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Thorstein Veblen's Concept of Capitalization in the Context of Western Economic Thought*

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Abstract

This study investigates the intellectual foundations that led Thorstein Veblen to conceptualize earning capacity as a capitalization concept. It focuses on: (1) the development of monopolies within American capitalism, particularly in heavy and chemical industries, resulting in large-scale capital investment and financial demand; (2) the emergence of monopolistic firms that integrated industrial and financial operations from the late 19th to early 20th century; and (3) the contrast between Veblen's theory and perspectives of classical, neoclassical, and contemporary American economists, relating to Western capitalism. Veblen, drawing upon the intense inter-firm competition and the expansion of credit characteristic of the period, arrived at the conception of the capitalization of earning capacity through his intellectual exchanges with contemporary scholars, most notably Irving Fisher.

Keywords

Veblen, Fisher, Earning Capacity, Loan Credit, Capitalization, Intangible Assets, Goodwill.

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Table of Contents

1. Introduction

1.1 Issues

Thorstein Veblen's economics stand in marked contrast to both British classical theory and the ideas of his American contemporaries. Observing the transformations in consumption and lifestyle at the end of the 19th century, Veblen sought to incorporate consumers into the scope of economic analysis. Concurrently, he closely examined the behavior of profit-seeking business enterprises operating in competitive markets. These enterprises pursued pecuniary profits and secured the largest possible amount of operational capital through capital markets. This expansion was facilitated by the development of loan credit, which was based on the capitalization of the differential gains achieved by business enterprises.

Veblen observed that a firm's ability to consistently generate persistent differential gains over its competitors, when capitalized, was recognized as an asset. In his view, this process constitutes a mechanism through which corporate capital expands by means of the capitalization of earning capacity.[1]

According to Veblen, the structural basis for this phenomenon was established under a machine-based industrial regime. As industrial production became standardized and systematized, profit attainment became more predictable. In this context, business enterprises competed to secure higher profits than their rivals by employing strategies to maximize returns. One such

[1] Cf., Kawanami (2024).

strategy was the expansion of loan credit through the capitalization of earning capacity, a process Veblen identified as the foundation for the emergence of capitalization in the machine industry.

Although previous research has addressed the socioeconomic foundations of Veblen's capitalization theory,[2] the specific question of how Veblen intellectually developed the idea of capitalizing on earning capacity remains insufficiently explored. This study investigates the intellectual trajectory that led Veblen to formulate a distinctive theoretical framework.

Beyond this issue, a further and equally consequential question must be confronted: by what intellectual impetus and analytical trajectory did Veblen come to formulate his theory of the capitalization of earning capacity? This facet of his thought has not, thus far, been subjected by the present author to an adequately comprehensive or systematic examination. The purpose of this paper is to elucidate the sequence of reasoning through which Veblen arrived at the conceptualization of the capitalization of earning capacity, by situating his arguments in critical juxtaposition with those advanced by economists and other contemporary observers of American capitalism. This inquiry constitutes the central objective of this study.

1.2 Research Perspectives

This study adopts three analytical perspectives. First, it examines Veblen's understanding of the actual functioning of American capitalism during his era. In contrast to Britain, which experienced a prolonged depression beginning in the 1870s, the United States underwent gradual economic expansion. Monopoly enterprises emerged in the heavy and chemical industries, leading to large-scale fixed capital investments and a substantial demand for financing.

Second, this study emphasizes the types of economic actors pursuing earning capacity. While 19th century British capitalism was led by industrial capital centered on the textile sector, American capitalism from the late 19th to early 20th centuries was characterized by monopolistic enterprises that integrated both industrial and financial operations to maximize profit.

Third, this study examines the unique features of Veblen's theory of earning capacity capitalization in comparison with the perspectives of neoclassical economists who analyzed 19th century British capitalism and those of his American contemporaries.

This perspective highlights the theoretical originality of Veblen's approach, in contrast to British classical and neoclassical economics, American

[2] Cf., Kawanami (2024).

neoclassical economics, and institutionalist thought. It also clarifies Veblen's work within the intellectual lineage of capitalization theory and emphasizes its significance.

This paper focuses on Veblen's theory of the capitalization of earning capacity, not as a study in the history of economic thought, but as a framework for developing an analytical perspective for approaching contemporary finance. Veblen was deeply concerned with the large-scale expansion of loan credit. In examining this expansion, he focused on firms' earning capacity—their ability to generate regular differential gains anticipated in the future. He identified this phenomenon within the realities of the merger movement of his age. At a more concrete level, earning capacity corresponded to the cash flow of the firm.

The centrality of cash flow observed by Veblen reappears in later developments as well, including postwar medium- and long-term lending, securitization, and derivatives. In this sense, Veblen's conception of the capitalization of earning capacity provides a valuable analytical perspective for approaching various phenomena of modern finance.

To clarify this orientation, it is useful to provide a more detailed account of the connection between Veblen's concept of the capitalization of earning capacity and modern financial phenomena. Veblen analyzed the phenomenon in which periodic gains came to be recognized as intangible assets in turn of the century America, thereby giving rise to a subsequent expansion of credit. His formulation of the capitalization of earning capacity offered an original explanation for the expansion of credit and the enormous financial gains realized during the contemporaneous merger and acquisition movement.

Moreover, Veblen's analysis—grounded in the financial phenomena around the turn of the century—can be understood as providing a broader analytical framework for approaching subsequent developments in American finance. However, it is impossible to apply Veblen's theory directly to contemporary financial phenomena without passing through several important conceptual steps. For example, the idea that the cash flow generated by a firm or a specific asset constitutes a crucial basis for evaluating the value of the entity that generates it was not confined to the merger movement but also emerged in many other contexts. In bank lending, for instance, lenders estimated borrowers' future earning capacity to determine their ability to repay over a given future period, and, through discounting at an appropriate interest rate, established the lending terms at the present point—an approach visible from the interwar years to the postwar era.

Likewise, in the securitization of mortgage claims, large-scale securitization practices emerged in which mortgage-backed securities were issued backed by the cash flows generated by pools of mortgage loans. Derivatives exhibit a similar structure. A wide range of financial derivatives are structured around the cash flows derived from specific underlying assets, and their prices fluctuate according to changes in those cash flows. In the case of derivatives, even cash flows contingent on future states of the world—such as option exercise values or swap net settlements—become objects of capitalization under certain assumptions about probabilities and discount rates. Consequently, even when expected earning remain constant, fluctuations in discount rates lead to corresponding changes in asset prices. What Veblen described as the "self-augmenting" nature of pecuniary valuation resurfaces in the contemporary economy in the form of asset inflation and valuation overheating driven by interest-rate movements.

Approaching these distinctive features of modern finance, Veblen's theory of the capitalization of earning capacity can be regarded as one of the theoretical sources that illuminate their underlying logic. Nevertheless, his theory cannot be applied to contemporary financial phenomena without situating it within a series of intermediate developments and passing through several conceptual stages. In this respect, the originality of the present study lies in its central claim that the innovative phenomena of modern finance—such as M&A, securitization, and derivatives—should not be seen merely as institutional or technological innovations, but rather as grounded in deeper transformations in financial theory. Veblen's formulation of the capitalization of earning capacity is positioned as one such theoretical foundation.

1.3 Survey of the Research History

Veblen prioritized a wide range of issues—human behavior, institutions, culture, and other related ones—as observed in American capitalism from the late 19th to early 20th century. He approached these questions from a broad interdisciplinary perspective, integrating economics, sociology, and philosophy. Among Veblen's contributions, this study emphasizes one of his key theoretical developments: the theory of the capitalization of earning capacity, which is central to his discussion of loan credit in *The Theory of Business Enterprise* (1904)[3]. While a comprehensive review of the studies on Veblen's loan credit

[3] Cf., Veblen (1904, 1994 Rep.), in *The Collected Works of Thorstein Veblen*, Vol. II (*The Theory of Business Enterprise*), Routledge/Thoemmes Press. When citing Veblen's articles or books included in this collected edition, refer to *The Collected Works*, and,

theory focuses on the capitalization of earning capacity[4], this section does not aim to repeat that broad review. Instead, it revisits prior scholarship from the specific perspective of how researchers interpret earning capacity capitalization. This approach enables the identification of research gaps in the literature and provided an avenue for reassessing the contemporary relevance of Veblen's theory. The literature review follows three main axes.

The first focuses on the evaluation of Veblen's theory of earning capacity capitalization and its relationship with intangible assets.

Medlen (2017) characterizes a key feature of Veblen's theory as the treatment of differential gains as a form of discounted expected income. According to Medlen, Veblen recognized that the ability to consistently generate such differential gains could be capitalized and thereby treated as an asset.

Medlen highlights Veblen's insight that intangible assets—capitalized earning capacity—often rely on both measurable expectations and speculative estimations. From Veblen's perspective, income flows can be projected and institutionalized even when they are not directly observable, and purely accounting-based manipulations may create fictitious income streams that appear real. When such practices are normalized through fraud or manipulation, the assets recognized on corporate balance sheets assume a fictitious nature. Medlen argues that Veblen sharply exposed this mechanism of financial fictitiousness.

Other scholars have evaluated Veblen's theory of intangible assets from various perspectives. For instance, McCormick (2002) emphasizes Veblen's recognition of the economic importance of intellectual property as a foundation for modern economic growth. McCormick links this insight to contemporary theories of endogenous growth, arguing that Veblen's understanding of intangible capital contributes significantly to redefining capital as socially embedded knowledge and innovation.

The second axis of scholarship examines the relevance of Veblen's loan credit and earning capacity capitalization theories to modern finance.

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when necessary, indicate the title of the article or book, the volume and page number. Note that in this collected works, terms used by Veblen should be enclosed in double quotation marks when quoted. In addition, hereafter, only the year of publication of *The Collected Works* will be indicated.

[4] For studies that acknowledge the relevance of Thorstein Veblen's discussion of the capitalization of earning capacity—while also situating it within the context of issues such as credit expansion, financial crises, and the movement of corporate mergers and acquisitions—see: cf. Hake and King (2002), Raines and Leathers (1992), Hake (1998), Davanzati and Pacella (2014), Baskoy (2003), Cornehls, (2004), Hake (2004). For specific details of these studies, see Kawanami (2024), pp. 5–7.

Cornehls (2004) highlights how Veblen's theory explains the expansion of the monetary economy driven by business enterprises seeking pecuniary gains through deception and manipulation. Using corporate scandals involving Enron, WorldCom, and AOL Time Warner as examples, Cornehls argues that Veblen's analysis remains highly pertinent to understanding contemporary financial capitalism.

Minsky (2008), in his work on securitization, identifies the conversion of mortgage-backed cash flows into marketable securities as a key feature of modern finance. Although Minsky does not directly cite Veblen, his analysis aligns with Veblen's concept of capitalization as a means of transforming expectations into asset valuations. Minsky's theory suggests that Veblen anticipated the institutional mechanisms underlying contemporary financial products and their reliance on repackaged income streams.

The third axis concerns the historiographical and theoretical placement of Veblen's monetary and credit theories within a broader history of economic thought.

Ganley (2004) argues that the divergence between Veblen and Irving Fisher regarding the nature of capital is critical in the separation of neoclassical and institutionalist thought in American economics. Veblen criticized Fisher's taxonomy of capital for its lack of proper recognition of intangible assets.[5] Ganley interprets this theoretical divergence as stemming from contrasting views on economic decision-making. Fisher assumed that rational economic agents use perfect information and risk assessments to maximize returns, whereas Veblen observed actual business practices shaped by institutional constraints and speculative manipulation. According to Veblen, corporate mergers and acquisitions are not only rational decisions based on clear expectations but also strategic maneuvers by business elites who control the flows of capital and information for pecuniary gain. These elites, whom Veblen termed as “captains of industry and finance,” influence both economic outcomes and the rules governing the economic game. Ganley concludes that in an era dominated by financial expansion and speculative behavior, Veblen's theory offers a more effective analytical framework than neoclassical models.

Davanzati (2014) identifies conceptual similarities between Veblen's views on money and credit, and Keynes's theories of effective demand and the marginal

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[5] Cf., Veblen (1908) ‘Fisher's Capital and Income’, *Political Science Quarterly*, (*The Collected Works*, Vol. X , pp.148-172); Veblen (1908) ‘On the Nature of Capital: Investment, Intangible Assets, and the Pecuniary Magnate’, *The Quarterly Journal of Economics*, (*The Collected Works*, Vol.Ⅷ, pp.324-351.). cf., Dimand (1998), p.449.

efficiency of capital. Veblen argues that money is endogenously supplied by the banking system and that interest rates function as distributive variables that influence economic activity. According to Davanzati, this perspective establishes a theoretical link with Keynes's monetary economics.

Wray (2007) further explores these connections and identifies three major commonalities between Veblen and Keynes. First, both reject the classical dichotomy between real and monetary economies, emphasizing the influence of financial structures on economic outcomes. Second, both conceptualize capital in relation to expected future earnings: Veblen, through the function of business capital, and Keynes, through the discounting of future profit streams using interest rates. Third, both recognize the potential for demand deficiencies. Veblen noted that capitalization can trigger a rapid nominal expansion of business capital, resulting in a relative shortage of real demand for productive resources. Diverging from Say's law, Keynes emphasized that insufficient effective demand could cause economic stagnation. Wray criticized previous scholarship for failing to sufficiently explore these parallels.[6]

Argitis (2016) evaluates Veblen's theory using Minsky's financial instability hypothesis. He argues that Veblen demonstrated how increased incentives for pecuniary gains among corporate managers and bankers lead to a decline in physical investment and the expansion of speculative activity. This tendency results in overleveraging and excessive debt, generating a credit structure that is disconnected from the real earning capacity. Conspicuous consumption simultaneously reduces effective demand and lowers capacity utilization, contributing to macroeconomic instability. Argitis argues that Veblen had identified the institutional underpinnings of financial fragility long before Minsky formalized the theory.

Based on the foregoing review, three major findings can be identified. First, while there is broad agreement that the theory of earning capacity capitalization is a defining feature of Veblen's loan credit analysis, few studies have examined the origins of his conceptualization. Instead, most researchers have focused on linking Veblen's theory to topics such as economic crises, corporate mergers, and competition. Second, there is growing recognition of the applicability of Veblen's theory to contemporary phenomena, such as accounting fraud and securitization. Veblen's framework offers valuable tools for understanding the unique features of modern capitalism that have emerged since his time.[7] Third, Veblen's thought

[6] Cf., Wilson (2006), pp.1029-1044.

[7] For studies that explore the relationship between Veblen's theory of earning capacity and financial instruments such as securitization and derivatives, see cf. Medlen (2003).

holds a unique position in the history of economic theory, distinguishing itself from British classical and neoclassical traditions as well as American neoclassicism. Notably, the theoretical similarities between Keynesian monetary theory and the Minskyan crisis theory strengthen Veblen's economics as a form of evolutionary institutionalism.[8]

Despite these valuable contributions, there remains a critical gap in the literature. Notably, existing studies have not sufficiently examined why the capitalization of earning capacity constitutes the theoretical core of Veblen's system. This gap stems from the lack of attention paid to the specific socioeconomic conditions under which Veblen hypothesized that this process emerged. In particular, the analysis of how Veblen identified these conditions in *The Theory of Business Enterprise* and connected them to his broader theoretical framework has gained little attention. Having examined the socioeconomic basis of earning capacity capitalization, this study explores how Veblen developed it into a distinctive theoretical innovation.

Another important issue in tracing the origins of Veblen's conception of the capitalization of earning capacity concerns his intellectual exchanges with contemporary scholars.

Existing research has not adequately addressed the question of how Veblen's theory bears significance for analyzing the realities of American finance after his time. Among the studies that show an interest in the relationship between Veblen and modern finance, Medlen (2017) stands as the sole example. However, even in Medlen (2017), the crucial issue of *why* Veblen arrived at the conception of the capitalization of earning capacity remains unexplored.

As noted earlier, an important factor was his observation of the contemporary merger movement and the issuance of securities based on earning capacity. In addition to this point, the present paper demonstrates that Veblen's intellectual exchange with Fisher served as a critical impetus for the development of his idea of the capitalization of earning capacity.

Although Veblen offered critical commentary on Fisher, Fisher did not formulate a substantive counter-critique in response. Consequently, their discussions did not evolve into a full-fledged controversy but remained at the level of intellectual exchange. For this reason, Veblen's critique of Fisher was not subsequently taken up in any significant way by later scholars. Nevertheless,

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For specific details of these studies, see cf. Kawanami (2024), p.8.

[8] For studies that offer a positive evaluation of Veblen's theory, see Wray (2007), Argitis (2016), Medlen (2003), Davanzati (2014), Ganley (2004), McCormick (2002), and Dillard (1987). For specific details of these studies, see Kawanami (2024), pp. 7–8.

Fisher's interaction with Veblen provided an important stimulus for Veblen's formulation of the concept of the capitalization of earning capacity.

2. Modern Private Property and the Principle of Profit

2.1 Pre-Capitalist Systems and Modern Ownership Rights

In Chapter 4 of *The Theory of Business Enterprise*, Veblen analyzed modern business activity based on the assumption that such activity is fundamentally governed by the principle of profit. He distinguished between two foundational business dimensions: material and ideological.

The material basis of machining processes governs both the pace and the scope of industrial growth. The principles governing the machining process define the conceptual framework necessary for technological development. Conversely, the ideological basis refers to the principle of pecuniary gain, which emerges as the normative orientation of a business under the institution of private ownership.

In the preceding chapters (2-3), Veblen analyzed the nature of the machine process, arguing that the machine process requires the standardization of action and knowledge while presupposing physical causality comprehension. This framework evaluates human capabilities and empirical facts based on their alignment with the forces of physical nature. The philosophical orientation underlying this framework is materialism, with causal analysis as the dominant mode of reasoning. The development of natural science and the widespread understanding of its principles have allowed individuals to manipulate machines and enhance industrial efficiency. In countries with advanced machine based industrialization, efficiency has become necessary and culturally entrenched.

Prior to the dominance of machine processes, socioeconomic norms were largely customary and emotional, based on religion, kinship, clan solidarity, cultural traditions, and patriarchal authority. However, these traditional norms have become increasingly obsolete with the rise of modern society, which is structured around machine processes.

Veblen situated his analysis within the historical context of the Industrial Revolution and the emergence of capitalism. As machines replaced handcrafted techniques and became fundamental to production, major shifts occurred in the normative order of society. A key insight is that industrial operations grounded in machine processes must be organized around the principles of standardization and regularization derived from the natural sciences.[9]

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[9] The first foundation lies in the fact that the process of mechanization inevitably

Turning to the ideological foundation of business activities, Veblen discusses how notions of ownership evolved. He critically examined the historical decline in traditional institutions and customs, including feudal relationships, based on personal loyalty and deference. The transition to capitalism was accompanied by the institutionalization of private property. Although customary norms declined, their influence did not dissipate abruptly. Early forms of ownership were intrinsically linked to kinship, religion, and patriarchal lineage. These traditional frameworks are pervasive and influential.

Nonetheless, people began to deviate from these older norms, a process that Veblen attributed to the rise of the capitalist economy based on private ownership and the social division of labor. As private property became more widespread, and the market economy expanded, customary elements gradually eroded. Under capitalism, individuals began to specialize in productive activities based on their abilities or natural talents and exchanged the resulting goods with others through market transactions, which Veblen termed social metabolic interaction. As the scope of exchange widened, monetary transactions became the standard medium and money emerged as a unit of account for all forms of exchange. This phenomenon included goods and services, contracts, loans, and credit relationships.

As all social relations became mediated by monetary transactions, the impact of the money economy extended into every aspect of society, including the domains governed by customary norms. Personal relationships are now being interpreted using pecuniary logic. In this context, the modern theory of property must account for its roots in the earlier traditions. Modern concepts of ownership retain traces of these traditional frameworks.[10]

Overall, within a capitalist society, private property gradually becomes autonomous and acquires an internal logic and legal framework.

2.2 The Establishment of Property Rights and the Business Enterprise

Veblen further analyzed private property by examining the concept of ownership and its evolution with the rise of capitalism. Prior to the 18th century, ownership was typically legitimized by divine will, and property rights were

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creates fissures within the demands for standardization and uniformity, thereby necessitating adjustments to these fissures. This necessity, in turn, leads to corporate consolidation, monopoly, differential gains, and capitalization, thus establishing a connection with the second foundation. cf., Veblen (1994), *The Theory of Business Enterprise* in *The Collected Works of Thorstein Veblen*, Vol. II, pp.66-70.

[10] Cf., Veblen (1994), *The Theory of Business Enterprise*, in *The Collected Works of Thorstein Veblen*, Vol. II, p.68-69.

considered God-given. However, this theological justification gradually diminished over time. For instance, in John Locke's philosophy, ownership was no longer perceived as divinely granted, but rather as a natural right derived from one's labor and engagement with nature.[11] Veblen echoes this transition, asserting that "ownership is a natural right resting on the productive work and the discretionary choice of the owner."[12]

In medieval society, ownership was based on status, privileges, and a hierarchy. Property rights were sustained through feudal relationships of authority and subordination and were ultimately legitimized by reference to secular or divine authority.

Feudal lords, perceived as divinely sanctioned, asserted ownership and control through military and symbolic powers. When these structures began to disintegrate, internal intellectual developments—especially the emergence of natural rights theory—gained prominence. Originating in the English legal tradition, this theory has become embedded in modern jurisprudence.

The material and historical foundations of the emergence of modern property rights included the rise of handicraft production and foreign trade, both of which significantly enhanced economic development. The idea that rights were divinely conferred gradually yielded to secular conceptions of truth and legitimacy, a shift driven by the expansion of the market economy. The most

[11] Like Darwin, Veblen constructed his dynamic theoretical system based on natural and observable forces, without relying on divine or teleological explanations. cf. Dugger (1979), 'The Origin of Thorstein Veblen's Thought', in *Social Science Quarterly*, Vol. 60, No. 3, Dec.

[12] Cf. Veblen (1994), p. 73. Incidentally, Locke argues that property is not granted by God, but rather that labor enables individuals to appropriate the common goods of nature as their own. On this point, Locke states the following.

> "Whether we consider natural reason, which tells us, that men, being once born, have a right to their preservation, and consequently to meat and drink, and such other things as nature affords for their subsistence: or revelation, which gives us an account of those grants God made of the world to Adam, and to Noah, and his sons, it is very clear, that God, as king David says, Psal. C X V.16. has given the earth to the children of men; given it to mankind in common. <u>But this being supposed, it seems to some a very great difficulty, how any one should ever come to have a property in any thing: I will not content myself to answer, that if it be difficult to make out property, upon a supposition that God gave the world to Adam, and his posterity in common, it is impossible that any man, but one universal monarch, should have any property upon a supposition, that God gave the world to Adam, and his heirs in succession, exclusive of all the rest of his posterity.</u> But I shall endeavor to shew, how men might come to have a property in several parts of that which God gave to mankind in common, and that without any express compact of all the commoners."

(Locke [1823], Chapter V. sec.25; underline added.)

important political milestone in this transformation was the series of bourgeois revolutions in England, especially the Puritan and Glorious Revolutions, which established the foundational principles for Locke's modern theory of property. Locke extended the basis of property to productive labor, defining ownership as the right to freely use and dispose of property.

Veblen interpreted the practical foundations of property rights within this framework. Ownership is conferred when a property effectively serves as a means of production under the control of its producer or legitimate recipient. As free and private labor gained broader acceptance, the idea that labor could enhance productivity and contribute to wealth accumulation and industry became widespread. Regardless of historical variations, the belief that free labor constitutes the source of wealth, and the foundation of ownership emerged as a dominant ideological doctrine. This belief—that property constitutes part of the natural order—was institutionalized as British common sense and ultimately spread to continental Europe.

Initially rooted in the craft economy, this perspective on ownership spread concurrently with the increasing specialization of occupations, leading to the emergence of exchange systems and the development of retail commerce. As commercial practices advanced, securing property rights as natural rights became imperative and complemented the growing emphasis on individual liberty. During the Industrial Revolution, productivity increased and pricing systems became central to economic activity. Prices serve as standardized signals for both production and consumption, establishing an informational basis for profit oriented enterprises.

Veblen's objective in reexamining the history of modern private property and profit making principles was to clarify how these institutions influenced contemporary firms and industries. He demonstrated how private property and individual liberty became recognized as legal entitlements deeply embedded in the prevailing norms of justice and social order. As feudalism receded in the 18th century, the pursuit of pecuniary gain was recognized as a legitimate exercise of discretionary freedom.[13] Along with the development of credit systems and contractual freedom, this shift enabled the institutionalization of orderly competition among business enterprises.

By grounding his analysis in Locke's conception of modern property rights—not as divinely ordained but as founded on natural right—Veblen extended the scope

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[13] Taking this point into account, Veblen argues that the practice of lending at interest also came to develop in England—albeit later than in continental Europe—through the establishment of natural rights. cf. Veblen (1994), p. 81.

of his inquiry to encompass the pursuit of financial gain by modern corporations and the corresponding expansion of credit that such pursuits entailed. This constitutes a distinctive feature of Veblen's argument, and the identification of this point represents the originality of the present chapter.

3. The Concept of Capitalization

3.1 The Principle of Profit under Machine-Based Industry

In modern industrial societies, where industries have developed under a system of private property, and the freedom to contract is recognized as a natural right, all economic transactions, including those of business enterprises, are expressed in monetary terms. These transactions necessitate the stability of monetary value. The assumption that money has a fixed value underlies all economic and financial exchanges. While the ultimate object of most transactions is consumer goods rather than the currency itself, the monetary system serves as more than just a neutral medium of exchange; it becomes embedded in the habitual methods of perceiving and calculating value.

Veblen emphasizes that price fluctuations may stem from changes in production costs and variations in the value of money itself. For instance, changes in the supply and cost of precious metals (such as gold), shifts in demand and supply conditions during business cycles, and the circulation of fiat currencies were all factors contributing to price fluctuations in the 19th century. Even during the peak of the gold standard, when monetary stability was institutionally enforced, it operated more as an axiomatic principle than as an empirical certainty.

Veblen recognized that the assumption of a stable monetary value could be undermined, particularly under conditions where credit relations had become widespread. He proposed that the assumption of a fixed money value was appropriate only during the relatively early stages of economic development, such as in handicraft economies, or in the early phases of monetary exchange. As capitalism advanced and credit relations expanded, monetary stability became increasingly fragile.

Although Veblen does not extensively detail the mechanisms by which credit expansion destabilizes the monetary unit in Chapter 4 of *The Theory of Business Enterprise*, he addresses this issue more comprehensively in Chapter 5, titled “The Use of Loan Credit.” In this section, he shifts the analysis from the level of real goods to the dynamics of financial markets. Notably, Veblen recognizes the possibility that fluctuations in the value of money in a credit-based monetary economy must be considered when analyzing enterprise behavior.

3.2 Business Enterprise and Capitalization

To understand Veblen's conception of capitalization further, it is necessary to return to his analysis of the principle of profit. Although business activities are premised on standardization, regularization, and assumptions of stable monetary value, in practice, they are subject to inevitable fluctuations in profits caused by business cycles, shifts in supply and demand, and changes in production costs. In this context, monetary gains and losses, expressed in terms of fixed currency units, have become the primary concerns for business activity. Veblen contends that the central question involves rendering monetary capital productive, specifically, ensuring that it functions as capital capable of generating profits. For Veblen, capitalization is not the mere act of discounting a stream of periodic income. Rather, it is the process by which a given monetary amount is actively mobilized as profit-generating capital. Alternatively, capitalization is grounded in the ability to produce pecuniary returns.

Business operations require that invested capital be strategically positioned to reliably generate profits. This became possible with the rise of the machine based industry, where the recovery of invested capital along with a surplus became increasingly secure. By contrast, wealth accumulation under feudal manorial systems or through speculative mercantile ventures and usury did not arise from stable economic processes but from exploitative or hierarchical relations. Under modern capitalism, profit predictability emerges through stable employment and organized production under the capitalist–labor relationship.

Once the profit generating function of capital is institutionalized, attention shifts to profit variability. Veblen refers to the average or expected rate of return as the "rate of ordinary profits."[14] He argued that this average rate eventually becomes the normative benchmark by which business ventures are evaluated and capitalized. As he states:

> "At any given time and place there is an accepted ordinary rate of profits, more or less closely defined, which, it is felt, should accrue to any legitimate and ordinarily judicious business venture. However shifty the definition of this rate of profits may be, in concrete, objective terms, it is felt by the men of affairs to be of so substantial and consistent <u>a character that they habitually capitalize the property engaged in any given business venture on the basis of</u>

[14] Veblen (1994), p.88.

this ordinary rate of profits. Due regard being had to any special advantages and drawbacks of the individual case, any given business venture or plant is capitalized at such a multiple of its earning-capacity as the current ordinary rate of profits will warrant."

(Veblen [1994], *The Theory of Business Enterprise*, in *The Collected Works*, II, p.88; underline added.)

Veblen's argument assumes the prior establishment of a capitalist economy in which profit generation becomes relatively stable. Within this context, it is assumed that businesses operating under average technological conditions and labor arrangements should be capable of earning the average profit rate. The "ordinary" profit rate is not merely a retrospective observation, but a forward-looking expectation used to assess the future earning potential of invested capital.

As this expectation becomes generalized, entrepreneurs capitalize assets on the belief that they will yield profits at ordinary rates. This process involves assigning value to capital based on its ability to generate future earnings rather than on historical performance. In this context, the evaluation of capital becomes autonomous, whereby entrepreneurs recognize that increasing capital investment, provided that it continues to yield ordinary profits, leads to greater aggregate returns.

Moreover, given that this assessment is not based on past results, it becomes self-referential and relies on managerial judgment and expectations. In effect, capital perceived as generating ordinary profits can be capitalized at multiple earning capacity levels. This logic anticipates the core idea of Veblen's theory: the capitalization of earning capacity.

While this insight on loan credit is detailed in Chapter 5, Chapter 4 contains the incipient stage of Veblen's theory of capitalization. Veblen conceptualized capitalization not only as a technical issue but also as a fundamental feature of enterprise behavior in a capitalist economy. His interest in topics such as corporate consolidation and goodwill has positioned his work at the forefront of contemporary research on capital and finance.[15] In this respect, his theory offers an original, forward-looking perspective on the institutional logic of capitalist enterprises.

Veblen, viewing the intense inter-firm competition of his time and the reliance

[15] Cf., Kawanami (2024).

on increasingly greater amounts of credit as a means of overcoming it, arrived at the idea that capitalizing not past or present earnings, but future earning capacity made such competitive strategies possible. This interpretation becomes clear when viewed from the first analytical perspective.

Veblen's distinctiveness lies in his conception of a firm's capacity to generate persistent differential profits over its competitors as an intangible asset. This point has not been made explicit in previous studies and constitutes a central contribution of the present paper.

4. The Concept of Capitalization and the Use of Credit

4.1 Business Enterprises and the Rate of Return on Capital

Business activity inevitably follows a business cycle, meaning that corporate profits increase or decrease during periods of economic boom or recession. Firms constantly face profit fluctuations. Despite these fluctuations, the central issue regarding business capital has shifted from the scale of physical equipment or production costs to how capital can be capitalized based on earning capacity.

The latter half of the 19th century marked a period in which securing returns on capital and the rate of return on investment emerged as paramount concerns. Consequently, rather than evaluating corporate capital from the perspective of how high its current rate of return yields, the focus shifted to expectations of the extent to which it could generate future returns.

Competition among enterprises began to focus on the expected rate of return. Hence, the core of business management shifted from the current earnings capacity of capital to the capability of the firm to produce future earnings.

This shift redefined competition, with enterprises now striving to demonstrate their long term earning potential, thereby making future oriented management the core of business strategy.

Furthermore, Veblen observed that as firms pursued profits, the managed capital (i.e., business capital) began to assume an autonomous character.

> "Under the exigencies of the quest of profits, as conditioned by the larger industry and the more sweeping business organization of the last few decades, <u>the question of capital in business has increasingly become a question of capitalization on the basis of earning-capacity, rather than a question of the magnitude of the industrial plant or the cost of production of the appliances of industry.</u> From being a sporadic trait, of doubtful legitimacy, in the old days

of the 'natural' and 'money' economy, the rate of profits or earnings on investment has in the nineteenth century come to take the central and dominant place in the economic system. Capitalization, credit extensions, and even the productiveness and legitimacy of any given employment of labor, are referred to the rate of earnings as their final test and substantial ground. At the same time the 'ordinary rate of profits' has become a more elusive idea. The phenomenon of a uniform rate of profits determined by competition has fallen into the background and lost something of its matter of fact character since competition in the large industry has begun to shift from the position of a stable and continuous equilibration to that of an intermittent, convulsive strain in the service of the larger business men's strategy. The interest of the business community center's upon profits and upon the shifting fortunes of the profit-maker, rather than upon accumulated and capitalized goods. Therefore the ultimate conditioning force in the conduct and aims of business is coming to be the prospective profit-yielding capacity of any given business move, rather than the aggregate holdings or the recorded output of product."

(Veblen [1994], *The Theory of Business Enterprise*, in *The Collected Works*, II, pp. 89–90; underline added.)

Notably, Veblen emphasizes that, natural economy to a monetary economy and further to a credit economy, the evaluation of "business capital" shifted. It is based not on the scale of physical properties, the total amount of a firm's assets, or the volume of production, but rather on profitability.

Capitalization, credit expansion, and labor employment are ultimately evaluated not by their productivity or legality (i.e., whether they are institutionally rational) but by the rate of return they yield. In other words, the appropriateness of a business activity is judged by its realized rate of return.

According to Veblen, this rate of return differs from the "normal rate of profit," which refers to the general or average profit rate typically achieved by firms. However, in actual business practice, such average profit rates diminish in prominence as intense inter-firm competition is fundamentally directed toward surpassing the average and achieving a higher rate of return.

Additionally, the standard for evaluation is not the rate of return already achieved but rather the rate of return expected in the future. Ultimately, what truly matters is the expected future earning capacity, not the actual output or total assets.

In sum, the basis of capital valuation lies not in realized profits or in assets held as stocks, but in the earning capacity that is expected to be generated in the future. Veblen's recognition of this shift constitutes the central distinctive feature of his conception of the capitalization of earning capacity.

4.2 Veblen and Fisher on the Theory of Capitalization

In *The Theory of Business Enterprise*, Veblen conceptualized capital based on its anticipated future earning capacity. He regarded this notion as particularly relevant within a “credit economy”, where the development of a sophisticated credit system had led to the marked expansion of business capital via credit. Credit crises occasionally occur because of credit expansion. For Veblen, the capitalization of earning capacity, credit expansion secured by such capitalization, and resultant expansion of business capital were essential tools for analyzing the dynamics of a credit economy.

The intellectual trajectory of this idea, particularly the context that critically shaped Veblen's concept of the capitalization of earning capacity, is noteworthy. This was his theoretical dispute with Fisher, a prominent economist. While Fisher shared certain understandings of capital and its valuation, Fisher also held divergent views. To explore the significance of Fisher's arguments in relation to Veblen's perspective, it is important to examine both *The Theory of Business Enterprise* and Veblen's subsequent works.

(1) Veblen Thorstein, ‘Fisher's Capital and Income,’ *Political Science Quarterly*, Vol 23, No.1, Mar. 1908(*The Collected Works*, Vol. Ⅹ, pp.148-172.).
(2) Veblen, Thorstein, ‘On the Nature of Capital: Investment, Intangible Assets, and the Pecuniary Magnate’, *The Quarterly Journal of Economics*, Vol. 23, No. 1, Nov. 1908(*The Collected Works*, Vol. Ⅷ, pp.324-351.).
(3) Veblen, Thorstein, ‘Fisher's Rate of Interest,’ *Political Science Quarterly*, Vol. 24, No. 2, Jun. 1909(*The Collected Works*, Vol.Ⅹ, pp.137-147.).

The central issue in these articles was Veblen's critical assessment of Fisher's concepts of capital and income. Veblen appeared to positively evaluate Fisher's work with respect to the classification and definition of capital.[16] For example, Fisher's *The Nature of Capital and Income* (1907) provides definitions of capital and income, whereas Veblen acknowledges that capital and income possess a certain value as a systematic categorization of economic concepts.

Concurrently, Veblen criticizes Fisher for failing to recognize nonphysical

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[16] Cf., Veblen (1994), ‘Fisher's Capital and Income’, pp.112-113, in *The Collected Works*, Ⅹ, pp.149-150.

or intangible assets.[17] He argues that Fisher's definition of capital is problematic because it does not include such intangible assets and explains this shortcoming in the following manner:

> "But the fault of the definition at this point is more serious than the mere exclusion of a serviceable general term which might be avoided by a circumlocution. 'Intangible assets' is not simply a convenient general term covering certain more or less fluctuating property rights in certain material items of wealth. The elements of capital so designated are chiefly of the nature of differential advantages of a given business man, or a given concern, as against another. But they are capitalized in the same way as tangible items of wealth are capitalized, and in large part they are covered by negotiable securities, indistinguishable, and in most cases inseparable from, securities representing tangible assets. So, being blended in the process of capitalization with the tangible assets, the securities based on the intangible assets create claims of ownership co-ordinate with those based on the material items and enter, in practice, into 'capital summation' on the same footing as other items of wealth. Hence they become a basis of credit extensions, serving to increase the aggregate claims of creditors beyond what the hypothecable material wealth of the debtors would satisfy. Hence, in a period of general liquidation, when the differential advantages of the various concerns greatly contract, the legitimate claims of creditors come greatly to exceed the paying capacity of debtors, and the collapse of the credit system follows. The failure of classical theory to give an intelligent account of credit and crises is in great part due to the habitual refusal of economists to recognize intangible assets, and Mr. Fisher's argument is, in effect, an accentuation of this ancient infirmity of the classical theory."

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[17] On this point, Veblen states the following:

> "As has already been indicated in passing, 'immaterial wealth,' or 'intangible assets,' is exclude from 'capital' in Mr. Fisher's analysis. Indeed, the existence of intangible assets is denied. The phrase is held to be an untoward misnomer for certain classes of property rights in material objects which are not wholly owned by the individual to whom these property rights inure. An important part of these incomplete property rights are rights of quasi-ownership in other persons, or claims to services performed by such persons."

(Veblen [1994], 'Fisher's Capital and Income', p.116, in *The Collected Works*, X , p.154; underline added.)

(Veblen [1994] 'Fisher's Capital and Income', pp.116–117, in *The Collected Works*, X, pp.155–156; underline added.)

Veblen emphasizes that firms possess both tangible and intangible assets. Intangible assets do not merely represent property rights over physical assets; rather, they represent what Veblen terms "the nature of differential advantages" over other enterprises. Furthermore, such intangible assets, such as tangible ones, possess capacity for capitalization. Consequently, any asset that generates a regular income stream for a person may be capitalized, even if it lacks any physical form. Thus, the capacity to generate regular income constitutes an intangible asset.

Moreover, in practice, these intangible assets often manifest as securities representing the ownership of regular income streams and may be incorporated into a firm's own capital. The recognition of intangible assets is of critical importance because they form the basis of credit. Firms that expand credit based on intangible assets may accumulate excessive debt. During periods of liquidation in a business cycle, excessive indebtedness can exceed firm's repayment capacities, ultimately leading to the collapse of the credit system. These arguments are based on *The Theory of Business Enterprise*.

Veblen emphatically asserted that any analysis of credit expansion, growth of business capital, or breakdown of the credit system must be premised on a proper understanding of intangible assets.

Although Veblen criticizes Fisher for failing to recognize intangible assets, he acknowledges the phenomenon of capitalization. In this respect, a point of commonality can be found between Veblen and Fisher. Notably, Veblen acknowledges Fisher's incorporation of the time element into capital theory, which posits capital value as the present value of the total future income generated by a given capital, as one of the most advanced and valuable developments in economic theory.[18]

Specifically, while Veblen accepted the idea of defining capital value as the present value of regular income derived from capital, he criticized Fisher's concept of capital as consisting only of physical capital goods (means of production) and excluding intangible assets.[19]

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[18] Cf., Veblen (1994), 'Fisher's Capital and Income', p.119, in *The Collected Works*, X, p.159.

[19] For example, the following statement by Veblen reflects such a mixed evaluation:

> "...this 'capital value,' or capitalization of values, is to be taken as the value of a congeries of tangible things (productive goods). [...] intangible assets, are excluded

Next, Veblen's attempts to conceptualize capitalization as encompassing both tangible and intangible assets are worth examining. His earlier essay 'On the Nature of Capital' offers a particularly helpful explanation.

> "In modern business practice, capital is distinguished into two co-ordinate categories of assets, tangible and intangible. 'Tangible assets' is here taken to designate pecuniarily serviceable capital goods, considered as a valuable possession yielding an income to their owner. Such goods, material items of wealth, are 'assets' to the amount of their capitalizable value, which may be more or less closely related to their industrial serviceability as productive goods. 'Intangible assets' are immaterial items of wealth, immaterial facts owned, valued, and capitalized on an appraisement of the gain to be derived from their possession. These are also assets to the amount of their capitalizable value, which has commonly little, if any, relation to the industrial serviceability of these items of wealth, considered as factors of production."

(Veblen [1994], 'On the Nature of Capital', p.105. in *The Collected Works*, Ⅷ, pp.352–353; underline added.)[20]

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from the capital concept as already indicated above. Capital value is 'simply the present worth of future income from a specified capital' (p. 202); but this capital value, it is held, is always the value of tangible things (including persons?)."

(Veblen (1994),'Fisher's Capital and Income', p. 121, in *The Collected Works*, Vol. X, p. 162. Note: the page numbers in quotation refer to Fisher's *The Nature of Capital and Income*.)

[20] The distinction between tangible and intangible assets in a similar sense is also expressed in the following statement:

> "As has already been remarked, 'assets' is a pecuniary concept, not a technological one; a concept of business, not of industry. Assets are capital, and tangible assets are items of material equipment and the like, considered as available for capitalization. The tangibility of tangible assets is a matter of the materiality of the items of wealth of which they are made up, while they are assets to the amount of their value. Capital goods, which typically make up the category of tangible assets, are capital goods by virtue of their technological serviceability, but they are capital in the measure, not of their technological serviceability, but in the measure of the income which they may yield to their owner. The like is, of course, true of intangible assets, which are likewise capital, or assets, in the measure of their income-yielding capacity. Their intangibility is a matter of the immateriality of the items of wealth–objects of ownership–of which they are made up, but their character and magnitude as assets is a matter of the gainfulness to their owner of the processes which their ownership enables him to engross. The facts so engrossed, in the case of intangible assets, are not of a technological or industrial character; and herein lies the substantial disparity between tangible and intangible assets."

The cited passage emphasizes the evaluation of tangible and intangible assets. According to Veblen, tangible assets refer to physically manifested assets such as capital goods. However, the evaluation of these assets is a central issue. Veblen argued that tangible assets are assessed based on the regular monetary gains they generate. If this assertion holds, even nonphysical wealth that yields a regular income stream should be considered an asset. Given that these assets are nonmaterial but generate periodic returns, they are referred to as intangible assets.

If tangible assets can be capitalized insofar as they yield regular income for their owners, then intangible assets can likewise be capitalized based on their capacity to generate such income. Veblen noted that elements of nonphysical wealth that could generate differential gains against competing firms exist in monopolistic competition. These elements include market dominance of a monopolistic firm, superior technological conditions, robust fundraising capacity, established brand recognition, and goodwill.

The presence of such intangible assets is an important analytical tool to explain monopolistic competition,[21] the movement of corporate mergers and acquisitions, the expansion of business capital and credit, and the eventual onset of credit crises.

Let us now take a closer look at Veblen's understanding of capitalization: As highlighted in the preceding discussion, Veblen defines capitalization as the pecuniary income stream[22] produced by an asset. At this point, he wrote:

> "Intangible assets are capital as well as tangible assets; that is to say, they are items of capitalized wealth. Both categories of assets, therefore, represent expected 'income-streams' which are of such definite character as to admit of their being rated in set terms per cent. per time unit; although the expected income need not therefore be anticipated to come in an even flow or to be distributed in any equable manner over a period of time. The income-streams

(Veblen [1994] 'On the Nature of Capital', pp.111–112, in *The Collected Works*, Ⅷ, pp.359–360; underline added.)

In this reference the distinction between tangible and intangible assets is reaffirmed from the perspective of whether they are material or immaterial in nature; concurrently, their commonality is emphasized in the sense that both generate monetary gains for their owners and serve as a measure of capital value.

[21] Cf., Veblen (1994), 'On the Nature of Capital', p.107, pp.115-116, in *The Collected Works*, Ⅷ, p.355, pp.363-365.

[22] Cf., Veblen (1994), 'On the Nature of Capital', p.122. in *The Collected Works*, Ⅷ,p.371.

> to be so rated and capitalized are associated in such a manner with some external fact (impersonal to their claimant), whether material or immaterial, as to permit their being traced or attributed to an income-yielding capacity on the part of this external fact, to which their valuation as a whole may be imputed and which may then be capitalized as an item of wealth yielding this income-stream. Income-streams which do not meet these requirements do not give rise to assets, in the accepted sense of the term, and so do not swell the volume of capitalized wealth."

(Veblen, T, [1994] 'On the Nature of Capital', p.124. in *The Collected Works*, Ⅷ,pp.373–374; underline added.)

From this reference, Veblen understood capitalization as being based on the income stream generated by a particular asset. Notably, this income stream is not grounded in past performance but rather in future expectations. The assets that produce these expected future income streams include both tangible and intangible assets. This mode of asset valuation rests on forward looking expectations and acquires a degree of objectivity by being expressed through specific indicators. Through this process, the "income stream yielding capacity" of an asset becomes capitalized as "an item of wealth."[23]

From the above analysis, it becomes clear that Veblen acknowledged the capacity to generate income streams as the basis for capital.

Veblen's idea can be better understood by comparing it with Fisher's capitalization theory, which offers insights into the relationship between capital and income. Notably, the intellectual stimulus that led Veblen to such a conceptualization warrants consideration. In this context, the discussions by Fisher, who actively published research on capital and its valuation during the same period, served as a useful point of departure. We now examine how Fisher approached the issue of capitalization.[24]

Fisher recognizes capital as a form of tangible wealth. However, it was not

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[23] Veblen(1994), 'On the Nature of Capital', p.124. in *The Collected Works*, Ⅷ,p.373.

[24] Fisher (1896), 'What is Capital?' in *The Economic Journal*, Vol. 6, No. 24. This article is also included in Fisher's collected works. cf. Fisher (1996), *The Early Professional Works*, in *The Works of Irving Fisher*, Vol. I, edited by William J. Barber, London: Pickering & Chatto, Reprint, originally published: 1894–1946. When citing or referring to this collection, please use *The Works of Irving Fisher*, indicating only the main title, volume, and page number. The following literature is also essential for further consideration. cf., Fisher, I., *The Nature of Capital and Income*, in *The Works of Irving Fisher*, Vol.Ⅱ. Chap.Ⅳ. Fisher, I., *Elementary Principles of Economics* in *The Works of Irving Fisher*, Vol.Ⅹ. Chap.Ⅵ.

regarded merely as wealth, but as property. Property entails property rights, including the right to possess and dispose of an asset and the right to its expected future benefits. From Fisher's perspective, property rights are conceptualized within a temporal framework that includes both the present and the future. His statement, “Property is the right to the more or less probable future benefits of wealth”, clearly reflects this time based understanding of property rights. Fisher defined property rights in relation to both a physical asset and its expected future.

Let us consider Fisher's temporally grounded concept of property rights in detail. One crucial aspect of Fisher's thinking was the clear distinction between a specific point in time and a continuous period. Based on this distinction, he explains the relationship between the stock of wealth and flow of benefits. At this point, Fisher states the following:

> “The most important purpose of the distinction between a stock and a flow is to differentiate between capital and income. Capital is a stock, and income a flow. This, however, is not the only difference between capital and income. There is another, equally important; namely, that capital consists of *wealth*, while income consists of *benefits*. We have, therefore, the following definitions: *A stock of wealth* existing at a given *instant* of time is called *capital*; *a flow of benefits* from wealth through a *period* of time is called *income*.”

(Fisher [1996], *Elementary Principles of Economics*, in *The Collected Works*, Vol. Ⅴ, p.73. Original italics retained.)

In this passage, Fisher argues that wealth at a given point in time constitutes stock, whereas the benefits generated over a given period constitute flow. Stock corresponds to capital and flow to income. His central claim is that capital and income should be understood in relation to time, a perspective central to Fisher's theory of capitalization.

After distinguishing between capital and income, Fisher addresses the determination of the value of capital by introducing the interest rate concept. For Fisher, capital is not defined by the physical form of wealth, but by its magnitude when converted into a monetary value. He argues that the interest rate represents a premium on capital at some future date relative to its present availability. Alternatively, the interest rate expresses the “time price” of capital—specifically the terms under which present capital can be exchanged for a specified amount of future value (e.g., one year later).

Through time valuation, present and future values are connected. The interest rate enables the conversion of future value to present value, or vice versa. Crucially, the value of capital arises not from the market price of capital goods, but from the relationship between the present value and the total expected income flow (i.e., the future value).

This relationship depends on two conditions: accurately projecting future income flows and clearly understanding the interest rate used to discount that flow to its present. The discount rate applied to convert future income into the present value is determined by the prevailing market interest rate. Accordingly, the present value of capital is derived from its future value through the interest rate, whereas the expected future value of capital is estimated from its present value.

Fisher defines capitalization as the process through which expected future income is discounted by the market interest rate to derive the value of capital.[25] The distinctive feature of Fisher's theory lies in how the present value of capital is determined through the relationship between the total expected income flow (future value) and the interest rate.[26]

The originality of this section lies in elucidating this point by setting it in contrast with Veblen's own understanding of capitalization.

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[25] Fisher, I., *The Works of Irving Fisher*, Vol.Ⅹ, p.144, pp.148-49. cf., *ibid.* cf., Tobin, J., 'Editorial Introduction', in *The Works of Irving Fisher*, Vol.Ⅱ, p.6.

[26] Even in Fisher's time, there existed views that regarded the value of capital in terms of replacement cost or production cost. Fisher's perspective, however, reflects the growing prominence of the method whereby the value of capital is derived by discounting the future income stream it generates at a given interest rate. Moreover, such an evaluation was not limited to physical capital goods but was also applicable to financial assets. cf. Fisher, I., *The Works of Irving Fisher*, Vol. V, p. 143, pp. 148–49. Notably, Rudolf Hilferding had already established the idea that the periodic returns on securities such as bonds and stocks are capitalized at the rate of interest. vgl., Hilferding, R., *Das Finanzkapital; eine Studie uber die jungeste Entwicklung des Kapitalismus* mit einen Vorwort von Fred Oelsner, Dietz Verlag, Berlin, 1955.

The idea of assessing the value of time and recognizing capital value across different points in time—between the present and the future—existed even prior to I. Fisher. For example, in the 17th century, William Petty—known for his diverse activities as a physician and economist—made significant proposals regarding equitable taxation from the standpoint of public finance. Although he did not use the term 'discounted present value', he effectively advanced the notion that the value of capital should be evaluated based on the income it generates annually. cf., Petty, William, Sir [1662] pp. 52-53. Although Adam Smith did not use the term 'present value', he effectively understood the concept. He recognizes that because money yields interest, a difference arises between the amount of money at a future point in time and its amount at present, corresponding to the interest earned. cf., Smith, A. [1776, 6th edition, 1950] p.291. Furthermore, J. S. Mill presented the idea of capitalizing monetary assets—such as land or securities—based on the rate of interest. cf., Mill [1848, 1996 rep], p.658.

4.3 Business Activity and the Role of Credit

Another issue to consider is why Veblen focused on anticipated future earning capacity and used it to analyze the distinct features of the "credit economy." He emphasized the capacity to generate future earnings, treating it as an intangible asset, and criticized Fisher for overlooking its significance.[27] Veblen's criticism was not directed at Fisher's idea of valuing capital as the discounted value of expected income. Rather, Veblen regarded Fisher's incorporation of the time dimension into the assessment of capital value— the present value of the total future income produced by a given capital asset—as one of the most advanced and valuable developments in economic theory.[28] Veblen accepted the idea of defining capital value as the present value of the regular income generated by capital. This suggests that Veblen may have drawn on the concept of evaluating capital through future income flows from his intellectual engagement with Fisher.

Moreover, the notion of valuing capital based on future income flows was not unique to this period. Earlier works of William Petty and Adam Smith explored the relationship between the present and future values of capital along a time axis and related them to interest rates. By the late 19th century, Alfred Marshall had further refined these ideas. In this context, it is not novel for Veblen and Fisher to evaluate capital in terms of its ability to generate future income flows. The key difference lies in whether one recognizes the role of intangible assets as a source of income flows.

Veblen's distinctive contribution to the theory of capitalization—while

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[27] Cf., Veblen (1994), 'Fisher's Capital and Income', p.119, in *The Collected Works*, Ⅹ, p.155.

[28] Cf., Veblen (1994), 'Fisher's Capital and Income', p. 119, in *The Collected Works*, Vol. X, p. 159. As seen above, although their understandings of intangible assets differ, Veblen and Fisher share a common perspective in recognizing capital value as the present value of the total future income generated by capital.

Marshall argues that the capital stock existing in financial markets is not determined by the relationship between demand (investment) and supply (waiting), but rather by the relationship between the expected income it generates and the interest rate. Notably, Marshall's understanding in this respect is shared by both Fisher and Veblen. cf., Marshall (1920), pp. 492-493.

Although Keynes's point of departure differed from that of Fisher, Veblen, and Marshall, what is notable is the similarity in the theoretical tools they employed. The marginal efficiency of capital is calculated for each type of capital asset and represents the profitability of the investment. Profitability refers to the expected return a given investment will yield in the future, making the marginal efficiency of capital the critical linkage between the capital asset's supply price at present and its anticipated future returns. cf., Keynes (1936), p.82.

A more detailed examination of the theoretical history concerning capitalization and the value of capital cannot be undertaken here and must be reserved for a separate discussion.

based on the same foundational ideas as Fisher's—was shaped by the rise of the "credit economy" and monopolistic enterprises in the late 19th century. Among these large enterprises, competition was not a stable, equilibrating process but a strategic effort to create discontinuous, often abrupt changes. This competition does not always restore equilibrium but often triggers structural transformations. Large-scale mergers and acquisitions are a practical expression of such strategies, leading to significant shifts in market dominance, technological capacity, and innovation.

Securing future profitability has become a critical objective for firms adopting these strategies and remaining competitive. Competition between firms is increasingly centered on expected rates of return, with fundraising capacity emerging as the decisive factor in generating expectations of high returns. During this monopolistic era, large financial institutions, such as investment banks, promoters, and commercial banks, began to consolidate their positions in the United States. A capital market capable of concentrating vast financial resources has also developed.

Against this backdrop, firms have transformed inter-firm competition into a race for innovation, driven by credit based financing to inspire expectations of high future returns. Veblen's analytical perspective naturally turned toward the nature and structure of credit utilization. Central to this analysis was the capitalization of anticipated future earnings capacity.

Veblen's theoretical examination of autonomous credit expansion does not merely consider the development of capital markets or the emergence of large financial institutions. Rather, it involved an inquiry into the underlying mechanisms that supported these phenomena. The core of this inquiry is the concept of capitalizing on expected future earnings. While Fisher perceived interest rates as a benchmark for discounting future income into capital value, Veblen argued that capitalization, including intangible assets, must be understood in terms of its broader implications for interest rates, enterprise competition, and the overall structure of the credit economy.[29]

This distinctive argument in Veblen's theory of the capitalization of earning capacity comes into sharper relief when examined from the standpoint of financial gains pursued not only by firms but also by large financial institutions—such as investment banks, promoters, and commercial banks—with which they operated in close conjunction.

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[29] Cf. Veblen (1994), 'Fisher's Rate of Interest', p.299, in *The Collected Works,* X, pp.142-143.

Veblen provided a theoretical perspective for analyzing the phenomenon in which the use of credit based on expected future earning capacity made possible the mobilization of largescale capital and the realization of substantial financial gains. The originality of this section lies in evaluating Veblen's theory from this analytical perspective.

5. Conclusion

This study traces the origin and evolution of Thorstein Veblen's notion of capitalization, particularly its emergence as the idea of expected earning capacity. It examines the intellectual trajectory through which Veblen developed and formalized this idea into a coherent theoretical framework. Alternatively, this study clarifies the thought process that led Veblen to formulate the idea of capitalizing on earning capacity.

Veblen partly refined his conceptualization of capital through his critical engagement with Fisher. While he criticized Fisher's understanding of capital as being primarily classificatory in nature, Veblen concurred with the broader idea that capital is a form of pecuniary wealth that generates returns for its owner and that its value is determined by the magnitude of those returns. There are several pathways through which such monetary value—namely, *earning*—may be realized.

Veblen emphasizes the significance of regular periodic gains as the empirical basis for forming expectations about future earning capacity. As expectations of stable future earning become increasingly fixed based on observed performance, the logic of valuation gradually shifts. Rather than relying solely on empirical past performance, actors begin to autonomously project a certain level of expected returns based on available information. This shift marks a critical transition: the expected ability to generate future income becomes a recognized economic asset on its own.

Unlike Fisher, who did not develop a theoretical lens for treating earning capacity as an asset, Veblen emphasized its importance and treated it as a form of *intangible capital*. This conceptual leap, treating expected earning capacity as autonomous and economically significant, makes a distinctive contribution to Veblen's theory of capitalization. While Veblen shared with Fisher the view that the value of capital is to be understood in terms of the periodic gains it generates, he differed in holding that expected earning capacity could acquire an autonomous status as an intangible asset. This point of distinctiveness becomes more clearly delineated when Veblen's theoretical position is set in contrast with

Fisher's.

The distinctiveness of Veblen's conception of the capitalization of earning capacity becomes clearer when contrasted with Fisher's understanding of capital. Moreover, Veblen's formulation provides an effective analytical perspective for approaching contemporary financial phenomena such as M&A, securitization, and derivatives in which cash flow plays a central role.

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