

Economic Waste and Social Provisioning: Veblen and Keynes on the
Wealth Effect

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Abstract: Economic waste stems from the abuse of power that interferes with the process of social provisioning. For Veblen, waste stems from individual efforts to show superiority, corporate efforts to increase pecuniary returns without increasing industry, or national efforts to exert military dominance. For Keynes, waste assumes the form of idle factories, unemployed workers, and unsold goods resulting from insufficient demand. From a broader perspective, waste results from the efforts of the rentier to increase their returns. Both dimensions of waste relate to the Fed's efforts and that of other central banks to address the problem of social provisioning through the wealth effect. The ideas of Veblen and Keynes provide guidance for evaluating policy directed at enhancing the provisioning process. Based on Veblen's ideas, policies should promote the life process policies and avoid promoting conspicuous consumption. Based on Keynes ideas, policies should stimulate demand, increasing profits that in turn create jobs.

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Economic waste stems from the abuse of power that interferes with the process of social provisioning. For Veblen, waste stems from individual efforts to show superiority, corporate efforts to increase pecuniary returns without increasing industry, or national efforts to exert military dominance. For Keynes, waste assumes the form of idle factories, unemployed workers, and unsold goods resulting from insufficient demand.¹ From the broader perspective of Keynes' institutional analysis, waste results from the efforts of the rentier to increase their pecuniary returns, that is, from the "cumulative oppressive power of the capitalist to exploit the scarcity-value of capital" (Keynes [1936]1964, 376).

Both dimensions of waste come to bear on the Fed's efforts and that of other central banks to address the problem of social provisioning through the wealth effect.² The policy prompts the question: is increasing the wealth of the few an effective means of providing employment for many? Or does it merely foster wasteful consumption?

Veblen analyzed waste from a cultural perspective, focusing primarily on individual efforts to acquire goods and engage in leisure activities that enhance status. Such efforts recall Mandeville's concept of "private vices" in which he included pride, vanity, and envy (Mandeville 1924). Focusing on effective demand, Keynes agreed with Mandeville that "private vices" create "public benefits," a view with which Veblen differed.³

This difference prompts a question: what is the role of effective demand in Veblen's theory? Specifically, do increases in wasteful expenditures provide employment? Keynes made

¹ "For if effective demand is deficient, not only is the public scandal of wasted resources intolerable, but the individual enterpriser who seeks to bring these resources into action is operating with the odds loaded against him" (Keynes [1936]1964, 380-381).

² For a critique of quantitative easing based on the monetary theory of production, see Watkins (2014).

³ Veblen, of course, would likely object to the use of vice. Such expenditures are wasteful in the sense that their purpose is to demonstrate superiority, or match the superiority of others.

employment and hence social provisioning depend on effective demand, the decline of which impairs the provisioning process. While individual aggrandizement contributes to social provisioning, Keynes concedes there are more effective means. Veblen avoided inferences that individual aggrandizement contributes to the provisioning process, despite acknowledging the role of conspicuous consumption in providing employment and raising living standards,

Nevertheless, their ideas provide guidance for evaluating policy directed at enhancing the provisioning process. Veblen's ideas provide two criteria. First, Veblen advocated fostering those activities that promote the life process: "the test to which all expenditure must be brought in an attempt to decide that point is the question whether it serves directly to enhance human life on the whole—whether it furthers the life process taken impersonally" (Veblen 1953, 99). And second, Veblen's comments regarding conspicuous waste implies that policies should avoid promoting conspicuous consumption. Based on Keynes ideas, policies should stimulate demand, increasing profits that in turn create jobs.

The tests come to bear with regard to the Fed's policy of quantitative easing, specifically, the Fed's efforts to stimulate the economy by increasing the wealth of asset owners. Admittedly, the Fed's efforts did help restore the assets of retirees and soon-to-be retirees. Nevertheless, given that 85% of the wealth is owned by the top ten percent of households, and 94% of the wealth is owned by the top 20% of households, quantitative easing both increases inequality and encourages conspicuous consumption. Hence, the policy fails Veblen's tests, while possibly passing Keynes' test.

Role of Wasteful Expenditures in Veblen and Keynes

Conspicuous consumption and conspicuous waste are the obverse and reverse of the same coin. Conspicuous waste involves one-upmanship; it entails a struggle for superiority. “In order to be reputable it must be wasteful” (Veblen 1953).

Invariably, the struggle for superiority increases the standard of living. In the pursuit of status, the masses embrace the values, habits, and desires of the leisure class. They want to join the party, consume like things and engage in like activities. Lack of income, however, relegates them to the kitchen instead of the dining room. Hence, the masses must content themselves with living at the pecuniary standard.⁴

In modern times, business enterprise has made displays of status profitable. Businesses spend money to increase sales that foster wasteful expenditures, which, in turn, increase profits. Advances in technology make possible the mass production of *some* status goods. The subsequent price reductions make luxuries previously enjoyed by the few purchasable by the many. The automobile comes to mind, a product that initially represented a luxury of the rich. The democratization of status goods undermines their status, relegating them to those goods requisite for a respectable life. This elevated standard creates new uses, habits, and institutions, raising the requisite standard of living.

In a community where class distinctions and class exemptions run chiefly on pecuniary ground, wasteful conventions spread with great facility through the body of the population by force of the emulative imitation of upper-class usage by

⁴ "A large proportion, perhaps the greater part, of what is included under the standard of living for any class, whether rich or poor, falls under the theoretical category of Conspicuous Waste, which comprise the consumption of time and effort as well as of substance" (Veblen [1915]1968, 132)

the lower pecuniary classes; so that an exemption of this kind which is an easy means of distinction among the well-to-do, will presently find its way among the indigent as a necessary mark of reputable living" (Veblen [1915]1968, 142).

Even so, many status goods are not readily scaleable. Veblen notes the country gentleman who distinguishes himself by having more homes "than he can conveniently make use of," but "as many and as large as he can afford to keep up" (Veblen [1915]1968, 144). Many of the sports enjoyed by the British elites that Veblen notes including polo, big-game hunting, and mountain climbing also elude mass production. Such leisure activities require money and time, both of which the masses lack.

Whether scaleable or not, however, the economic function of wasteful expenditures is to absorb increases in output. Wasteful expenditures come to serve a pecuniary end.

Keynes view of consumption resembles Veblen's. In *Essays in Persuasion* (1963), Keynes identified two motives underlying consumption: to satisfy urgent needs, and to show superiority.⁵ In *The General Theory*, however, Keynes attributes consumption to a psychological law: as income rises consumption rises, but not by as much as income. For Keynes, consumption is habitual, which explains why the rich save more than the poor.

For a man's habitual standard of life usually has the first claim on his income, and he is apt to save the difference which discovers itself between his actual income and the expense of his habitual standard; or, if he does adjust his expenditure to changes in his income, he will over short periods do so imperfectly. Thus a rising income will often be accompanied by increased

⁵ Veblen agrees; the pecuniary standard bears little relation to the requisite level of consumption required for survival. Further, Veblen estimated that half of all expenditures were wasteful, the remaining expenditures were necessary for survival.

saving, and a falling income by decreased saving, on a greater scale at first than subsequently. (Keynes [1936]1964, 97)

Unspent saving poses a problem, for an increase in saving merely represents a decision not to have dinner today. Keynes does not suggest changing the habits of the rich. Instead, he addressed the problem of social provisioning by advocating government deficits and socializing the rate of investment, both of which increase the prospective income to businesses, thereby stimulating employment. Nevertheless, Keynes concedes that individual aggrandizement provides an alternative means of increasing prospective income.

In so far as millionaires find their satisfaction in building mighty mansions to contain their bodies when alive and pyramids to shelter them after death, or, repenting of their sins, erect cathedrals and endow monasteries or foreign missions, the day when abundance of capital will interfere with abundance of output may be postponed. “To dig holes in the ground,” paid for out of savings, will increase, not only employment, but the real national dividend of useful goods and services (Keynes [1936]1964, 220).

Effective Demand and Conspicuous Waste

Keynes omitted Veblen among the “brave army of heretics” who anticipated Keynes’ ideas (Keynes [1936]1964, 371), prompting one such author to feel that Keynes erred (Vining 1939, 692). If Keynes “army of heretics”—Malthus, Mandeville, Hobson, and Gesell—emphasized the role of effective demand, why didn’t Veblen?

The answer, perhaps, lies in three parts. First, Veblen did not analyze the economy in terms of equilibrium. He eschewed formal models, preferring to analyze the economic process in

in terms of habituated forms of behavior, behavior shaped by the material processes used in production and the material standards established in consumption. Veblen's analysis of capitalist production rests on his distinction between pecuniary pursuits and serviceability. His analysis of consumption rests on pecuniary emulation. Emulation stems from the individual's desire for acceptance. "Those members of the community who fall short of this, somewhat indefinite, normal degree of prowess or of property suffer in the esteem of their fellow-men; and consequently they suffer also in their own esteem, since the usual basis of self-respect is the respect accorded by one's neighbors" (Veblen 1953, 30).

Second, despite overlapping periods, both Veblen and Keynes came to age in different milieus confronting different issues. Veblen was a first generation Norwegian born on the American frontier. The effects of changes in technology on American society influenced Veblen's perspective (See Mayhew 1987). Advances in productivity transformed agricultural, prompting a migration from the country to the cities; increased urbanization expanded opportunities for emulation helping give rise to a consumer society; increased competition based on new production processes that enhanced economies of scale proved ruinous. The subsequent merger movement represented efforts of the banks to restrict output to drive up prices.

Keynes confronted a different situation: "the characteristics of England's aging capitalism as seen from the standpoint of an English intellectual" (Schumpeter 1954, p. 42). Declining investment opportunities, rising incomes, and a habit of saving combined with Britain's efforts to return to the gold standard following World War One laid the foundation for depression.

Third, Veblen expressed hostility towards capitalism. He believed that the machine process was undermining the institutional basis of capitalism. Further, he believed that the

enjoyments of the rich impeded the life process for the masses. In contrast, Keynes sought to save capitalism. Moreover, Keynes agreed that there may be justifications for inequality besides saving. Hence, wasteful expenditures have a role in the theory of effective demand. For Keynes, effective demand provides the income flows to corporations, enabling them to provide employment. This, however, assumes that both the price level and technology remain unchanged, implying that rising expenditures correlate with rising employment.

In contrast, Veblen recognized that prospective income depends on the prices obtained from selling goods. As noted, competition combined with economies of scale increases output, but collapses profits. Depression is not a matter of demand; it is a matter of prices and profits. “The whole matter is very largely a matter of price—of “values” in the commercial sense” (Veblen 1919, 112). Depression means that businessman cannot “derive a satisfactory gain from letting the industrial process go forward on the lines and in the volume for which the material equipment of industry is designed” (Veblen [1904]1975, 213).

For Veblen, increases in demand may absorb output at profitable prices, but such increases will not necessarily provide employment. Advances in technology make possible increasing output without increasing jobs. Conspicuous waste absorbs the difference between output and productive consumption, the level of expenditures necessary to create the output. Conspicuous waste provides income for workers engaged in wasteful production, but it detracts from the goods and services that contribute to social provisioning. The production of status goods and efforts to sell those goods represent for Veblen a waste, a waste because the deny providing goods that enhance the life process. In depressed times, conspicuous waste declines

along with output, leaving the difference between output and productive consumption little changed.

It may be added that the rate of consumption is also appreciably lower during dull times, particularly in the more wasteful forms of consumption. This lowered aggregate consumption offsets the lowered intensity of production during dull times to such an extent that it is probably safe to say that the net surplus product, measured by weight and tale, is at least not appreciably smaller during depression than during prosperity (Veblen [1904]1975, 239n).

As noted, wasteful expenditures can help absorb the surplus. But given the efficiency of production, wasteful expenditures cannot sustain profits for any length of time. What is need is a sabotage of the production process..

In contrast to Keynes, Veblen focuses on restricting supply as a means of driving up prices and resurrecting profits. Perhaps because of his hostility to capitalism, Veblen gives short shrift to the idea of increasing demand. Veblen recognized that advertising could in fact increase sales, but he like Keynes was blind to the possibility to increasing demand through the extension of credit (Watkins 2000, Wray 2007) .

Effective Demand and Economic Sabotage

In *The General Theory*, Keynes presents two different analyses of the economy, a static model exploring the determinants of effective demand, and an institutional analysis focusing on motives and power of the various classes. In the theory of effective demand, both demand and supply are functions of the level of employment. The demand function specifies the expected revenue from employing a specific level of employment. The aggregate supply function specifies the revenue

sufficient to provide a specific the level of employment (Keynes 1964, Chapter 3). For Keynes, employment depends on effective demand, which in turn depends on the propensity to consume and the inducement to invest. The framework is explicitly short-run. Both the price level and technology are held constant. Hence, increases in demand increase social provisioning.

From an institutional perspective, depressions represent a form of economic sabotage. Entrepreneurs control the means of production; the rentier control debt financing. In an effort to increase their returns, the rentier increase interest rates, thereby restricting both capital and employment, limiting the provisioning process.

The Wealth Effect and Wasteful Expenditures

As noted, both Veblen's and Keynes's ideas provide tests for evaluating policy, specifically, the Fed's efforts to stimulate the economy through the wealth effect. The Fed's purchases of US treasury bonds and mortgage backed securities increase asset prices, which increase the wealth of asset holders. Supposedly, the increased wealth stimulates expenditures, which in turn provides employment, thereby expanding the provisioning process.

The Survey of Consumer Finances indicates mixed results. Insofar as the Fed policy caused a rebound in stock prices benefiting those retirees and soon-to-be retirees, the wealth effect would be beneficial. Table 1 indicates that stock values fell precipitously between 2007 and 2010 for the Head of Households aged 45-54, 65-74, and 75 and older. For all aged groups, stock values rebounded since 2010.

Table 1: Mean Value of Stock Holdings for Households in different Age Groups (data in the thousands of dollars)

Age of Head of Household	2004	2007	2010	2013
Less than 35	16.9	27.4	29.5	87.3
35–44	98	103.3	101.4	135.2
45–54	183.8	251.8	208.5	235
55–64	272.6	303.6	298.8	348.4
65–74	398.8	533.5	344.7	490.9
75 or more	253.3	410.9	347.7	446.4

Source: Survey of Consumer Finances 2013, Federal Reserve System,
<http://www.federalreserve.gov/econresdata/scf/scfindex.htm>

The problem, however, stems from inequality in the distribution of wealth. In 2013, the top 10% of households in terms of income own 85% of the wealth, the top 20% own 94% of the wealth. Hence, the wealth effect affects primarily those in the upper income brackets. By inference, the wealthy are more likely to consume conspicuously.

Table 2: Distribution of Wealth (Net Worth) Among Households by Quintiles and Deciles by the Distribution of Income as a Percent of Total Wealth

Family characteristic	2004	2007	2010	2013	Percentage Decline From 2007 to 2013
Less than 20	0.25%	0.22%	0.17%	0.17%	-33%
20–39.9	1.14%	1.02%	0.72%	0.63%	-47%
40–59.9	2.44%	2.37%	1.84%	1.74%	-38%
60–79.9	5.43%	5.54%	3.60%	4.48%	-31%
80–89.9	10.65%	9.59%	8.03%	8.46%	-25%
90–100	80.09%	81.26%	85.64%	84.52%	-11%

Source: Survey of Consumer Finances 2013, Federal Reserve System,
<http://www.federalreserve.gov/econresdata/scf/scfindex.htm>

To reiterate, the policy tests inferred from Veblen's and Keynes ideas include adopting policies that promote the life process, discourage conspicuous waste, and create jobs. Excepting retirees owning modest amounts of wealth, quantitative easing appears to fail the first two tests, while possibly passing the second.

Nevertheless, the wealth effect has likely contributed somewhat to the record profits as a percentage of GDP sustained by corporations as a whole. This despite excess capacity and a lack of employment growth. Record profits are consistent with Veblen's view that increases in conspicuous waste help absorb increases in output without necessarily creating jobs. Hence, society needs to find alternatives to policies that encourage "building mighty mansions," "digging holes," or promoting other forms of wasteful expenditures.

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