Berle and Veblen: An Intellectual Connection

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> Accepting the institution of the large corporation (as we must), and studying it as a human institution, we have to consider the effect on property, the effect on workers, and the effect upon individuals who consume or use the goods or service which the corporation produces or renders. This is the work of a lifetime . . . .[1]

I. INTRODUCTION

"Great men have two lives," Adolf Berle once observed, "one which occurs while they work on this earth; a second which begins at the day of their death and continues as long as their ideas and conceptions remain powerful."[2] As the contributions to the first and second annual Berle symposia attest, Berle's ideas and conceptions remain powerful, and there is keen interest in placing his thoughts in their proper historical context.[3] Berle continues to be the dominant intellectual force undergird-

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My thanks go to Kelli Alces, Angus Burgin, John Cioffi, Allan Hutchinson, Anita Krug, Richard Marens, Ugo Pagano, Brian Sawers, Luke Scheuer, Marc Schneiberg, Michael Siebecker, Fenner Stewart, and Harwell Wells for commenting on an earlier draft of this article. All errors and omissions are, of course, mine.

1. ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY, at viii (1932).

2. Adolf Berle, Speech at the Ceremony of Homage to President Roosevelt, Itamaraty, Brazil (May 12, 1945), *in* NAVIGATING THE RAPIDS: 1918–1971: FROM THE PAPERS OF ADOLF A. BERLE 535 (Beatrice Bishop Berle & Travis Beal Jacobs eds., 1973); *see also Foreword*, Beatrice Berle Meyerson, 34 SEATTLE U. L. REV. 993 (2011).

3. *See*, *e.g.*, William W. Bratton & Michael L. Wachter, *Shareholder Primacy's Corporatist Origins: Adolf Berle and the Modern Corporation*, 34 J. CORP. L. 99 (2008) [hereinafter Bratton & Wachter, *Shareholder Primacy's Corporatist Origins*]; William W. Bratton & Michael L. Wachter, *Tracking Berle's Footsteps: The Trail of the Modern Corporation's Last Chapter*, 33 SEATTLE U. L. REV. 849 (2010); Marc T. Moore & Antoine Rebérioux, *Corporate Power in the Public Eye: Reassessing the Implications of Berle's Public Consensus Theory*, 33 SEATTLE U. L. REV. 1109 (2010); Charles R. T. O'Kelley, *Berle and the Entrepreneur*, 33 SEATTLE U. L. REV. 1141 (2010); Fenner L. Stewart, Jr., *Berle's Conception of Shareholder Primacy: A Forgotten Perspective for Reconsideration During the Rise of Finance*, 34 SEATTLE U. L. REV. 1457 (2011); Dalia Tsuk, *From Pluralism to Individualism: Berle and Means and 20th-Century American Legal Thought*, 30 LAW & SOC. INQUIRY 179 (2005).

ing our understanding of modern corporate law; in his "second life," he continues to animate discourse about needed financial market reforms and regulation of the continuously evolving corporate system.

For my contribution to *Berle II*, I have chosen to highlight the need for further research into the connection between *The Modern Corporation and Private Property*[4] (*Modern Corporation*) and the work of Thorstein Veblen, the father and intellectual inspiration of institutional economics.[5] While the connection between Veblen and *Modern Corporation* is indisputable, the meaning of that connection has not been explored in any depth. I will provide a framework for thinking about the nature of Veblen's influence on *Modern Corporation* and suggest that further research on Veblen's influence would be most fruitful. I will then provide an initial account of how Veblen's work may help us understand what Berle intended to convey in *Modern Corporation*.

Veblen's pathbreaking approach to economics first received prominent attention in 1899 with the publication of *The Theory of the Leisure Class*.[6] For the next twenty-five years, Veblen's books, articles, essays, and book reviews[7] laid out his continuously evolving critique of the institutions of modern capitalism and his evolutionary institutionalist approach to economics, culminating with the publication in 1923 of *Absentee Ownership and Business Enterprise in Recent Times*[8] (*Absentee Ownership*). During this period, Veblen was one of America's most influential public intellectuals, and his ideas remained central in the minds of leading jurists, lawmakers, and other public intellectuals in the early years of the New Deal.[9] His strongest influence, of course, was felt in the world of economics.

Writing at the beginning of the New Deal, one observer noted:

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4. BERLE & MEANS, *supra* note 1.

5. On Veblen's influence among institutional economists and related scholars, see Malcolm Rutherford, *Institutional Economics: Then and Now*, 15 J. ECON. PERSP. 173, 174–76 (2001) [hereinafter Rutherford, *Institutional Economics*]; Malcolm Rutherford, *Institutionalism Between the Wars*, 34 J. ECON. ISSUES 291, 292–94 (2000) [hereinafter Rutherford, *Institutionalism Between the Wars*].

6. THORSTEIN VEBLEN, THE THEORY OF THE LEISURE CLASS: AN ECONOMIC STUDY OF INSTITUTIONS (1899).

7. For a bibliography of Veblen's work, see JOSEPH DORFMAN, THORSTEIN VEBLEN AND HIS AMERICA, 519–24 (1934). For a summary analysis of Veblen's less well-known essays and book reviews, see Donald A. Walker, *New Light on Veblen's Work and Influence*, 37 AM. J. ECON. & SOC. 87, 87–93 (1978).

8. THORSTEIN VEBLEN, ABSENTEE OWNERSHIP AND BUSINESS ENTERPRISE IN RECENT TIMES: THE CASE OF AMERICA (A.M. Kelley 1964) (1923).

9. For a summary introduction to Veblen's broad influence, see Walker, *supra* note 7, at 93–101.

> No small part of the recent discussion in economics in this country centers in the controversy between the "institutional" and the "orthodox" schools of theory. The debate in this connection has gone on almost incessantly, and sometimes at a high heat, for some thirty years, and it has attracted so much interest that the American Economic Association has found it worth while on several occasions to provide a round-table for the pursuance of the argument.[10]

As to the nature of the dispute, the same observer noted:

> It is generally recognized, of course, that the broad question is one of the method and scope of economic analysis, and that the choice to be made is between following in the tradition of Alfred Marshall and taking the standpoint of Thorstein Veblen.[11]

At the eve of the New Deal, Alfred Marshall was the acknowledged intellectual giant of orthodox economics.[12] The orthodox school of thought that Marshall's name evoked was well understood and developed. Ironically, the name it bore—neoclassical economics—was coined by Thorstein Veblen.[13] In contrast to neoclassical economics, institutional economics was a much looser confederation of scholars for whom Veblen's voluminous body of work provided a guiding inspiration.[14]

As Malcolm Rutherford has documented, by the eve of the New Deal, institutional economists and legal realists dominated Columbia University. Berle joined the law faculty at Columbia in 1927 and was a member of that vibrant intellectual community.[15] *Modern Corporation*

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10. Karl L. Anderson, *The Unity of Veblen's Theoretical System*, 47 Q. J. ECON. 598, 598 (1933).

11. *Id.*

12. Paul A. Samuelson, *Economists and the History of Ideas*, 52 AM. ECON. REV. 1, 4 (1962) ("Back in 1935, Marshall was still propped up on his throne and in large parts of the world even the zealots of the mathematical method tended to look upon Walras merely as the predecessor to the great Pareto."); R. W. Souter, *"The Nature and Significance of Economic Science" in Recent Discussion*, 47 Q. J. ECON. 377, 378 (1933) ("[T]he genuine Classical Tradition . . . has so far reached its highest integration in the work of Marshall.").

13. For Veblen's first published usage of the term, see Thorstein Veblen, *The Preconceptions of Economic Science*, 14 Q. J. ECON. 240, 261, 265, 268 (1900); for discussion, see Tony Aspromourgos, *On the Origins of the Term 'Neoclassical,'* 10 CAMBRIDGE J. ECON. 265 (1986).

14. *See* Anderson, *supra* note 10.

15. Malcolm Rutherford, *Institutional Economics at Columbia University*, 36 HIST. POL. ECON. 31, 31–33, 44–59 (2004). The structure at Columbia University facilitated interaction among like-minded social scientists:

> Between 1913 and the early 1930s Columbia became the academic home of a particularly large concentration of economists of institutionalist leaning. These include Wesley Mitchell, J. M. Clark, Fredrick C. Mills, Paul Brissenden, James Bonbright, Robert Hale, Joseph Dorfman, Carter Goodrich, Rexford Tugwell, Gardiner Means, Leo Wolman, Horace Taylor, A. F. Burns, and, later on, Karl Polanyi. Perhaps A. R. Burns and Eveline Burns should also be included as being, at the least, sympathetic to institutionalist ideas. Furthermore, over the period in question, the Department of Economics was a graduate

was certainly viewed by that community as, in part, a work of institutional economics, and thus, as a work following in Veblen's general footsteps. But it was also viewed as an extension of Veblen's last comprehensive analysis of American capitalism—*Absentee Ownership*.[16]

Berle[17] directly signaled these connections to Veblen at the beginning of *Modern Corporation*. In the book's very first paragraph, Berle pronounces the book's central theme and clearly indicates that his study of the emerging corporate system is a work in the institutional economics genre:

> The corporation has, in fact, become both a method of property tenure and a means of organizing economic life. Grown to tremendous proportions, there may be said to have evolved a "corporate system"—as there was once a feudal system—which has attracted to itself a combination of attributes and powers, and has attained a degree of prominence entitling it to be dealt with as a major social institution.[18]

In the book's second paragraph, Berle cites Veblen's last book, *Absentee Ownership* (1923).[19] Veblen is the first scholar cited by Berle and one of only three scholars cited in the first and last four chapters of *Modern Corporation*, the book's theoretical core.[20]

Thus, we can be certain that *Modern Corporation* was intended by Berle and understood by his Columbia colleagues to be a work in the Veblenian tradition. But we can be less certain about what Berle and his contemporaries understood that tradition to entail; unlike the neoclassical school, Veblen's contributions had not been systematized.

> department offering degrees within the Faculty of Political Science. The Faculty also contained the graduate departments of sociology, history, and public law. Karl Llewellyn and Adolf A. Berle were members of the Department of Public Law and the Law School. Robert Hale moved from economics to the Law School, and Gardiner Means was a member of the economic research staff of the Law School between 1927 and 1933, and was an associate in law from 1933 to 1935. From 1919 to 1927 the sociology department included William Ogburn. . . . Outside of the Faculty of Political Science, the philosophy department contained John Dewey, whose instrumentalist philosophy was widely influential and closely connected to institutional economics.

Id. at 32.

16. Rutherford, *Institutional Economics*, *supra* note 5, at 181.

17. Although Gardiner Means contributed economic analysis, the project that gave rise to *Modern Corporation* and the major ideas and writing were Berle's. *See* JORDAN A. SCHWARZ, LIBERAL: ADOLF A. BERLE AND THE VISION OF AN AMERICAN ERA 58–59 (1987).

18. BERLE & MEANS, *supra* note 1, at 1.

19. *Id.* at 2.

20. For analysis of Berle's citations in the first and last four chapters of *Modern Corporation*, see O'Kelley, *supra* note 3, at nn.66–83 and accompanying text.

> [Although] the Marshallian type of theory has been amply expounded, defended and elaborated, so that every economist can know what it stands for, the Veblenian type of theory remains something of a mystery. It is no compliment to the institutional economists that as a rule they have not taken the trouble to attempt a consistent statement of the doctrines of Veblen, nor even to set forth clearly the points upon which they agree with him.[21]

This Essay is not the place to attempt a heroic reconstruction of what Berle and his contemporaries understood Veblen's philosophy to be at the writing of *Modern Corporation*, and were it the place, I am not the engineer to undertake that task. Instead, I will draw from Veblen's own writings to provide a sketch of his life's work. I quote long passages from his work with the intention of providing an access point for readers unfamiliar with it. Then, I place *Modern Corporation* in the context of Veblen's work. In so doing, I will suggest that *Modern Corporation* should be considered a work of evolutionary economic science as Veblen used that term. Part II of this Essay details Veblen's vision of modern economics as an evolutionary science. Part III highlights Veblen's twenty-five year attempt to create an evolutionary economic account of American capitalism, with particular emphasis on Veblen's seminal insights concerning the modern corporation and separation of ownership and control. Part IV visits *Modern Corporation*'s account of separation of ownership and control and interprets that account in light of Veblen's body of work.

II. VEBLEN AND THE EVOLUTIONARY GROUNDING OF INSTITUTIONAL ECONOMICS

Writing at the close of the nineteenth century, Thorstein Veblen posed a question in the title of his seminal article, *Why is Economics not an Evolutionary Science?*[22] In posing and answering this question, Veblen provided the grounding inspiration for what would later become known as Institutional Economics.[23] Veblen also effectively outlined the project that would consume the remainder of his working life—studying the American economic system from an evolutionary scientific perspective.[24]

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21. Anderson, *supra* note 10, at 598–99.

22. Thorstein Veblen, *Why is Economics not an Evolutionary Science?*, 12 Q. J. ECON. 373 (1898).

23. The label "institutional economics" is said to have come into usage between 1916 and 1918. *See* Rutherford, *Institutionalism Between the Wars*, *supra* note 5, at 292.

24. Veblen supplemented his analysis in *Evolutionary Science* with two contemporaneously written articles: *The Instinct of Workmanship and the Irksomeness of Labor*, 4 AM. J. SOC. 187

At the beginning of his seminal paper, Veblen provocatively stated:

> [I]t may be taken as the consensus of those men who are doing the serious work of modern anthropology, ethnology, and psychology, as well as those in the biological sciences proper, that economics is helplessly behind the times, and unable to handle its subject-matter in a way to entitle it to standing as a modern science.[25]

As Veblen would explain, to become "modern," economics would need to become an evolutionary science.

A. Neoclassical Economics

Initially, Veblen distinguished between neoclassical economics, which he identified with the work of Alfred Marshall and his followers, and the Austrian school, which he indentified with Menger, Jevons, and related scholars. Economists in both schools were devotees of marginal utility analysis, and Veblen saw little practical difference between the two schools.[26] By the 1930s, Veblen's term—neoclassical economics—had come to denote the field of economics identified broadly with wealth or utility maximization and marginal utility analysis, a usage that continues to this day.[27]

Veblen saw in the work of Alfred Marshall, and other scholars working in the classical tradition, an aspiration to make economics a modern, evolutionary science. But the work they produced remained fundamentally pre-evolutionary.[28]

> [T]he work of the neoclassical economics might be compared, probably without offending any of its adepts, with that of the early generation of Darwinians . . . . Economists of the present day are commonly evolutionists, in a general way. They commonly accept, as other men do, the general results of the evolutionary speculation in those directions in which the evolutionary method has made its way. But the habit of handling by evolutionist methods the facts with which their own science is concerned has made its way among the economists to but a very uncertain degree.[29]

(1898), and *The Preconceptions of Economic Science*, published in 3 parts—*Part I*, 13 Q. J. ECON. 121 (1899); *Part II*, 13 Q. J. ECON. 396 (1899); and *Part III*, Veblen, *supra* note 13.

25. Veblen, *supra* note 22, at 373.

26. Thorstein Veblen, *The Limitations of Marginal Utility*, 17 J. POL. ECON. 620, 621 (1909).

27. William A. Mackintosh, *An Economist Looks at Economics: The Presidential Address Delivered at a Joint Meeting of the Canadian Political Science Association and the Canadian Historical Association on May 25, 1937*, 3 CANADIAN J. ECON. & POL. SCI. 311, 314 (1937).

28. Veblen, *supra* note 13, at 265–66.

29. *Id.*

Veblen viewed the chasm separating neoclassical and evolutionary economics as "a difference of spiritual attitude or point of view . . . a difference in the basis of valuation of the facts for the scientific purpose."[30] Neoclassical economics was teleological, and the economic theory it produced was "'deductive' or 'a priori' as it is often called—instead of being drawn in terms of cause and effect."[31] In contrast, "[t]he prime postulate of evolutionary science, the preconception constantly underlying the inquiry, is the notion of a cumulative causal sequence."[32]

Neoclassical economics achieved its scientific, deductive results within a framework of assumptions about reality that removed all considerations of evolutionary change and human action.[33] The human actor is conceived in terms of "the traditional psychology of the early nineteenth-century hedonists."[34] He is farsighted and rational, concerned only with maximizing his pleasure and minimizing his pain.[35] But he is not an actor in the sense of being a causative agent. He is a totally passive reactor to what the environment presents—an automaton.

> The hedonistic conception of man is that of a lightning calculator of pleasures and pains, who oscillates like a homogeneous globule of desire of happiness under the impulse of stimuli that shift him about the area, but leave him intact. He has neither antecedent nor consequent. He is an isolated, definitive human datum, in stable equilibrium except for the buffets of the impinging forces that displace him in one direction or another. . . . When the force of the impact is spent, he comes to rest, a self-contained globule of desire as before. Spiritually, the hedonistic man is not a prime mover. He is not the seat of a process of living, except in the sense that he is subject to a series of permutations enforced upon him by circumstances external and alien to him.[36]

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30. Veblen, *supra* note 22, at 377.

31. Veblen, *supra* note 26, at 625.

32. Veblen, *supra* note 13, at 266.

33. Thomas Sowell, *The 'Evolutionary' Economics of Thorstein Veblen*, 19 OXFORD ECON. PAPERS 177 (1967). According to Sowell:

> Had economics followed Veblen, it would have become a fundamentally different kind of inquiry. His sustained attacks on the "preconceptions of economic science" were not attacks on the validity of particular doctrines but attacks on the general outlook which gave rise to such a line of (to him) meaningless inquiry into economic statics, while leaving the glaring fact of qualitative economic and social change largely unexplored. Veblen attacked the *questions* of traditional economics rather than the answers.

Id. at 180–81 (internal citation omitted).

34. Veblen, *supra* note 26, at 622.

35. *Id.* at 623.

36. Veblen, *supra* note 22, at 389–90.

Neoclassical economics imagines this rational man inhabiting a world in which the major economic institutions that affect life have been simplified to data points as lifeless and unchanging as man himself. Likewise, these key institutions, including the institution of private property in the means of production, are conceived as preexisting, immutable features of society that need not and should not be studied or questioned.

> The cultural elements involved in the theoretical scheme, elements that are of the nature of institutions, human relations governed by use and wont in whatever kind and connection, are not subject to inquiry but are taken for granted as pre-existing in a finished, typical form and as making up a normal and definitive economic situation, under which and in terms of which human intercourse is necessarily carried on. This cultural situation comprises a few large and simple articles of institutional furniture, together with their logical implications or corollaries; but it includes nothing of the consequences or effects caused by these institutional elements. The cultural elements so tacitly postulated as immutable conditions precedent to economic life are ownership and free contract, together with such other features of the scheme of natural rights as are implied in the exercise of these. These cultural products are, for the purposes of the theory, conceived to be given a priori in unmitigated force. They are part of the nature of things; so that there is no need of accounting for them or inquiring into them, as to how they have come to be such as they are, or how and why they have changed and are changing, or what effect all this may have on the relations of men who live by or under this cultural situation.[37]

In sum, Veblen saw neoclassical economics as a snapshot of economic relations at a given moment in time, with permanence and immutability attributed to that depicted. In contrast, an evolutionary science would inquire as to why the things depicted were as they were, and how circumstances were likely to change in the future. In other words, a modern science must be historical and predictive, based on an evolutionary and realistic understanding of human psychology and social institutions. Nothing is given or preordained, everything is contestable and contested.[38]

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37. Veblen, *supra* note 26, at 623–24.

38. For analysis of Veblen's theory of knowledge, see Helge Peukert, *On the Origins of Modern Evolutionary Economics: The Veblen Legend after 100 Years*, 35 J. ECON. ISSUES 543 (2001). Peukert argues that Veblen's epistemology is akin to that of Richard Rorty and other postmodernist thinkers:

> Veblen shared their critique of scientific foundationalism, the belief in an absolute bedrock of truth in the Cartesian–Lockean–Kantian tradition. Veblen combined his deconstructivism with an attitude of irony and pastiche, and sometimes melancholy, cynicism and despair. For Rorty and Jean-Francois Lyotard modernity was characterized by the

B. Economics as Evolutionary Science

For evolutionary economics, the human actor is not a passive utility calculator, otherwise incidental to the processes of economic life, but is instead the central causative factor in economic activity.[39] Man is an actor who always seeks to do something.[40] "He is not simply a bundle of desires that are to be saturated by being placed in the path of the forces of the environment, but rather a coherent structure of propensities and habits which seeks realization and expression in an unfolding activity."[41] The resulting human activity must be the central focus of modern economic science. It cannot be presumed that such activity will be rational

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> tendencies of commodification, mechanization, and technology (which—according to Veblen—led to the concept of cumulative causation). Postmodernity means the end of the secure positives, grand referents, and finalities (like Smith's concept of a civil and commercial society), an incredulity toward meta-narratives, and a hermeneutics of suspicion with reference to the matter-of-fact problem of meaninglessness.

Id. at 550–51. For discussion of linkage between Veblen and Einstein, and their respective theories of knowledge, see William T. Ganley, *A Note on the Intellectual Connection Between Albert Einstein and Thorstein Veblen*, 31 J. ECON. ISSUES 245 (1997). Veblen and Einstein agreed on the fundamental nature of scientific theory:

> [Veblen believed] that in modern science the imputation of activity to the observed objects remained at the center of scientific theory. It was here that the minds of Einstein and Veblen met on the meaning of scientific theory:
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> > Activity continues to be imputed to the phenomena with which science deals; activity is, of course, not a fact of observation, but is imputed to the phenomena by the observer.
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> Since Einstein's physicist freely created the most significant concepts for theoretical physics, Veblenian analysis of science methodology was consistent with Einstein's assessment:
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> > physical concepts are free creations of human mind, and are not, however it may seem, uniquely determined by the external world.

Id. at 248–49 (internal citations omitted). Einstein acknowledged his appreciation of Veblen's work in connection with remarks he had been asked to make about Bertrand Russell:

> When the editor asked me to write something about Bertrand Russell, my admiration and respect for that author at once induced me to say yes. I owe innumerable happy hours to the reading of Russell's works, something which I cannot say of any other contemporary scientific writer, *with the exception of Thorstein Veblen*.

Id. at 245–46 (internal citations omitted) (quoting Albert Einstein, *Remarks on Bertrand Russell's Theory of Knowledge*, *in* THE PHILOSOPHY OF BERTRAND RUSSELL (THE LIBRARY OF LIVING PHILOSOPHERS) (Paul A. Schilpp ed., 1944)).

39. *See* Ann Jennings & William Waller, *Evolutionary Economics and Cultural Hermeneutics: Veblen, Cultural Relativism, and Blind Drift*, 28 J. ECON. ISSUES 997 (1994). "The problems confronting individuals and most of the tools for their solution are posed by current cultural relationships, but some scope for novel individual responses to them must exist." *Id.* at 1005.

40. *See* VEBLEN, *supra* note 6, at 15 ("As a matter of selective necessity, man is an agent. He is, in his own apprehension, a centre of unfolding impulsive activity—'teleological' activity. He is an agent seeking in every act the accomplishment of some concrete, objective, impersonal end.").

41. Veblen, *supra* note 22, at 390.

or guided by a narrow focus on utility maximization.[42] Rather, the reasons for such activity are the proper focus of economic science.[43]

Veblen sees human activity as an evolutionary process. What a man does today is a product of what Veblen calls his habits of thought or circumstances of temperament.

> [These habits of thought or circumstances of temperament] are elements of the existing frame of mind of the agent, and are the outcome of his antecedents and his life up to the point at which he stands. They are the products of his hereditary traits and his past experience, cumulatively wrought out under a given body of traditions, conventionalities, and material circumstances; and they afford the point of departure for the next step in the process.[44]

This process of cumulative change plays out as each individual adapts "means to ends that cumulatively change as the process goes on, both the agent and his environment being at any point the outcome of the past process."[45] The environment consists of other persons with whom the agent relates, and social institutions that shape his state of mind and circumscribe his options. Ultimately, "economic change is a change in the economic community,—a change in the community's methods of turning material things to account."[46] This "change is always in the last resort a change in the habits of thought."[47]

Only one vague presumption underlies an evolutionary economics—that man's desire to act is at least partially directed towards achieving his "economic interest," his "interest in the material means of life."[48] But this end competes with numerous others, including the aesthetic, sexual, humanitarian, and devotional interests.[49] And all human activity takes place adaptively and sequentially in concert and in reaction to the actions of others as shaped by the institutions of the day.[50]

Thus, Veblen concluded a modern, evolutionary economics must focus on history, process, and change, and must seek "to trace the cumulative working out of the economic interest in the cultural sequence."[51] "It must be a theory of the economic life process of the race or the com-

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42. John Wenzler, *The Metaphysics of Business: Thorstein Veblen*, 11 INT'L J. POL. CULTURE & SOC'Y 541, 548 (1998).

43. Veblen, *supra* note 22, at 390.

44. *Id.* at 390–91.

45. *Id.* at 391.

46. *Id.*

47. *Id.*

48. *Id.*

49. *Id.* at 393.

50. *Id.* at 392–93.

51. *Id.* at 394.

munity."[52] It must focus on "questions of genesis and cumulative change, and it [must converge] upon a theoretical formulation in the shape of a life history drawn in causal terms."[53] Though the focus is on human action, it must not lose sight of the relation between human action, habits of thought, and social institutions.

> Like all human culture this material civilization is a scheme of institutions—institutional fabric and institutional growth. But institutions are an outgrowth of habit. The growth of culture is a cumulative sequence of habituation, and the ways and means of it are the habitual response of human nature to exigencies that vary incontinently, cumulatively, but with something of a consistent sequence in the cumulative variations that so go forward—incontinently, because each new move creates a new situation which induces a further new variation in the habitual manner of response; cumulatively, because each new situation is a variation of what has gone before it and embodies as causal factors all that has been effected by what went before; consistently, because the underlying traits of human nature (propensities, aptitudes, and what not) by force of which the response takes place, and on the ground of which the habituation takes effect, remain substantially unchanged.[54]

Accordingly, "an evolutionary economics must be the theory of a process of cultural growth as determined by the economic interest, a theory of a cumulative sequence of economic institutions stated in terms of the process itself."[55]

III. VEBLEN'S EVOLUTIONARY ACCOUNT OF THE EMERGING ABSENTEE OWNERSHIP SYSTEM

A. Absentee Ownership—An Overview

Beginning in 1898 and continuing for twenty-five years, Veblen wrote numerous books, articles, and reviews that developed his evolutionary account of the emerging industrial system. The system continued to evolve as Veblen continued to study and write; Veblen's theories evolved apace, culminating with the publication of *Absentee Ownership* in 1923.[56] Veblen began his last great book by identifying the current

52. *Id.*

53. Veblen, *supra* note 26, at 627.

54. *Id.* at 628.

55. Veblen, *supra* note 22, at 393.

56. Stephen Edgell, *Rescuing Veblen from Valhalla: Deconstruction and Reconstruction of a Sociological Legend*, 47 BRIT. J. SOC. 627, 637 (1996) ("Essentially [*Absentee Ownership*] is the sequel to Veblen's first book on modern capitalism [*The Theory of Business Enterprise* (1904)] and takes into account the changes that he had observed during a lifetime of scholarly endeavour, notably

age's most dominant institution—absentee ownership—and highlighting the role of absentee ownership in the organization of society. Veblen wrote: "In recent times absentee ownership has come to be the main and immediate controlling interest in the life of civilised men. It is the paramount issue between the civilised nations, and guides the conduct of their affairs at home and abroad."[57]

For the individual, achieving the status of absentee owner and thereby becoming a "substantial citizen" had become the social ideal. The motivating ideal was investment for profit: "[T]o get something for nothing, to get legal possession of some source of income at a less cost than its capitalisable value."[58]

This development had happened gradually and over a course of years, but the reality of absentee ownership was now evident.

> [Absentee ownership] has now plainly come to be the prime institutional factor that underlies and governs the established order of society. At the same time and in the same degree it has, as a matter of course, become the chief concern of the constituted authorities in all the civilised nations to safeguard the security and gainfulness of absentee ownership.[59]

Though the controlling interest in the life of civilized men had changed, the habits of thinking had not. Men continued to experience and justify economic and social relations and realities with concepts and beliefs suited for an earlier time.

> These matters are still spoken of in terms handed down from the past, and law and custom still run in terms that are fit to describe a past situation and conform to the logic of a bygone alignment of forces. As always, the language employed and the principles acted on lag behind the facts.[60]

Veblen asserted that this lag between older institutions and changed reality could not continue indefinitely.

> [U]nder the urgent pressure of new material conditions some degree of adjustment or derangement of these ancient principles is due to follow. . . . Continued irritation and defeat begot of a system of law and custom that no longer fits the material conditions of life will necessarily be an agency of unrest . . . .

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the growth in the power of capital at the expense of the 'underlying population.'") (citations omitted).

57. VEBLEN, *supra* note 8, at 3.

58. *Id.* at 12.

59. *Id.* at 4.

60. *Id.* at 5.

> Therefore, these time-worn principles of ownership and control, which are now coming to a head in a system of absentee ownership and control, are beginning to come in for an uneasy and reluctant reconsideration; particularly at the hands of the underlying population who have no absentee ownership to safeguard.[61]

Veblen was not content with merely describing the current governing institutions. He was constructing an evolutionary economics. Thus, he sought to explain how the prevailing habits of thought and governing institutions came to be and the material conditions of life with which they were consonant. He sought to explain how and why those material conditions of life had come to be out of balance with the prevailing habits of thought. In other words, he endeavored to explain how the system of ownership and control originally developed, and how it became transformed into a system of absentee ownership and control. To explain, Veblen first brought into play another major social institution—the nation-state. He saw two competing systems evolving in overlapping and supporting ways. He called these the system of national integrity and the system of natural rights.[62] Subsequently, he introduced other major social institutions that played major roles in the creation of the world of the 1920s: chief among these were the handicraft industry, the Masterless Man, the Captain of Industry, and the Corporation.

B. Nationalism: The System of National Integrity

Veblen's brilliant analysis of the system of national integrity shows the linkage between the habits of mind that sustained the nation-state, and the later evolution of the business corporation and the system of absentee ownership. In essence, nation-states were and are corporations, and like absentee owners, their goal was and is to obtain unearned income. The process of state-making during the Middle Ages and afterwards gave rise to the spirit or habit of national integrity.

> State-making was a competitive enterprise of war and politics, in which the rival princely or dynastic establishments, all and several, each sought its own advantage at the cost of any whom it might concern. Being essentially a predatory enterprise, its ways and means were fraud and force. The several princely and dynastic establishments took on a corporate existence, with a corporate interest, policy and organisation; and each of them worked consistently at cross purposes with all other similar corporations engaged in the same line of adventure. Among them were also principalities of the Faith, including the Holy See. The aim of it all centered in princely

61. *Id.*
62. *Id.* at 21.

> dominion and prestige, and in unearned incomes for the civil, military, and ecclesiastical personnel by whose concerted efforts the traffic in state-making was carried on.[63]

These dynastic corporations carried out their adventures at the cost of their underlying populations. It was in the nature of a zero-sum game, but the losers in life and property were always the same. As these adventures continued, each prince sought unbending control and a total usufruct over his underlying population.[64] In turn, the underlying population came to see their subservience as part of the natural order.

> In time, and indeed in a relatively short time, by force of strict and unremitting discipline and indoctrination the underlying population learned to believe that this princely usufruct of their persons and property by Grace of God was indispensably right and good, in the nature of things. By law and custom the underlying population came to owe, and to own, an unbounded and unquestioning allegiance of service to the princely establishment in whose usufruct they are held. Therefore servile allegiance has become not only a point of law but also a point of morals and honor. Such is the force of use and wont.[65]

The underlying populations' identification with their princely masters went deeper. As the various dynastic corporations went about their business of seeking advantage by fraud and force, by war and warlike diplomacy, they were each "imbued with an all-pervading spirit of enmity and distrust, suitable to that enterprise in mutual damage and discomfort for which they were organized and equipped."[66] The underlying populace quickly came to adopt this mendacious and warlike spirit in the natural course of habituation:

> [The] spirit of dynastic statecraft spread down and outward by diffusion, by precept and example, throughout the underlying population until presently they were, all and several, bound together in the service of their predacious masters by an inveterate and unreflecting solidarity of national conceit, fear, hate, contempt, and an enthusiastically slavish obedience to the constituted authorities.[67]

In time, the monarchic nation-state gave way to the democratic nation-state. The aims of the state and its relations to the underlying population were unchanged by this transition. The divine right of the princely

63. *Id.* at 22.
64. *Id.* at 23–24.
65. *Id.* at 24.
66. *Id.*
67. *Id.*

sovereign became the divine right of the democratic state. In theory, each citizen in the democratic state was a sovereign, and the state was the servant of its collective citizens. In practice, the citizens continued to see themselves as bound together in service to the constituted authorities.[68]

The monarchic state sought unearned income for its absentee owners—the princely establishment and its kept class. The new democratic state continued in that role. The citizens of the new democratic state were led to believe that its constituted authorities sought to benefit all citizens and not just the rulers and the kept classes. Thus, as the democratic state continued to seek unearned income from rival nations through force or fraud, through war or sabotage, its loyal citizens were led to believe that they would all share in that income. In fact, the democratic state did not serve the broad underlying population. It continued to seek unearned income for its administrative, military, and diplomatic personnel, but now its primary goal was to serve the business interests of the new class of absentee owners who arose, around 1850, with the full blooming of the industrial revolution.[69]

C. Masterless Men, the Handicraft Industry, and the System of Natural Rights

The Masterless Man is the central actor, and the handicraft industry is the central institution, in the creation of the modern democratic state and the transition from feudal habits of thought to the system of natural rights and ownership. Both arose gradually in the shadow of the long-dominant feudal system and the habits of thought produced by and conducive to the maintenance of that system.

> [T]he feudal (manorial) system, which was a settled order of mastery and service, orderly, standardised, and stabilised as fully as might be, resting on a population engaged in mixed farming and bound to the soil. The law and custom of the feudal régime was a balanced scheme of coercion and submission, dependence and fealty, in which all human values—rights and obligations, security of life and limb, equity and justice, neighborly respect and affection, religious profit and loss—were of right to be rated and apportioned according to a settled schedule of graded privilege, standardized superiority and inferiority. It was always and by settled principle a question of gradation in respect of mastery and service. In this scheme of human beings there was no place and no room for the masterless man.[70]

68. *Id.* at 25–26.
69. *Id.* at 34–38.
70. *Id.* at 44.

But Masterless Men there were—scattered outcasts, nuisances, and institutional misfits making a living with their hands, mixing their labor with readily available materials, and developing a craft.

> So, by drift of circumstance, these masterless men drew together to seek a livelihood by the work of their hands and without formal dependence on the absentee rights and powers of those who owned the material world in that time. Out of the resulting scattered parcels of industrial drifters there grew up in course of time and experience the industrial towns and the arts, principles and mysteries of the handicraft industry.[71]

As time wore on, these now-congregated Masterless Men developed new habits of thought congruent with the material conditions of masterless, ungraded life. They became accustomed to a life in which no absentee landlord had a claim on their product: it belonged to them and no one else. They came to place value on workmanship, not privilege. As Veblen noted, "Out of this workday experience appears to have arisen the common-sense notion that ownership is a 'natural right'; in the sense that what a man has made, whatsoever 'he hath mixed his labor with,' that has thereby become his own, to do with it as he will."[72]

The craftsman's ability to do as he would with the product of his hands gave rise to "a natural right of free bargain and contract in all that concerns his labor and its product."[73] This, in turn, gave rise to trade. As Veblen stated, "Trade—in this connection spoken of as the 'Petty Trade'—is of the essence of the handicraft system of industry. The trade runs on this 'natural right' of free bargain, and comes in on an equal footing with workmanship as an inalienable right of the masterless man."[74]Petty trade makes possible the simple division of labor envisioned by Adam Smith. Each craftsman and trader is a solo producer. Each is engaged in workmanship and therefore morally "entitled to a livelihood on the ground of work done."[75]

D. The Rise of Absentee Ownership in Industry

As the industrial revolution approached, the society of Masterless Men was undergoing an initially unnoticed and gradual change that, with the coming of the industrial revolution, sprang forth as a markedly different world. A minority of Masterless Men became absentee owners. A

71. *Id.* at 46.
72. *Id.* at 48.
73. *Id.*
74. *Id.*
75. *Id.* at 53.

majority of Masterless Men surrendered their ownership and control and became wage laborers.[76]

This change first appeared in trade. The petty trader was engaged in small-time, barter-like dealings. "But the traffic presently grew greater in range, scale, and volume, and took on more of the character of 'business,' in that the necessary management of contracts, bargaining, and accounts became an occupation distinct from the handling and care of the merchandise in transit and in the market-place."[77] Gradually, the petty trader became "an enterprising absentee investor who took care of the business; while agents, super-cargoes, factors took over the handling, carriage, and even the buying and selling of the goods, which so passed under the merchant's ownership without passing under his hand."[78] The petty trader became a "merchant prince" and "the trade became a business enterprise."[79]

A similar transition occurred with the craftsman, with "industry proper, in the shape of ownership of industrial equipment and materials and the employment of hired labor."[80] As with trade, the change was not obvious at first. The master generally remained on the grounds overseeing the work.[81] But with the coming of the industrial revolution, the change came to the fore. With the rapid increase in mechanization and the scale and scope of factory operations, capitalism arose.

> Instead of continuing to act as foreman of the shop, according to the ancient tradition, the owner began to withdraw more and more from personal contact and direction of the work in hand and to give his attention to the financial end of the enterprise and to control the work by taking care of the running balance of bargains involved in procuring labor and materials and disposing of the product. Instead of a master workman, he became a business man engaged in a quest of profits . . . . The result was that investment and absentee ownership presently became the rule in the mechanical industries . . . .[82]
>
> . . . [F]rom this time on [the owner] became, in the typical case, an absentee manager with a funded interest in the works as a going business concern. The visible relation between the owner and the works shifted from a personal footing of workmanship to an impersonal footing of absentee ownership resting on an investment of funds. Under the new dispensation the owner's guiding interest cen-

76. *Id.* at 54–59.
77. *Id.* at 54.
78. *Id.*
79. *Id.*
80. *Id.* at 55.
81. *Id.*
82. *Id.* at 58.

> tered on the earnings of the concern rather than on the workmen and their work. The works—mill, factory, or whatever word may be preferred—became a business concern, a "going concern" which was valued and capitalised on its earning-capacity; and the businesslike management of industry, accordingly, centered upon the net earnings to be derived in a competitive market,—earnings derived from the margin of the sale price of the product over the purchase price of the labor, materials, and equipment employed in its production.[83]

The rise of absentee ownership coincided with the shift from simple division of labor to a world unfamiliar to Adam Smith. The rise of absentee ownership marked the beginning of the end of the era of free competition.

E. The Era of Free Competition

The shift from the era of the Masterless Men to the era of the absentee owner occurred over a brief period of time, roughly between 1775 and 1850.[84] That period of time was the true era of free competition. It was a time of rapidly increasing mechanization and large increases in production and material wealth. It was the time when the needs for capital first exceeded the capacity of the Masterless Men. Credit became an established factor in industrial business, and the businesslike management of industry, focused as it was on net earnings, took into account a new objective: providing a reliable means of income for the creditor.[85] It was during this era that "investment for a profit established itself in civilised law and custom as the staple manner of ownership and control in industry."[86]

The era of free competition was not a period in which considerations of business and finance conflicted with considerations of production and workmanship. Markets were vast and untapped and could absorb as much as industry could produce.[87] Until 1850 or so, the nature of industry was substantially unchanged from what had existed at the beginning of the era of free competition:

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83. *Id.* at 59.

84. The era of free competition finds its genesis and initial guiding spirit in England:

> By a concourse of historical accidents, both the origins of the Machine Industry and the principles of Natural Right were first worked out in England. Between them, these two factors of modern civilisation gave rise to that Competitive System that governed the conduct of industry through much of the nineteenth century and that has continued to dominate the speculations of the economists and the make-believe of the statesman since that time.

Id. at 69.

85. *Id.* at 69–73.

86. *Id.* at 70.

87. *Id.* at 73.

> Electricity, petroleum, and rubber had no share in industry then, and even that extensive use of structural iron and steel that has characterised the later age was still in its beginnings. Industrial chemistry was but a slight and inconspicuous matter, and the industrial uses of the rarer metals were still unknown.[88]

Gradually, the habits of thought from the handicraft era accommodated these new relationships of ownership and control, and the gradualism by which the nature of work changed facilitated that accommodation. The natural rights of ownership were seen as naturally attaching to the absentee owner even though his hands were not involved in workmanship, just as the merchant prince was earlier accorded the moral rights of ownership.[89] This accommodation was also facilitated by, and facilitated the rise of, a new institution: the Captain of Industry.

F. The Captain of Industry

The Captain of Industry is a mythological character—the entrepreneur, the spirit of the new industrial age in its period of free competition, and a bridge between the equally mythical Masterless Man and the absentee owner of the 1920s. But, like the Masterless Man, the Captain of Industry had his counterpart in reality.

> In the beginning the captain was an adventurer in industrial enterprise—hence the name given him; very much as the itinerant merchant of the days of the petty trade had once been an adventurer in commerce. He was a person of insight—perhaps chiefly industrial insight—and of initiative and energy, who was able to see something of the industrial reach and drive of the new mechanical technology that was finding its way into the industries, and who went about to contrive ways and means of turning these technological resources to new uses and a larger efficiency; always with a view to his own gain from turning out a more serviceable product with greater expedition. He was a captain of workmanship at the same time that he was a business man; but he was a good deal of a pioneer in both respects, inasmuch as he was on new ground in both respects. In many of the industrial ventures into which his initiative led him, both the mechanical working and the financial sanity of the new ways and means were yet to be tried out, so that in both respects he was working out an adventurous experiment rather than watchfully waiting for the turn of events. In the typical case, he was business manager of the venture as well as foreman of the works,

88. *Id.* at 74.
89. *Id.* at 55–56.

> and not infrequently he was the designer and master-builder of the equipment, of which he was also the responsible owner.[90]

Veblen acknowledges that even at the beginning of the era of free competition, many of the great fortunes were built not by persons fitting the archetype of the Captain, but instead by sharp practice and careful investment.[91] Still, there was enough consonance between the myth and reality to shape a changed vision of what constituted morally praiseworthy activity and the highest form of ownership, enabling

> this type-form of the captain of industry to find lodgement in the popular belief; a man of workmanlike force and creative insight into the community's needs, who stood out on a footing of self-help, took large chances for large ideals, and came in for his gains as a due reward for work well done in the service of the common good, in designing and working out a more effective organisation and industrial forces and in creating and testing out new and better processes of production.[92]

This common belief became central to economic science as well, and the Captain of Industry was transformed "under the name of 'Entrepreneur,' as a fourth factor of production, along with Land, Labor and Capital."[93]

The habits of thought and beliefs engendered in the era of handicraft did not disappear with the coming or maturing of the mechanized industrial age. Instead, "[a]ccording to the moral bias created by age-long experience during the era of handicraft, men are still inclined to justify property rights on the ground of productive industry, serviceable work, rather than prescriptive tenure."[94] And, according to this habit of thinking, the Captain of Industry—the most productive of all citizens—is morally entitled to his profits.

G. The Full Separation of Ownership and Industry

The era of free competition initially featured the unification of ownership and industry that typified the handicraft era. The unification was beginning to unravel, but in the early years, it still served as a fair representation of reality.[95] Consistent with that unity of ownership,

> industries were habitually conducted on a relatively small scale on a basis of self-ownership, with credit relations playing a subsidiary

90. *Id.* at 102–03.
91. *Id.* at 104.
92. *Id.* at 104.
93. *Id.* at 105.
94. *Id.* at 49.
95. *Id.* at 80.

> and essentially transient part, and by owners who exercised a personal supervision of the works from day to day and dealt with their hired workmen on something of a personal footing.[96]

The typical firm was owned and managed by a sole proprietor, or less commonly, by a small partnership.[97] This unity of ownership and industry was no longer a characteristic of industrial societies by the third quarter of the nineteenth century.

It is not possible to date the end of the era of free competition precisely, but somewhere around 1850, the first stage of the industrial revolution ended and a new stage commenced. In a very short period of time, perhaps from 1850 to 1875, the material conditions of industry changed dramatically. At the beginning of this transition period, the mechanical processes and materials used in industry were little changed from those used in 1800. By 1875, however, electricity, petroleum, rubber, structural iron and steel, rarer metals, and new products from industrial chemistry were incorporated into the industrial system. "The industrial system, the state of the industrial arts, as it stood before that date was complete without these things; since that time, since their invention has made them necessary, industry can not do without these things . . . ."[98]

With this feverish creation and introduction of new inventions, the productivity of the industrial system surged dramatically. New plants and equipment were constructed. More products were produced. This created a rapid increase in demand for not only new raw materials, but the old staples as well, providing a flood of new unearned income and wealth to the absentee owners of these resources. It also created new demand for capital, which from the absentee owners' perspective presented new opportunities to invest for profit. Much of this new investment took place in the form of credit, requiring the businessman to focus ever more attentively on business affairs—on earning a profit for the benefit of the absentee owners. At the same time, the growing complexity of the industrial plant and processes gave rise to a new institution—the technician.[99]

> So the interval since the middle of the nineteenth century stands in contrast to what went before, as a more or less sharply defined period of special growth in the industrial arts, during which the mechanical industry has progressively shifted to a footing of applied science, and during which also the immediate designing and conduct of the work has progressively been taken over by the technicians. At the same time and by force of the same drift of circums-

96. *Id.*
97. *Id.* at 80–81.
98. *Id.* at 74.
99. *Id.* at 254.

> tance the captain of industry, the owner-employer, business manager, has progressively been shifted to one side,—to the business side, the "financial end." Being a layman in matters of industry—that is to say in matters of technically applied science—the business man has perforce become an absentee, an outsider so far as concerns any creative work.[100]

While industry was now completely split away from the absentee owner in terms of technical control, he retained ultimate authority. He controlled the finances, decided the business strategy, and determined the relative emphasis given to production and salesmanship.[101] The owner-employer was now aligned with other absentee owners in the pursuit of net gain; in this pursuit, the owners were fundamentally at odds with the technicians and the underlying population.[102]

H. The Corporation, the Principle of Net Gain, and the New Order

By the end of the nineteenth century, the corporation had become "the master institution of civilised life,"[103] and the dominant mechanism for financing industrial business enterprises.[104] The corporation's primary function was to facilitate absentee ownership. Its sole purpose was to make a profit for its absentee owners, and its only interest in its industrial properties and hired technicians was how to use them to make a profit.[105] The rise of the corporation coincided with the conditions attending the end of the era of free competition, and its ascendancy was accompanied by, and facilitated, the complete separation of ownership and industry. Further, corporation finance and the principle of net gain now worked in concert to prevent the effective use of the country's industrial properties.[106]

> [T]he corporation is always a business concern, not an industrial appliance. It is a means of making money, not of making goods. The production of goods or services, wherever that sort of thing is included among the corporation's affairs, is incidental to the making of money and is carried only so far as will yield the largest net gain in terms of money,—all according to the principal of "what the traf-

100. *Id.* at 259.
101. *Id.* at 277.
102. *Id.* at 9–10.
103. *Id.* at 86.
104. *Id.* at 80–82.
105. *Id.* at 83. According to Veblen, the corporation is "an incorporation of absentee ownership . . . ." *Id*. at 82.
106. *Id.* at 9–10.

> fic will bear," or of "balanced return," which underlies all sound business, and more particularly all corporation business.[107]

Net gain was the underlying principle of business, and all else, including production, yielded to its demands.

> This principle has come to be formally recognised and accepted as good and final ever since the corporation came into general use as the standard form of business concern. . . . [S]ince the dominant interest of the civilised nations has shifted from production for a livelihood to investment for a profit . . . this principle of net gain has come to stand out naked and unashamed, as the sound and honest rule that should govern and limit the production of goods for human use. And the corporation incorporates this underlying principle of business enterprise more singly and adequately than any form of organisation that had gone before.[108]

The hegemony of the corporation and the absentee owner coincided with the end of the era of free competition. During the period between 1875 and 1900, oligopoly came to be the rule in several key industries. At the same time, the productivity of the industrial system came to greatly exceed what the market could bear at prices sufficiently profitable for the corporation to meet its obligations to absentee owners.[109] Guided by the net gain principle, corporations relentlessly acted to maximize the value of corporate securities—values based on a capitalization of the corporation's expected earnings. The period from 1900 to 1923 saw a steady increase in the overall wealth of the country.[110] But absentee owners of all stripes, particularly owners of corporate securities, reaped the gains. The underlying population fell behind. Men eager to work were unemployed; wages of labor were under constant attack.

Most attributed the reduction in wealth to the underemployment of the nation's industrial manpower and facilities.[111] But Veblen looked deeper to find the root cause—it was the principle of net gain combined with the absentee owners' control of the nation's industrial system.

> But capitalisation and earnings are a business proposition; livelyhood is not. And in any civilised country, like America, business controls industry; which means that production must wait on earnings. Under these circumstances it is, as a matter of common honesty, incumbent on the business men in charge to keep this—in a sense fictitious—capitalisation intact, and to make it good by

107. *Id.* at 85.
108. *Id.* at 85–86.
109. *Id.* at 209–14.
110. *Id.* at 211.
111. ARTHUR M. SCHLESINGER, JR., THE COMING OF THE NEW DEAL 88–96 (1958).

> bringing current earnings up to the mark. And they have been endeavoring to do this by curtailing employment and output to such a point that the resulting smaller volume of output at the resulting increased price per unit will yield the requisite increased total price-return. Among the expedients by which it is sought to save the capitalisation intact is a concerted effort to reduce wages.[112]

And that sabotage of the industrial system in the pursuit of net gain was made possible, indeed made inevitable, by the habits of thought and supporting laws that suited the era of the Masterless Man. While out of step with the material conditions of life in 1923, such habits of thought were shared by both the businessman and the underlying population.[113]

> It is not that these captains of Big Business whose duty it is to administer this salutary modicum of sabotage on production are naughty. It is not that they aim to shorten human life or augment human discomfort by contriving an increase of privation among their fellow men. Indeed, it is to be presumed that they are as humane as they profess. But only by shortening the supply of things needed and so increasing privation to a critical point can they sufficiently increase their (nominal) earnings, and so come off with a clear conscience and justify the trust which their absentee owners have reposed in them. They are caught in the net of business-as-usual, under circumstances which dictate a conscientious withdrawal of efficiency. The question is not whether the traffic in privation is humane, but whether it is sound business management; which reduces itself to a question of whether the underlying population will put up with a sufficient degree of privation for a sufficiently long time. And the underlying population of this country is notoriously tolerant as regards all those things that are done in the name of business.[114]

But what did the future hold? What could be expected to occur in the next twenty years? Veblen, the evolutionary scientist who dedicated his productive life to developing a modern, predictive economics, was remarkably prescient. He saw four possibilities. One, the least likely even operating in the aftermath of Bolshevik Russia, was some form of revolt by the underlying population.[115] The second possibility, which Veblen thought likely, was that the Federal Reserve Board and the major banks might work in concert to maintain a steadily increasing value for corporate securities, thereby minimizing corporations' need to curtail

112. VEBLEN, *supra* note 8, at 220.
113. *Id.* at 205–10, 284–85.
114. *Id.* at 220–21 n.11.
115. *Id.* at 226.

output and press downward on wages.[116] A third possibility was a voluntary corporatist solution, in which key industries and the banks would "draw together on a concerted plan of common action and set the pace for the country's industry as a whole by limiting output and service to such a rate and volume as will best serve their own collective net gain."[117]

The outcome Veblen thought most likely, however, was that corporations would continue to act within industry groups, with each group "seeking its own immediate advantage by charging what the traffic will bear, at the cost of any other vested interests and of the underlying population."[118] Following this course would mean a continuation of periodic underproduction, underemployment, and attacks on wages—in the service of absentee owners, corporations would continue "a haphazard and fluctuating sabotage on employment and output, after the pattern that had become familiar during the years before [World War I]."[119] And in that course, Veblen had no doubt, lay disaster.

> In that strategy of businesslike curtailment of output, debilitation of industry, and capitalisation of overhead charges, which is entailed by the established system of ownership and bargaining, the constituted authorities in all the democratic nations may, therefore, be counted on to lend their unwavering support to all manoeuvres of business-as-usual, and to disallow any transgression of or departure from business principles. . . . The outlook should accordingly be that the businesslike control of the industrial system in detail . . . should speedily pass beyond that critical point of chronic derangement in the aggregate beyond which a continued pursuit of the same strategy on the same businesslike principles will result in a progressively widening margin of deficiency in the aggregate material output and a progressive shrinkage of the available means of life.[120]

And so it came to pass: six years later, scant weeks after Veblen's death, the Great Depression struck.

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116. *Id.* at 227.
117. *Id.*
118. *Id.* at 227–28.
119. *Id.* at 228.
120. *Id.* at 445.

IV. *MODERN CORPORATION*

A. Modern Corporation *as Veblenian Evolutionary Economic Theory*

The long-standing, standard account of *Modern Corporation* credits Berle as identifying in neoclassical economic terms the problem of separation of ownership and control.[121] But any comprehensive reading of *Modern Corporation* reveals an overwhelming similarity in style, theme, and methodology with the evolutionary institutional economics of Thorstein Veblen. Further, such reading makes clear that Berle was not interested in solving, or even presenting for solution, the problem of separation of ownership and control. His research showed that the modern corporation had evolved into a social institution that could no longer be viewed as private property, nor could its owners, managers, or controllers claim the rights of the traditional sole proprietor modeled in neoclassical economics. His focus was evolutionary, and the problems on which he focused were both understanding what the modern corporation had become and might become, and laying the groundwork for continuing study of the emerging corporation system.

In the preface to *Modern Corporation*, Berle clearly reveals the institutional nature of the book's underlying project.

> Accepting the institution of the large corporation (as we must), and studying it as a human institution, we have to consider the effect on property, the effect on workers, and the effect upon individuals who consume or use the goods or service which the corporation produces or renders. This is the work of a lifetime; the present volume is intended primarily to break ground on the relation which corporations bear to property.[122]

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121. *See* Bratton & Wachter, *Shareholder Primacy's Corporatist Origins*, *supra* note 3, at 101 nn.4–5. The standard account often links Berle as a descendant of Adam Smith. For example:

> Eugene Fama and I have been working for several years to understand the characteristics that give survival value to . . . organizations like large public corporations characterized by separation of "ownership and control," or more precisely, separation of the decision management and residual risk-bearing functions. Scholars from Adam Smith (1776) to Berle and Means (1932) have pointed out the inconsistency of interests between managers and outside stockholders and emphasized the costs these conflicts generate.

Michael C. Jensen, *Organization Theory and Methodology*, 58 ACCT. REV. 319, 328 (1983); *see also* Edward A. Dyl, *Corporate Control and Management Compensation: Evidence on the Agency Problem*, 9 MANAGERIAL & DECISION ECON. 21, 21 (1988) ("The agency problem caused by the separation of ownership and control in large corporations has been discussed by numerous researchers interested in the corporate form of organization, ranging from the early work of Adam Smith (1776) and Berle and Means (1932) . . . ."); Eugene F. Fama & Michael C. Jensen, *Separation of Ownership and Control*, 26 J.L. & ECON. 301, 301 (1983) ("Our goal is to explain the survival of organizations characterized by separation of 'ownership' and 'control'—a problem that has bothered students of corporations from Adam Smith to Berle and Means . . . .").

122. BERLE & MEANS, *supra* note 1, at viii.

The very first paragraph of *Modern Corporation* announces an evolutionary economic research methodology and agenda:

> Corporations have ceased to be merely legal devices through which the private business transactions of individuals may be carried on. Though still much used for this purpose, the corporate form has acquired a larger significance. The corporation has, in fact, become both a method of property tenure and a means of organizing economic life. Grown to *tremendous proportions*, there may be said to have *evolved* a "*corporate system*"—as there was once a *feudal system*—which has attracted to itself a combination of attributes and powers, and has attained a degree of prominence entitling it to be dealt with as a *major social institution*.[123]

The neoclassical approach treats the corporation as a nullity; there is no such thing as a corporation. The term "corporation" is simply a label we apply to the contractual relations between the participants in an incorporated business venture.[124] *Modern Corporation*'s first paragraph clearly rejects that view. The modern corporation is more than a mere contractual device; it has become a system of property tenure. The remainder of the paragraph identifies an evolutionary economic project: the corporation system is a major social institution akin to the feudal system and should be studied as such.

The second paragraph thematically amplifies the first and emphasizes Berle's evolutionary economic focus:

> We are *examining this institution* probably before it has attained its zenith. Spectacular as its rise has been, every indication seems to be that the system will move forward to proportions which would stagger imagination today; just as the corporate system of today was beyond the imagination of most statesmen and business men at the opening of the present century. Only by remembering that men still living can recall a time when the present situation was hardly dreamed of, can we enforce the conclusion that the *new order* may easily *become* completely dominant during the lifetime of our children. For that reason, if for no other, it is desirable to *examine this system*, bearing in mind that its impact on the life of the country and of every individual is certain to be great; *it may even determine a large part of the behaviour of most men living under it*.[125]

Berle seeks to understand the corporation system as an evolving institution. He seeks to understand its genesis, and he understands that it

123. *Id.* at 1 (emphasis added).

124. Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 311 (1976).

125. BERLE & MEANS, *supra* note 1, at 1 (emphasis added).

will evolve still further. Like Veblen, Berle understands that the corporation system likely will constitute a new order[126] akin to feudalism in its effect on human behavior.

The remainder of *Modern Corporation*'s introductory chapter and key parts of the remainder of the book are similarly Veblenesque. Like Veblen, Berle seeks to trace and contrast present-day law and ideology to earlier times.[127] Like Veblen, he sees laissez-faire ideology as having developed as the material conditions of life evolved in ways fundamentally inconsistent with the habits of thought and organizing institutions of the feudal system. Like Veblen, he sees the currently dominant laissez-faire ideology as having arisen when feudalism and its ideologies no longer corresponded with the cultural situation.[128] Like Veblen, Berle understands that laissez-faire ideology justified private property ownership and pecuniary utility maximization—profit-seeking behavior—as socially beneficial and ordained to produce the best possible society.[129] Like Veblen, Berle sees the industrial revolution and the rise of the modern corporation as questioning the continued viability of the laissez-faire ideology.[130] There are differences in the details of the theories presented by Veblen and Berle, but they are not differences in spiritual outlook. Berle sees the modern corporation and the corporation system through the same evolutionary lens as Veblen.

B. Separation of Ownership and Control in Modern Corporation

Berle, like Veblen, traces the development of the modern corporation from preindustrial times to the present. Veblen's account ends with the world of 1923; Berle's account ends with the world of 1932. Looking back to the world immediately before the industrial revolution, the time of Veblen's Masterless Men, Berle identifies three functions of ownership—the right to manage the work, the right to delegate the management of the work, and the right to receive income or profits from the work. The preindustrial revolution owner normally carried out the work himself, so that the three functions of ownership were unified.[131] With the industrial revolution, this normal unification of ownership came to an end. At some point during the nineteenth century, it became the norm for the owner to delegate management of the works to a hired manager, while retaining the right to receive profits.

126. VEBLEN, *supra* note 8, at 205–28.
127. BERLE & MEANS, *supra* note 1, at 1–2, 8–9, 333–39.
128. *Id.* at 8.
129. *Id.* at 340–44.
130. *Id.* 345–50.
131. *Id.* at 119.

> Under such a system of production, the owners were distinguished primarily by the fact that they were *in a position* both to manage an enterprise or delegate its management and to receive any profits or benefits which might accrue. The managers on the other hand were distinguished primarily by the fact that they operated an enterprise, presumably in the interests of the owners.[132]

This carving away of one of ownership's three traditional functions—the actual doing of the work—was what Veblen meant by separation of ownership and control. To avoid confusion, I will refer to this mid-nineteenth-century phenomenon as the separation of ownership and industrial management. So termed, both Berle and Veblen agree that at some point in the nineteenth century, ownership became divested of its industrial management function, leaving ownership with two functions: (1) the ultimate power to control the ends that industrial management must serve (the "control" function); and (2) the right to receive all profits produced by industry (the "investor" function).

For Veblen, writing in 1923, separation of ownership and industrial management was the fundamental defining characteristic of the American economy. Ownership remained lodged in each corporation's absentee owners. He saw no conflict of interest between the absentee owners carrying out the control function and those carrying out the investor function. It is here that Veblen and Berle part company.

Gardiner Means's[133] research revealed that of the 200 largest American corporations at the beginning of 1930, 5% were controlled by majority stock ownership, and 6% were privately held. The remaining 89% were controlled by management (44%), a legal device (21%), or a minority shareholder group (23%).[134] Based on these numbers, it was already the norm that control of America's largest corporations was determined on a basis other than stock ownership. Further, Means's research revealed a continuing dispersion of stock ownership; accordingly, the percentage of firms in which control was not dependent on stock ownership would steadily increase. Thus, Berle and Means indentified a new archetypal corporation—the modern corporation—in which the power to elect the board of directors resided in the hands of a person or persons who owned substantially less than a majority of the corporation's stock.

Berle identifies the person or persons having the power to elect a majority of a modern corporation's board of directors as the corpora-

132. *Id.* at 119 (emphases in original).
133. For Means's role in *Modern Corporation*, see *supra* note 17.
134. BERLE & MEANS, *supra* note 1, at 94.

tion's "control."[135] The shareholders who are not part of control are relegated to the investor function only. By definition, these investors constitute a majority of the modern corporation's stockholding body. Berle describes these majority shareholders as passive and geographically dispersed; we can think of them, institutionally and in the way described by Berle, as the "Dispersed Majority Shareholders." As corporation law norms grant ultimate authority over the election of directors to the majority shareholders, Berle views the Dispersed Majority Shareholders as the modern corporation's owner. Separation of ownership from control, then, means that the Dispersed Majority Shareholders are excluded from control.

Making this dichotomy work requires a nifty move. The person or persons carrying out the corporation's control function are also shareholders, and thus also seemingly carrying out the investor function. For Berle's schema to pass muster, there must be some reason to believe that those in control will disregard their status as investor and act only in the interest of control. Berle solves this problem by identifying a fundamental divergence of interest between control and the Dispersed Majority Shareholders.

The interests of each of the Dispersed Majority Shareholders seemed clear:

> In general, it is to his interest, first that the company should be made to earn the maximum profit compatible with a reasonable degree of risk; second, that as large a proportion of these profits should be distributed as the best interests of the business permit, and that nothing should happen to impair his right to receive his equitable share of those profits which are distributed; and finally, that his stock should remain freely marketable at a fair price.[136]

Control would presumably share those interests if control owned all of the corporation's stock. If such were the case, control would be motivated by the desire to maximize personal profit as had been the traditional owner. But can we assume that control will operate the modern corporation so as to maximize control's personal profit? And if we do, will control's interests diverge from that of the Dispersed Majority Shareholders, the firm's owners?

> If we are to assume that the desire for *personal profit* is the prime force motivating control, we must conclude that the interests of control are different from and often radically opposed to those of own-

135. *Id.* at 69. In Veblenian terminology, this person or person could be termed the "Central Absentee Owner."

136. *Id.* at 121.

> ership; that the owners most emphatically will not be served by a profit-seeking controlling group. In the operation of the corporation, the controlling group even if they own a large block of stock, can serve their own pockets better by profiting at the expense of the company than by making profits for it. If such persons can make a profit of a million dollars from a sale of property to the corporation, they can afford to suffer a loss of $600,000 through the ownership of 60 per cent of the stock, since the transaction will still net them $400,000 and the remaining stockholders will shoulder the corresponding loss. As their proportion of the holdings decrease, and both profits and losses of the company accrue less and less to them, the opportunities of profiting at the expense of the corporation appear more directly to their benefit. When their holdings amount to only such fractional per cents as the holdings of the management in management-controlled corporations, profits at the expense of the corporation become practically clear gain to the persons in control and the interests of a profit-seeking control run directly counter to the interests of the owners.[137]

Of course, control may be otherwise motivated—perhaps by the desire for power or prestige. Berle concludes, however, that even if this were so, the corporation would be operated counter to the owners' interests.[138] Accordingly, persons in control, despite their ownership of shares, are not aligned in interest with the Dispersed Majority Shareholders. Ownership and control are truly separated.

C. Meshing Veblen and Modern Corporation

It is easy to see how present-day readers would view *Modern Corporation*'s description of the divergence of interests between control and owners as presenting a problem to be solved—a problem which present-day neoclassical economists believe they have solved.[139] And it is easy to see Berle and Means's description of separation of ownership and control as at odds with Veblen's analysis. But this was not Berle's intent.

Veblen had already powerfully critiqued and delegitimized the separation of ownership from industrial management. His critique demonstrated that control of the modern corporation had only a financial interest in the underlying business. Control viewed the underlying business as an earnings stream to be maximized for the benefit of corporate security holders, the value of whose securities was based on a capitalization of

137. *Id.* at 122 (emphasis in original).

138. *Id.* at 124.

139. *See* Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1417–21; Eugene F. Fama, *Agency Problems and the Theory of the Firm*, 88 J. POL. ECON. 288, 289–90 (1980); O'Kelley, *supra* note 3, at 1150 n.46.

those earnings. Thus, control was motivated to keep wages low, and to allow factories to lie idle and workers to go unemployed when necessary to keep prices at the appropriate level. As Veblen put it, the law allowed control to sabotage its underlying industry, and control obliged when and as necessary to maximize the corporation's net gain.[140]

It is clear that Berle shared Veblen's belief that control was responsible for the periodic underutilization of factories and manpower.[141] But Berle saw events since Veblen wrote in 1923 that enabled and called for a further attack on control. First, the makeup of shareholders had changed dramatically at the beginning of the 1920s, a fact probably too new to have been noticed by Veblen. Second, the great depression that Veblen predicted had in fact occurred.

Gardiner Means's research revealed that a dramatic decline in the proportion of corporate stock held by the wealthy occurred between 1916 and 1921. The result was a shift from dominant ownership of corporate securities by the wealthy in 1916 to a drastic reduction in the percentage of such securities owned by the wealthy in 1921, with a corresponding increase in securities ownership by persons of moderate means.[142] The 1921 proportions had remained unchanged in the ensuing decade. Means's research also showed that the portion of national savings going into corporate securities was steadily increasing: in 1922, 54.2% of property income had come from investments in corporate securities; by 1927 the percentage had increased to 62.8%.[143]

Veblen had been correct in viewing the ownership of securities as principally an activity for absentee owners—the wealthy. But what Berle called "a change of almost revolutionary proportions" had occurred in a very brief period of time.[144] The shareholders of the modern corporation now contained a large cadre of middle-class persons whose life savings were being drawn into the coffers of the modern corporation.

The second change in material conditions that occurred since Veblen wrote *Absentee Ownership* was the great depression that Veblen had predicted. The Great Depression not only devastated workers through wage cuts and unemployment, it also savaged the value of corporate securities. Persons of modest means who had invested their life savings in the stock market faced a radically altered future, but wealthy investors

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140. *See supra* text accompanying notes 104–22.

141. BERLE & MEANS, *supra* note 1, at 124, 355–56; *see also* O'Kelley, *supra* note 3, at nn.107–16.

142. BERLE & MEANS, *supra* note 1, 62–63.

143. *Id.* at 64–65.

144. *Id.* at 62.

were hard-hit as well. It seems likely that obtaining the status of absentee owner was no longer the prime objective for most citizens.[145]

The dramatic effects of the stock market crash on both middle-class and wealthy shareholders supported Berle's argument that shareholders not in control had more in common with each other, regardless of disparities in wealth, than they had in common with those in control of the modern corporation. Berle's account accorded with a growing sentiment in society that those in control of the modern corporation were responsible for the Great Depression.[146] His account supplemented Veblen's masterful critique by showing that control and the Dispersed Majority Shareholders had abdicated the traditional roles of owner and manager, thereby abdicating any claim that the modern corporation should be operated for their sole benefit.[147]

Like Veblen, Berle saw the modern corporation producing net gain far in excess of what could be traced to the contributions or reasonable expectations of either control or the Dispersed Majority Shareholders.[148] Thus, the stage was set for "the community . . . to demand that the modern corporation serve not alone the owners or the control but all society."[149] All that remained was for the community to approve and adopt "a program comprising fair wages, security to employees, reasonable service to their public, and stabilization of business, all of which would divert a portion of the profits from the owners of passive property . . . ."[150] Not surprisingly, Berle's account became the "bible" of the cadre of bright young men who moved to Washington with Franklin Roosevelt, intent on finding ways to bring control of the modern corporation under the control of the American people.[151]

V. CONCLUSION

Modern Corporation has captivated scholars in law and economics for nearly eighty years. But the context and spirit in which it was written has been largely ignored. In its time, it was understood as an extension of Thorstein Veblen's *Absentee Ownership* and must have been understood by economics scholars as a work of evolutionary institutional economics.

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145 . 1 ARTHUR M. SCHLESINGER, JR., THE CRISIS OF THE OLD ORDER: THE AGE OF ROOSEVELT 1919–1933, at 166–68, 171–72 (1957).

146. *Id.* at 177–203.

147. BERLE & MEANS, *supra* note 1, at 355–56.

148. Veblen was explicit that the great corporations derived unearned income from sabotage of industry and labor, and from ownership of natural resources. *See* VEBLEN, *supra* note 8, at 167–68; *see also supra* text accompanying notes 107–16.

149. BERLE & MEANS, *supra* note 1, at 356.

150. *Id.*

151. SCHWARZ, *supra* note 17, at 61, 55–68.

I have attempted to place *Modern Corporation* in the context of both *Absentee Ownership* and the broader current of evolutionary economics, and have described how that context provides coherence to Berle's account of the "problem" of separation of ownership and control.

There is, of course, so much more that could and should be done to understand Veblen's influence on Berle and others' writing at the eve of the New Deal. In addition, two projects strike me as promising great rewards. First is research into the influence of Walther Rathenau on both Veblen and Berle. Both Veblen and Berle were sparse in their citations, yet both frequently cited Rathenau.[152] The second is to trace the influence of Berle and Rathenau forward to the work of John Kenneth Galbraith. It is Galbraith, I suspect, who best understood the insights of Veblen and Berle and brought them to bear in his two greatest books—*The Affluent Society* (1958) and *The New Industrial State* (1967). I am sure there are numerous other projects that would and should complement these, and that would facilitate development of a comprehensive account of the modern corporation and the corporation system as they exist in our time. But these would be a good start.

152. Rathenau was the first author cited by Veblen in *Absentee Ownership*. VEBLEN, *supra* note 8, at 10. Rathenau was the second author Berle cited in *Modern Corporation*. BERLE & MEANS, *supra* note 1, at 2.