



Economies In Transition

CONCEPTION, STATUS AND PROSPECTS



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CHAPTER 5

Transition Economies and the Veblenian Financial Entrepreneur

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I. Introduction

A major part of Veblen's theory of institutional evolution as a by-product and cause of numerous drastic economic and technological changes, seems to be valid for transition economies. Some points of Veblen's analysis will be discussed below as an integral and functional part of economies currently in transition from a communist-socialist planned mode to a more market-based economic system. According to Veblen during the transition period from one economic regime to another, a number of new institutions emerge, while the economic motives and behavior of individuals show a drastic change. In the present paper these Veblenian views will be examined as a significant force in present day transition economies. Our purpose is to develop a Veblenian analytical framework for the promotion of entrepreneurship in these economies.

II. Institutional Changes in Transition Economies

Veblen's analysis of European economies in transition from feudalism and mercantilism toward industrialization offers a number of similes to significant changes that are currently taking place in present day transition economies. He advanced that significant institutions, namely the "prevalent habits of thought with respect to particular relations and particular functions of the individual and the community" (Veblen, 1899, p. 190), are constantly changing, especially through the emergence of new states of science, economies, and organizational structures, etc. Therefore, current institutions are based predominantly upon the effects of prior institutional influences.¹ In this case, one should expect ex-socialist countries in the midst of changing their economic and political environments to be highly cognizant of the effects of their prior institutions. For example, Veblen recognized that the establishment of the system of private ownership produced by the increase in industrial and economic efficiency (Veblen, 1914, pp. 157, 160), would carry in its wake a number of additional conditions, such as "individual self-direction, equal opportunity, free contract, security of earnings and belonging, and self-help, in the simple and honest meaning of the word" (Veblen, 1919, p. 222). Accordingly, in the majority of Eastern European ex-socialist countries (e.g. Romania, Bulgaria, etc.), the ownership and use of private property is the cornerstone of the transition process. One of the most prevalent effects of the system of ownership, according to Veblen, is the function of the motive of self-interest and particularly the desire for "the acquisition of property, in great part to result in the acquisition of more than is possessed by those others with whom the invidious comparison in ownership is made" (Veblen, 1914, pp. 172-3). For "the propensity for emulation—for invidious comparison—is of ancient growth and is a pervading trait of human nature" (Veblen, 1899, p. 109). In addition, when an economic system changes, moving toward more liberalization and/or the establishment of a new economic system, Veblen realized that some drastic institutional changes must take place as well, such as "to induce an animus of democratic equity and non-interference, self-help and local autonomy... the collapse of autocracy and the decay of coercive surveillance on the part of self-constituted au-

thorities" (Veblen, 1915, p. 100) as happened in England during the Industrial Revolution.²

The various institutional and economic changes would also induce within the population "new habits of thought on institutional matters" (Veblen, 1915, p. 250). During the transition period the economic motives and behaviors of individuals will likely also change. He argued that by changing the entire economic environment and institutions, the "habits of men" (namely their economic motives and behavior) will also change. He stated that in the early industrial state "man has a sense of the merit of serviceability or efficiency and of the demerit of futility, waste, or incapacity. This aptitude or propensity may be called the instinct of workmanship" (Veblen, 1899, p. 15). In such a community "where an invidious comparison of persons is habitually made, visible success becomes an end sought for its own utility as a basis of esteem. Esteem is gained and dispraise is avoided by putting one's efficiency in evidence. The result is that the instinct of workmanship works out in an emulative demonstration of force" (Veblen, 1899, p. 16). On the subsequent stage of the financial administration of business, the importance of wealth gained ground. Veblen argued that in such a stage, the criteria of esteem would be based upon wealth accumulation (Veblen, 1899, p. 28). People in such a system of financial capitalism act according to "the desire for added comfort and security" and "the power conferred by wealth" (Veblen, 1899, p. 32, and p. 36-37).

During the transition from a system of state ownership toward that of private ownership and a market-based economy, Veblen would have expected some drastic changes to have taken place in cultural and behavioral characteristics. He described a relevant situation when he analyzed the forthcoming changes in the German culture after the introduction of new technology from England and the adoption of the industrial system. He argued that changes would be expected from the establishment and advancement of a new industrial (i.e. financial) system, or a new "pecuniary stage of culture. It is from this time that we can date the development of a leisure class in fact as well as in theory" (Veblen, 1899, p. 39).³ For this new societal class "abstention from labor is the conventional evidence of wealth and therefore the conventional mark of social standing" (Veblen,

1899, p. 41 and p. 43).⁴ A second characteristic of the changing behavior which Veblen recognized is the increased demand for goods subject to conspicuous consumption (Veblen, 1899, pp. 48-49). Because, in the new economic state the "unproductive consumption of goods is honorable, primarily as a mark of prowess and a perquisite of human dignity; secondarily it becomes substantially honorable in itself, especially the consumption of the more desirable things" (Veblen, 1899, p. 69). As things progress in ex-socialist countries, wealth accumulation becomes the sole mechanism for building esteem and to a greater degree than in capitalist economies. Everyone wants to be rich as soon as possible and at the least effort in terms of work and energy. The free-riding problem which existed under the former system would be changed in terms of functional direction during the transition period. This problem is somewhat unavoidable because as Veblen recognized and stressed, "men desire above all things to get the goods produced by labor and to avoid the labor by which the goods are produced" (Veblen, 1899, p. 78).

Veblen would have felt that in transition, a new economic class would emerge between the leading nomenclature and the laborers. This is the so-called middle class, bourgeoisie or businessmen. As Veblen put it, in analyzing the passage from the old regime to the new industrial state, "the gainfulness of business traffic increases, and the middle (business) class grows along with it—It is in the conscious interest of this class to further the gainfulness of industry, and as this end is correlated with the productiveness of industry it is also, though less directly, correlated with improvements in technology" (Veblen, 1914, p. 185). Hence it is to be expected that the same advancement of a productive class will emerge in the ex-socialist countries of Central and Eastern Europe. An expected consequence of the emergence of this new class of entrepreneurs, as Veblen stressed in other cases, would be the alienation of classes (Veblen, 1915, p. 134) and a conflict of interest between the laborers and the entrepreneurs (Veblen, 1915, pp. 124-5).

As the result of the introduction of a new industrial system to the majority of countries, Veblen predicted an economic situation that has in fact come to pass at the present time, the globalization of productivity and firms. He argued (Veblen, 1915, pp. 242-3) that the financial-industrial system

functions more fully under a free trade environment. He even sketched the details of the system of a worldwide competitive market economy functioning under the following assumptions:

- (a) It is a system of pecuniary rivalry...
- (b) It is a price system, i.e. the competition runs in terms of money...
- (c) Technologically, it is dominated by mechanical industries...
- (d) Consumption is also standardized, proximately in mechanical terms...
- (e) The typical industries are industries carried on a large scale...
- (f) Material equipment is held in private ownership...
- (g) Technological knowledge and proficiency is in the main held and transmitted pervasively by the community at large, but it is also held in part by specially trained classes and individual workman...
- (h) The owners of this large material equipment have discretionary control over the technological proficiency of the community at large...
- (i) In effect, therefore, owners also own the working capacity of the community and the functioning of the state of the industrial arts. (Veblen, 1914, pp.218-20)

There is ample evidence to demonstrate that the majority of the above changes which Veblen found for other periods of economic history (from feudalism and mercantilism to industrialization) have in fact come to pass with respect to present day transition economies.

III. The Emerging Entrepreneurs and Their Strategic Role in Transition Economies

The role of the profit motive should be the leading economic variable in the function and advancement of transition economies. In addition, as Veblen clearly shows, this variable plays a key role in the determination of the direction of the innovation process (Veblen, 1915, p. 122). However, an empirical investigation (Hassid, 1997, p. 9-13) in two ex-socialist countries, Romania and Bulgaria, shows that the primary motive of entrepreneurs in establishing their businesses was a desire for independence and autonomy. This demonstrates that entrepreneurs are motivated to fulfill what they lack most. In ex-socialist countries, individuals primarily missed independence and freedom of action and secondarily an adequate living standard. However, this does not necessarily mean that in the coming decades a new

generation of entrepreneurs will emerge in these countries who will be more actively motivated by goals other than the classical pursuit of profit and/or wealth.

The majority of enterprises in transition economies are functioning under an old technological regime mostly based on 1950s and 1960s technology. The introduction of new technology and the "borrowed elements" of technology and culture, as Veblen analyzed for pre-industrial societies, cause tremendous changes in the economic and social structure. (Veblen, 1915, p. 24).

A crucial problem with transition economies stems from their old and non-competitive technological infrastructures. However, this problem is not without its positive aspects as illustrated by the countries joining the industrial revolution in the latter stages, such as Germany. Veblen advances significant arguments on the subject in question, which fit the situation of present day underdeveloped transition economies. More specifically, Veblen stated that the "community at large gains in efficiency by virtue of innovation" (Veblen, 1915, p. 129). He also recognized some negative effects of late industrialization, namely mass obsolescence. This could take place after the introduction of new technology. He argues that those countries which lagged behind in terms of technological progress are forced to change their infrastructures and a large part of their technological systems and are facing a huge cost of obsolescence, or of "systemic obsolescence" as he called this situation. This may come about due to the growth of the industrial community (or, also, due to its decay), or to changes in the work to be done. Also changes in the distribution of the population to be served or employed may bring about this condition: "Obsolescence of this kind is an affair of growth and is always in progress in any community where the state of the industrial arts is undergoing any appreciable degree of change" (Veblen, 1915, p. 129).

On the other hand, Veblen indicated that countries which imitate the technological advances of other countries do not bear the cost of trial and error in searching for technological advances and thus profit from being followers. Also, in the later introduction of new technology, countries profit from the experience of innovating countries in that they obtain "the immaterial equipment of technological proficiency" (Veblen, 1915, p. 133). Veblen

emphasized that those countries late in introducing technology are able to incorporate the most productive and/or economical processes.

In the advancement of industrial systems, as Veblen analytically shows (Griffin and Karayiannis, 1996, pp. 81-4), the role of the old "captain of industry" or of the capitalist-entrepreneur was of paramount importance, as "upon him and his fortunes centers the abiding interest of civilized mankind" (Veblen, 1904, p. 3).⁵ And, "industry is carried on for the sake of business, and not conversely; and the progress and activity of industry are conditioned by the outlook of the market, which means the presumptive chance of business profits" (Veblen, 1904, pp. 26-7).

As capitalism advances, the place of the "captains of industry" is taken by the "captains of finance" or the "captains of solvency" (Veblen, 1923, p.114).⁶ For Veblen, the modern financial entrepreneurs "are experts in prices and profits and financial maneuvers; and yet the final discretion in all questions of industrial policy continues to rest in their hands. They are by training and interest 'captains of finance'; and yet, with no competent grasp of the industrial arts, they continue to exercise a plenary discretion as 'captains of industry'" (Veblen, 1921, p. 40). They are also active in regard to "the run of the market, with margins of cost and profit, and especially with the ever increased executions and opportunities of credit and investment" (Veblen, 1923, p. 257). Moreover, the "captains of finance" perform activities directed towards an increase in the value of the intangible assets of the enterprise⁷ (Griffin and Karayiannis, 1996, pp. 84-8). Such intangible assets are: the firm's goodwill, "the possession of a trade secret, a trade mark, a patent right, a franchise, any statutory monopoly, or a monopoly secured by effectively cornering supply or the market for any given line of goods or services" (Veblen, 1919, pp. 71-2). Thus the "captain of finance" has the following main duties: "the businesslike manager's attention is continually more taken up with "the financial end" of the concern's interests; so that by enforced neglect he is necessarily leaving more of the details of shop management and supervision of the works to subordinates, largely to subordinates who are presumed to have some knowledge of technological matters and no immediate interest in the run of the market" (Veblen, 1919, p. 90). And by establishing a modern organization of enterprise the "captain of finance": (1) "reorganizes and consolidates a given range of industrial business con-

cerns"; (2) "gives them a collective form and name as an up to date corporation"; (3) "starts that intricate process of cumulative augmentation of business capital through the use of credit which otherwise may come gradually in the course of business competition"; (4) "brings a redistribution of the ownership of the property engaged in industry, such as otherwise occurs at a period of liquidation" that is, "when the operation is completed the ownership of the recapitalized industrial equipment, with whatever other property is involved, appears distributed between the former owners, the promoter, and the credit house which financed the operation"; and (5) "reorganizes the industrial concerns on a large scale" (Veblen, 1904, p. 121, 128 and 130).

He clearly described the process by which the "captains of industry" disappeared as businesses grew and the corporate scheme of business operation took hold. This system of corporate supremacy will unavoidably take place as well in transition economies. The process described by Veblen is as follows: "This impersonal corporate capital, which substitutes for the personal capital of the employer-owner of earlier times, is the outcome of a mutation of the scheme of things in business enterprise, scarcely less profound than the change which has overtaken material equipment in the shift from handicraft methods to machine technology. In practical fact today, corporate capital is the capitalized earning capacity of the corporation considered as a going business concern; and the ownership of this capital therefore foos up to a claim on the earnings of the corporation" (Veblen, 1919, pp. 42-5). Thus "corporation finance is one of the outgrowths of the New Order" (Veblen, 1919, p. 67). While the main role of the modern financial entrepreneur, according to Veblen, "is not industrial business... Nor is it of the same class as commercial business, or even banking business... It differs also from stock and produce speculation... this work resembles commercial business, in that it has to do with bargaining; but so does all business, and this peculiar work of the trust promoter differs from mercantile business in the absence of continuity. Perhaps its nearest business analogue is the work of the real-estate agent" (Veblen, 1904, p. 122). In other words, the primary role of the financial entrepreneur for Veblen is to promote the consolidation of business, enhance its financial goodwill⁸ and establish a corporate company (O'Donnell, 1973, pp. 210-1 and Rutherford,

1984, p. 335).⁹ Instructively, the preponderance of the earnings of the financial entrepreneur are not "of the nature of profits... but rather a bonus which commonly falls immediately into the shape of a share in the capitalization of the newly organized concern" (Veblen, 1904, pp. 124-5). The similarity to stock options, stock purchase rights and warrants and their use by the venture capitalist in modern day finance capitalism is all too apparent. Moreover, the need for transition economies to be watchful of such activities, lest they undermine the entrepreneurial innovative spirit and the benefits society can derive therefrom is most apparent as well.

A decisive characteristic of the new market system in transition economies, one which may be able to be effectively used to catch up with the West, may be in the bargaining behavior and telecommunication ability between individuals. Veblen recognized this advancement in civilization through innovations in private communication when he argued that in the industrial system "owners, investors, masters, employers, undertakers, and businessmen, have to do with the negotiation of advantageous bargains; it is by bargaining that their discretionary control of property takes effect, and in one way or another their attention centers on the quest of profits" (Veblen, 1914, pp. 189-190). Moreover, a special characteristic of the emerging entrepreneurs is their ability and practical management of affairs. In this connection Veblen noted a businessman's "...ability to turn facts to account for the purpose of the accepted conventions, to give a large effect to the situation in terms of the pecuniary conventions in force" (Veblen, 1904, p. 320).

IV. New Profit Opportunities and Entrepreneurial Activities

In the transition from one institutional environment to another (e.g. from an economy based upon small scale firms to one characterized, by large scale mass production) or during a period of economic growth, some drastic changes take place in the values, attitudes and economic preferences of consumers. These changes frequently also bring about tremendous opportunities for entrepreneurial profit generating ventures.

Veblen felt that in the modern market system, the role of entrepreneurs is very important for success in the promotion of the various goods and services offered and in the augmentation of their "vendibility." In such a case, "salesmanship" will bypass "workmanship" requirements in the strategies of the entrepreneur (Veblen, 1914, p. 214). The entrepreneur through his activities will try to gain some monopolistic advantages such as "the control of natural resources" or by operating through activities "resting on custom and prestige" (Veblen, 1904, pp. 54-5). The entrepreneur will rely mostly upon "the brute serviceability" of goods. The task of the entrepreneur would be successful when "his competitive strategy is confined to two main lines of endeavor, to reduce the production cost of a product whose output is restricted and to increase sales without lowering prices" (Veblen, 1923, p. 287). All these business actions attributed by Veblen to the modern entrepreneur are either currently taking place or are in the process of being introduced in the various transition economies. Another consequence of institutional and economic changes can be seen in consumers' behavior. Veblen attributed his theory of conspicuous consumption mainly to an institutional rather than to a technological change. He argued that in the modern economies of the developed countries the value of "the ways and means of reputable consumption" is a considerable part of total consumption expenditures (Veblen, 1915, pp.34-5). He emphasized (Veblen, 1899, pp. 110-11) that conspicuous consumption behavior is an effect of the industrial system where the rate of productivity has increased tremendously as well as the volume of production and wealth. Significantly, in transition economies such behavioral traits are rather the effect of emulation and imitation¹⁰ of the best than of increased productivity and wealth." The introduction of such "wasteful consumption" to transition economies both extends and enlarges the profit opportunities of entrepreneurs. Veblen illustrates this tendency of economically less advanced countries to borrow both new technology and cultural characteristics from more advanced countries by looking at Germany and England in the late 19th century. "There has grown up an appreciable number of special occupations devoted to the technical needs of reputable spending. The technology of wasteful consumption is large and elaborate and its achievements are among the monuments of human initia-

tive and endeavor; it has its victories and its heroes as well as the technology of production" (Veblen, 1915, pp. 35-6).

Veblen further describes a type of consumption behavior that could well impinge upon current entrepreneurs in transition economies. He holds that with a "pecuniary habit of thought" and unequal wealth distribution, a stratification of society would take place,¹² where the consumers of the upper and middle classes develop "the habit of disapproving cheap things as being intrinsically dishonorable or unworthy because they are cheap" (Veblen, 1899, p. 155).¹³ As evidence that such behavior and habit does indeed prevail in transition economies, one need only realize that the most expensive markets for consumer goods are now in Moscow. Accordingly, it seems that Veblen was right when he recognized that hand made goods would be preferable to those that are machine made. He noticed something which entrepreneurs in ex-socialist countries might well profit from. In these countries there is an abundance of cheap well-educated labor power which could be effectively exploited in the production of hand made high quality consumer goods. "The point of material difference between machine made goods and the hand wrought goods which serve the same purposes is, ordinarily, that the former serve their primary purpose more adequately. They are a more perfect product and show a more perfect adaptation of means to end. This does not save them from disesteem and depreciation, for they fall short under the test of honorific waste. Hand labor is a more wasteful method of production; hence the goods turned out by this method are more serviceable for the purpose of pecuniary reputability" (Veblen, 1899, p. 159).

Another Veblenian "habit of thought" which is taking place in transition economies and which also offers profit opportunities is related to dress fashion. Veblen recognized that "the commercial value of the goods used for clothing in any modern community is made up to a much larger extent of the fashionableness, the reputability of the goods than of the mechanical service which they render in clothing the person of the wearer. The need of dress is eminently a 'higher' or spiritual need" (Veblen, 1899, p. 168). Thus a Veblenian analysis of transition economies has shown that through economic and institutional transformation, many new profit opportunities result from conspicuous consumption. Real practical opportunities of this type may well exist in fields such as hand made products and dress fashion.

However, in order for any of the above profit opportunities to be effectively exploited by potential entrepreneurs in transition economies, two main prerequisites are needed. Market experience is necessary, which according to Veblen, would be gained by introducing managerial and entrepreneurial techniques through the encouragement of foreign investment and the establishment of foreign firms on their soil (Karayiannis, 1993, p. 47.) Also necessary is a financial system to canalize "funds available for investment" to various entrepreneurial opportunities (Veblen, 1915, p. 186). Thus the necessity of introducing a credit system which would canalize the necessary funds to the potential entrepreneurs in transition economies is of paramount importance (Karayiannis, 1993, p. 48 and Koveos and Young, 1996).

V. Conclusions

In this chapter we have tried to show that a Veblenian analysis has much to offer to present day entrepreneurs from transition economies. We have also demonstrated that such an understanding is of considerable utility in confronting the developmental problems of such economies. Surely the modern day equivalent of Veblen's "captains of solvency" and "captains of finance" as well as his "financial entrepreneur" are the contemporary venture capitalists. In designing synthetic securities, derivatives and other instruments which have helped finance the dot.com generation of companies characteristic of our so-called "New Economy," venture capitalists have been far more concerned with the "salesmanship" of these securities than their underlying "workmanship," as evidenced by their intrinsic value. The modern day "inside trader" and stock manipulator are also our era's "captains of solvency" with as scandalous a heritage as any from Veblen's time. These are lessons that transition economies would be well advised to learn as they attempt to constructively fashion a financial infrastructure designed for their own time and place, yet grounded in the important lessons of history. For such unscrupulous operatives will surely arise and raise the specters of Veblen's "captains of solvency" as they manipulate transition economies for their own profit and pecuniary interests. The current activities of the Russian oligarchs and their Mafioso enforcers have not only

brought the country to the brink of financial ruin, they have called into serious question the very efficacy of economic transition itself in the country. The activities of such operatives must be effectively controlled if the benefits of entrepreneurial innovation are to be allowed to accrue to transition economies. These conditions which were true in Veblen's time are also true in ours and are made manifest through a Veblenian analysis.

Notes

1. Veblen explained that "the situation of today shapes the institutions of tomorrow through a selective, coercive process, by acting upon men's habitual view of things, and so altering or fortifying a point of view or a mental attitude handed down from the past" (Veblen, 1899, pp. 190-191).
2. Additionally, Veblen noticed that some drastic political changes would occur such as those which "make statutory specifications and authoritative regulations fit the exigencies of the new industry and commerce, to standardize civil and political relations in such terms as should fit the new exigencies" (Veblen, 1915, p. 101).
3. Veblen argued for the significance of economic conditions in changing behavior: "There are two lines of agency visibly at work shaping the habits of thought of the people in the complex movement of readjustment and rehabilitation. These are the received schemes of use and want, and the new state of the industrial arts" (Veblen, 1915, p. 72).
4. As Veblen noticed, "The utility of consumption as evidence of wealth is to be classed as a derivative growth. It is an adaptation to a new end, by a selective process, of a distinction previously existing and well established in men's habits of thought" (Veblen, 1899, p. 69).
5. Veblen described the role of the "captain of industry" as being "a pioneer in industrial enterprise, a designer, builder and manager of industrial equipment and a foreman of the work at hand. At the same time he was a businessman and took care of the financial end of the enterprise, buying and selling, hiring and firing, investing and promoting" (Veblen, 1923, p. 256).
6. For Veblen, the "captains of finance" have rather different characteristics than the "captains of industry." They are more risk averse and less adventurous and look for safe and sane business opportunities (Veblen, 1923, p. 109).
7. According to Veblen, "Intangible assets are the capitalized value of income not otherwise accounted for. Such income arises out of business relations rather than out of industry; it is derived from advantages of salesmanship, rather than from productive work" (Veblen, 1919, pp. 69-70).

8. Veblen defined the financial goodwill of enterprises, as being in "the form of a large ability to help or hinder other financiers and financing houses in any similar maneuvers in which they may be engaged, or an ability to put them in the way of lucrative financing transactions" (Veblen, 1904, p. 171).
9. Davidson and Ekelund (1994) show that a change in institutions produces productive entrepreneurial activities even through rent seeking ventures.
10. As Veblen comments, "A large proportion, perhaps the greater part, of what is included under the standard of living for any class, whether rich or poor, falls under the theoretical category of conspicuous waste, which comprises the consumption of time and effort as well as of substance" (Veblen, 1915, p. 137).
11. Veblen describes this consumption imitation drive as follows:
 In communities where class distinctions and class exemptions run chiefly on pecuniary grounds, wasteful conventions spread with great facility through the body of the population by force of the emulative imitation of upper class usage by the lower pecuniary classes. (Veblen, 1915, p. 147)
12. Veblen recognized that in the new industrial system, individuals would "find their place by force of a consciousness of kind that draws into contact and cooperation with those of a like habit in point of breeding and on a like level in point of current expenditure, as also by force of exclusion from those pecuniary levels on which they do not belong" (Veblen, 1915, p. 137).
13. Veblen makes clear that "under the circumstances of the existing pecuniary culture, the reputability, and consequently the success, of the individual is in great measure dependent on his proficiency in demeanor and methods of consumption that argue habitual waste of time and goods" (Veblen, 1899, p. 345).

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