (material and social technology) has costs. Followers incur a lower cost of knowledge than leaders, both socially and

[7] Here we use the term more broadly than usual, in keeping with Veblen's *socio*economic perspective. Lock-in usually denotes the result of path dependency when switching costs become insurmountable. In our meaning, a pertinent example of lock-in is *regulatory capture*, whereby an institution meant to counter the power of an industry becomes its tool. The cost—difficulty—of altering such an arrangement is very high and may be considered a form of institutional lock-in.
[8] According to Cypher (2009), Alexander Gershenkron (1904-1978) briefly acknowledges his debt to Veblen in his work *Economic Backwardness in Historical Perspective* published in 1965.

economically. Veblen, however, went further than Gershenkron in several respects. Veblen stresses both a lack of knowledge (and ability to generate it) and the existence of institutions resistant to the application of new knowledge as more important than either capital accumulation or resource endowments (Cypher, 2009). In this way, he anticipates thinking on development by nearly a century (Hodgson, 2007).

A sophisticated analysis of developing economies would have resulted if Veblen had applied this framework in a more consistent manner. Cypher mines this vein extensively, arguing that while Veblen had considerable insight into the determinants of success in Japan—the preexistence of a feudal system resembling that of historical Europe—he was apparently blind to the determinants of failure in Africa, i.e. imperialism and the *persistence* of feudal modes of organization (p. 365-366, 2009). Cypher charges that Veblen probably failed to see Africa and Asia clearly for the same reason his approach to development would become fringe until the post-soviet era: he, like the rest of his profession, was a product of his time (p. 367, 2009).

Seeing Veblen Today

To Veblen we can attribute the development economist's emphasis on knowledge and the generation of knowledge in the process of sustained development; recognition of the regressive and frictional tendencies of institutions; and holistic, subjectivist approach to growth and development theory and policy. But is Veblen an ancestor or a predecessor? As an homage, we might invoke a Darwinian concept here: evolutionary convergence[9]. Though some connections between Veblen and the modern school may be traced directly, many scholars since the second world war seem loathe to cite such a controversial character, so his true influence may be unknowable. The broad appropriateness of his analytical framework, however, is indisputable

[9] This is the idea that when exposed to similar conditions, unrelated species evolve similar adaptations simply because there is only one, or maybe a handful, of optimal solutions to the same problem.

(Hodgson, 2007). Indeed, that the thinking of so many might converge with Veblen on development without any influence of the latter on the former would be an extraordinary testament to his insight. Either way, modern approaches to development economics are very similar to the Veblenian framework, which connects many seemingly disparate ideas in the field.

For example, David Landes[10] observes that even as we understand economics in isolation, even as we are reasonably successful in managing our own economy, and even as we enjoy unmatched wealth, *imparting* development in any real sense is impossible (1990). He then outlines a cost of institutional change, while agreeing with Veblen on Japan:

> "New ways demand and make new people… historically they were often achieved by building on the more docile members of the society, the ones who could not say no, that is, on women and children, and that way creating a new labor force over a period of generations. This is still true. They have been most readily effected in those societies, like the Japanese, which had already developed appropriate time and work values before the coming of modern industry." (Landes, p.11-12, 1990).

Landes goes on to almost wallow in the intractability of world development as he considers institutional resistance to change. The most backward economies correlate to the most entrenched traditionalism, which is reinforced by failure.

Preferring to focus on deriving better policy from evidence, Joseph Stiglitz[11] imagines successful development as balancing imperfect government with imperfect markets in the

[10] David Saul Landes (1924-2013) was a professor of history and economics at Harvard. He authored several books including *The Wealth and Poverty of Nations*.

[11] Joseph Eugene Stiglitz (1943-) is a professor of economics at Columbia University. He received the John Bates Clark Medal in 1979 and the Nobel Prize in economics in 2001. He served as chief economist of the World Bank

presence of resistant institutions (2011). He goes on to mention that—with few impediments to the flow of capital—knowledge, entrepreneurship, and the institutions to support them are more critical than material resource endowments. Stiglitz invokes path dependence, in a less dismal way than Landes, when he writes, “The problem [with structuring an economy to maximize comparative advantage] is that some of the most important elements of comparative advantage are endogenous[12]. Switzerland's comparative advantage in watch-making has little to do with its geography.” (Stiglitz, p.232, 2011).

Boettke[13], a world apart from Stiglitz and Landes, also owes a little to Veblen. He attempts to operationalize path dependence by conceptualizing the success of an institution as a function of its indigenous status. Here he builds a framework for understanding why development efforts fail by essentially reviving Gershenkron’s hypothesis that countries develop when they are ready. Instead, to Boettke, countries accept or reject new institutions the way a patient accepts or rejects an organ transplant. This relates to Landes’ lament that development, when forced, is doomed to fail. Boettke abstracts path dependence to fit it into the view that development may be reduced to a suite of prescriptions for growth. Weirdly, this is at once Veblenian and reductionist; cultural universalism with a hint of pragmatic sensitivity: having arrived, we ought to show the way—without thwarting the effort by indicating our smug superiority. At least Boettke’s claim is more testable than Gershenkron’s. Regardless, though it may very well be impossible to find a perspective more different from Veblen, we can still see

(1997-2000) and chaired the Council of Economic Advisors (1995-1997). He is the author of several books, the most pertinent here being *Creating a Learning Society: A New Approach to Growth Development and Social Progress* (2014).

[12] A variable is said to be endogenous to a model when it is explained by the model, i.e. arising from forces internal to the market. External forces—such as culture—are termed exogenous, of course.

[13] Peter Boettke is Professor of Philosophy and Economics; the BB&T Bank Professor for the Study of Capitalism (a grant for the study of economic morality inspired by Ayn Rand); and the Director of the Hayek Program for Advanced Study in Philosophy, Politics, and Economics at George Mason University. He describes his perspective as Austrian *and* Classical.

his framework behind Boettke's implicit assumption that culture precedes economic development; suggesting that to consider institutions from *any* perspective we have to step into a Veblenian mode.

Conclusion

We have purposely dehumanized Veblen and reimagined him as only a set of ideas which can be seen in the genetics of development economics. Through that exercise, it appears clear that Veblen anticipated and contributed to the field a broad framework for the analysis of economic growth and development. Cultural and historical relativity, institutional stickiness, the interrelatedness of economies and societies are all clearly foundational concepts in the study of economic development. Veblen himself failed to fully apply his own model; something we can either attribute to his tendency to self-contradict or to the power of culture over perspective. The former reinforces our collective memory of Veblen the eccentric; the latter bolsters his subjectivist argument.

The importance of timing, historic and cultural specificity; these concepts seem universal enough to apply to the development of *economics* just as much as to economies. Any consideration of the history of ideas should begin by realizing that the relevance and consequence of an idea is relative. How else to explain the abundance of thinkers "ahead of their time"? Well, we could also invoke the resistance of Veblen's "vested interests". Another approach to Veblen starts with a different location for ideas: analysis follows ideology, which follows *agenda*. Veblen's ideas fit poorly into the narrative defending capitalism—and its neoclassical underpinnings—against the threat of socialist thought. From this angle it may be little wonder that Veblenian thought all but disappeared in the 1950s, only to reemerge as the Soviet Union collapsed. Through another prism, institutional stickiness is just the result of humanity's dependence on normative judgment. Some mechanism exists in societies to detect changes in conditions that necessitate adaptation; why should there not be friction in that mechanism?

If there is anything that can be said for certain, any core lesson to be derived from Veblen's work or place in his profession and in history, it is probably this: there is an objective and timeless nature to even the most subjective ideas; the revelation of which may not be forthcoming, but with sufficient change in time and culture even the most obscure *universal* truth may be divined through a process of triangulation. Put another way, great ideas stand the test of time, place, and perspective.

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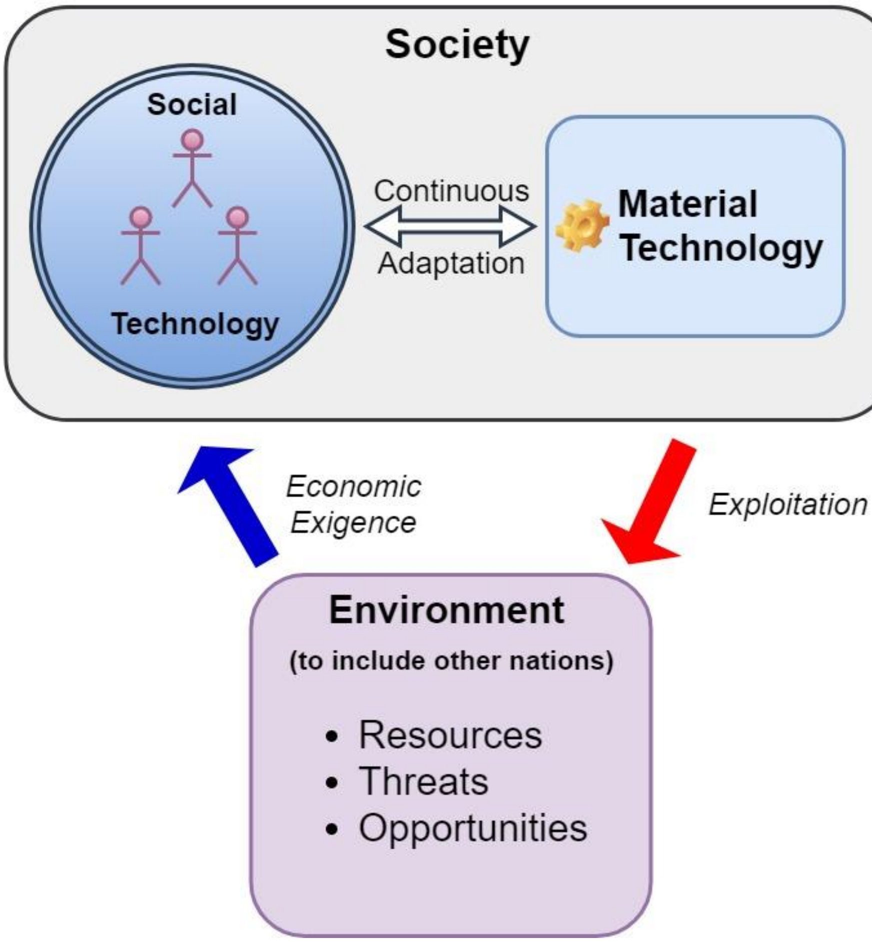
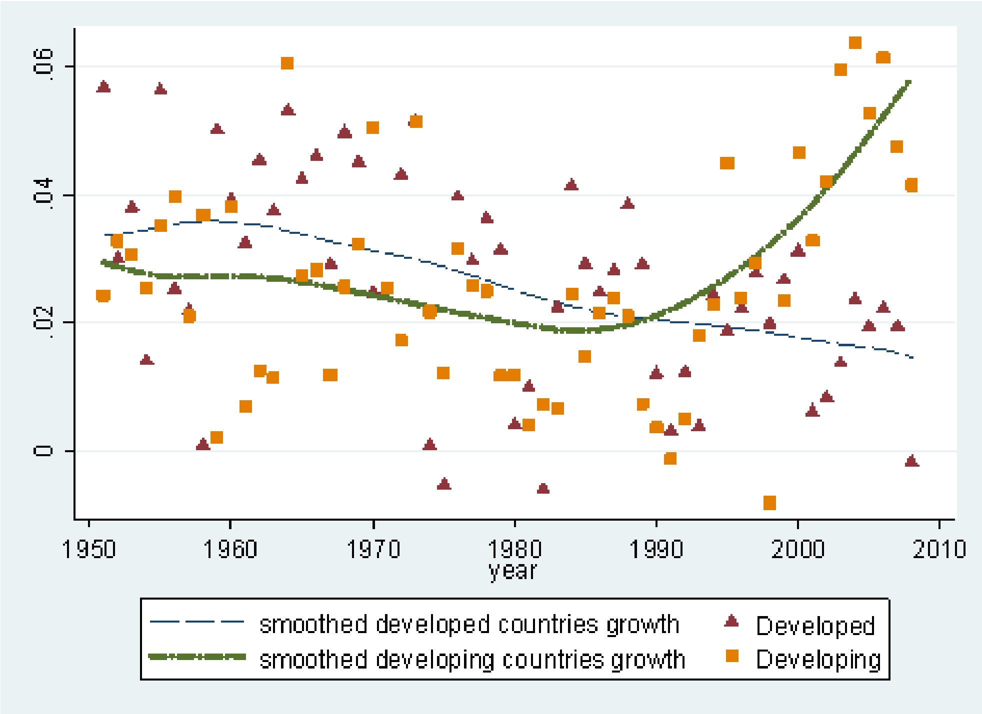
Appendix A

A Veblenian Evolutionary Development Framework



Appendix B

GDP Growth Trends 1950-2009, MDCs and LDCs



Note the very large residuals among LDCs during the cold war period. It was this unevenness, when theory predicted convergence instead, that led to a retake on growth. Interestingly, this chart also shows a long-run convergent trend. *Credit to Dani Rodrik http://rodrik.typepad.com/dani_rodriks_weblog/2011/07/the-great-divergence-the-other-way-around.html*