

RECONSIDERING THE ECONOMIC THOUGHT OF KARL POLANYI IN 2009

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Economists and their theories, like governments, come and go. But during times of change, in particular, people are wont to look to the past to shed light on current challenges. In this essay, Adam Larragy examines Karl Polanyi's critique of market liberalism in general and the self-regulating market in particular. Polanyi's advocacy of a democratic socially planned economy flies in the face of the last twenty years' experience, but - along with the ever-changing relationship between political ideology and the market - this is worth reassessing in light of recent global events.

Introduction

‘Our thesis is that the idea of a self-adjusting market implied a stark utopia. Such an institution could not exist for any length of time without annihilating the human and natural substance of society; it would have physically destroyed man and transformed his surroundings into a wilderness.’

(Polanyi, 2001: 3).

The above statement, an extract from Karl Polanyi's *The Great Transformation*, would have sounded discordant and out of sync with what J.K Galbraith called the ‘conventional wisdom’ if it had been quoted only one year ago.

Since the mid-1980s, most Western countries experienced ‘a substantial decline in macroeconomic volatility’ (Bernanke, 2004), as unemployment, economic growth and inflation seemed to become more stable, in marked contrast to the turbulent 1970s. The electoral victories of Margaret Thatcher and Ronald Reagan in the 1980s signalled the end of the post-war economic consensus in Britain and of the New Deal in the United States as laissez-faire economic thought guided, or at least legitimised, the economic policies of both governments. The end of the Communist experiment in the Soviet Union in 1991 supposedly signalled the ‘end of history’, leaving no alternative to a liberal capitalist economic and social structure that had proved itself as more successful than any other social and economic system or ideology (Fukuyama, 1993). By the 1990s, even the largest labour and socialist parties in Europe, which were brought into existence to protect workers from the depredations of the market economy, had accepted the idea that market relations and the market economy had to be extended and often proved more zealous advocates of privatisation and market liberalisation than their predecessors.

However, the ‘Great Moderation’ only applied to Western economies, as industrialising nations experienced ‘exchange rate, stock market, and interest rate volatility’ due to ‘the

volatility of ever-growing private capital flows' unleashed by financial liberalisation both within developing and developed countries (Wade, 2006:122).¹ Even within Western economies, the experience was one of stagnating real wages and greater inequalities in both wealth and income (Dumenil et al., 2004). However, it is the current crisis that has created the opportunity to raise fundamental questions about the desirability and scope of free-market policies, the assumptions behind such policies and the limitations of neo-classical economic theory. In this context, the work of Karl Polanyi, an ardent critic of his contemporaries, Ludwig von Mises and Friedrich von Hayek, should be reconsidered and his critique of market liberalism and classical economics re-examined.

Karl Polanyi: activist and economist

Karl Polanyi, economic historian and anthropologist, was born in Budapest in 1886 and grew up among a radical bourgeois Jewish intellectual milieu in which he played an active role. Polanyi moved to Vienna in the 1920s and it was here that he was introduced to the ideas of Mises and Hayek, who were engaged in a project to rehabilitate market liberalism (Polanyi, 2001: xx). Polanyi formulated his critique of market liberalism in response to their ideas, and advocated a democratically planned socialist economy on the grounds of 'social and moral superiority' rather than efficiency (Humphreys, 1969: 169). With the ascent of the Nazis in 1933, Polanyi's Judaism and socialism made his position in Vienna untenable and he was forced to resign from the newspaper *Der Osterreichische Volkswirt*. He immigrated to England where, like many socialists of his generation, he became involved in adult education, lecturing with the Workers' Educational Association. In the 1940s, he was a visiting scholar to Bennington College in Vermont, where he wrote *The Great Transformation*. He was appointed visiting Professor of Economics at Columbia University in 1947 where he taught General Economic History, characteristically redefining it as 'the place occupied by economic life in society' (Polanyi, 1971: v). At Columbia, he studied the economic aspects of institutional growth, producing *Trade and Market in Early Empires* (1957).

Polanyi is usually placed within the institutional school of economic theory, and his former students have made a strong case for Polanyi to be considered one of the key contributors to the 'old institutional' school (Stanfield, 1980; Fusfeld, 1988). The key concern of institutionalism is the impact of human institutions on economic behaviour. However, it must be noted there is a dividing line between the 'new institutionalism' of Douglass North and Ronald Coase and the 'old institutionalism' of Polanyi and Thorstein Veblen; for example, North emphasised that the market economy requires certain preconditions that can only be provided by the state, private property rights and constitutional protection of markets while Polanyi believed there was 'an impossible separation between markets and politics' made by market liberals (Davis, 2008: 1102).

The critique of neo-classical economics by the old institutionalists centres around what they see as the key mistake of separating man from his surrounding institutions, whether it is the state or any other social institutions created by man. Though such an analysis

¹ Notably, China still controls capital flows.

would usually be classed as political economy, many of the old institutionalists would have viewed this approach as the only way to analyse economics. Commenting favourably on Schumpeter's *Capitalism, Socialism, and Democracy*, noted institutionalist Warren J. Samuels asserts 'the inseparability of economy and politics, that is, the reality of a legal-economic nexus' (Samuels, 1985: 67). In terms of Polanyi's economic thought, *The Great Transformation* is his formulation of this critique, and constitutes his response to Hayek and Mises and what he saw as their fatal conceit, the belief in the self-regulating market.

The Great Transformation

The Great Transformation was published in 1944 in the same year as Friedrich van Hayek's *Road to Serfdom*, though characteristically of our age, rather more has been heard of Hayek's work of political economy in recent years. Polanyi's argument constitutes both history and theory, as he and his central European contemporaries (including Hayek) would have seen any attempt to construct theory without history as impossible. The book is divided into three parts; the first an account of the 'international system' resulting from the 'Great Transformation' of the nineteenth-century in which the market economy came to dominate Western societies and, through imperialist conquest, the world. The second part constitutes a historical narrative of the 'rise and fall of the market economy' (drawing on his historical research into English economic and social life while teaching in the 1930s). The third is a commentary on 'transformation in progress' in reference to current and future processes, from his contemporary viewpoint, such as the rise of fascism and possibly of socialism.

Though structured in part as a historical narrative, *The Great Transformation* is best examined in terms of its broader themes: the critique of the classical concept of 'economic man'; the moral and intellectual fallacy of treating as commodities land, labour and money; the impossibility and fatal effects of 'disembedding' economic life from social life, and the related phenomenon of the 'double movement'; and the importance of understanding the historical processes of social and economic change.

Economic Man

As previously noted, the key to classical and neo-classical economic theory is the idea of 'economic man': a being whose utility-maximising behaviour enables the market mechanism to function by responding to price changes rationally, thus allowing the co-ordination of supply and demand. The historical origins of the concept can be traced further back than Adam Smith (usually Mandeville's *Fable of the Bees*) but his observation that man's nature is to 'truck, barter and exchange' is its most famous expression (cited in Polanyi, 2001: 45). This concept was based on ideas of how man would behave in a state of nature (in a curious parallel to Rousseau, though with the opposite implications) and as such could be examined in historical terms. Polanyi, who had an interest in early economies, opposed the concept by claiming that 'economic motives spring from social life' (ibid.: 49).

He contended that empirical evidence showed that early societies tended to organise their economic life around four principles: reciprocity, redistribution, householding (using Aristotle's definition of *oekonomica* as 'production for use') and barter whose corresponding patterns were symmetry, centricity, autarky and the market pattern respectively (ibid.: 55). Polanyi reversed the classical view that man's 'propensity to barter' leads to local markets, the division of labour, foreign trade and eventually long-distance trade. Even in the case of long-distance trade, barter was embedded in relations bounded and regulated by custom, magic and religion whereas 'national markets' were a creation of the powerful centralising monarchies of Western Europe in the 15th and 16th centuries, driven by the imperatives of war and the need to unify their kingdoms.

The industrial revolution of the 19th century, with the introduction of the factory system into a commercial society, may have enabled the development of the vision of 'economic man', but everywhere this was contradicted by the mutualism of rural areas, of the new trade union and Chartist movements (ibid.: 78). Polanyi located the modern conception of 'economic man' in Joseph Townsend's *Dissertation on the Poor Laws* (1786), in which Townsend infamously claimed men were beasts and subject to the same laws of Nature; in Smith's formulation there was never any question that moral law and political life were excluded from the self-interested butcher's life (ibid.: 117). Malthus, Ricardo, Burke and Bentham all believed that 'economic society was subject to the laws of nature' (ibid.: 130). Polanyi's entire historical narrative implicitly affirms the contingency of human behaviour on history, that is, the contingency of human behaviour on the social, cultural, political and economic institutions that give rise to social life. 'The behaviour of man both in his primitive state and right through the course of history has been almost the opposite implied in this view [that of the existence of an ahistorical rational man]' (ibid.: 258).

The Fictitious Commodities: Land, Labour and Money

'Laissez faire was planned, planning was not'; Polanyi used this phrase to describe the 'birth of the liberal creed' in the 1820s, the decade in which it was to take on its full meaning. Labour must find its price on the market; money should be subject to an automatic mechanism (the gold standard); and the removal of impediments to the international free flow of capital and goods should occur (encapsulated in the political slogan 'free trade') (ibid.: 140-144). Central to economic liberalism was the conceit that land, labour and money were commodities, much the same as any other good or service produced for exchange. This presented both an intellectual and in the case of land and labour, a moral problem; the commodity labour is of course work provided by human beings, who by their very nature (which does not correlate historically with that of rational optimising man) cannot be expected to behave as a commodity. Land is the natural substance of the world and the basis for man's existence rather than a commodity.

European economic life in regard to land and labour was embedded in social life until the 19th century; feudal relations or older custom rights were prevalent on the land and land was often held in common. In England, elaborate social legislation under the Elizabethan

Poor Laws, the Statute of Artificers and the 1662 Act of Settlement regulated economic life. Legitimised by Malthus' Law of Population, Ricardo's 'iron law of wages' and Benthamite utilitarianism (which provides what amounts to the 'moral philosophy' element within classical economics) the creation of a labour market was accomplished by means of the 1834 New Poor Law, which 'for the sake of industry' removed any succour for those deemed capable of working (ibid.: 150). Rational man would react to the threat of starvation and hunger would drive him into the factories and work-houses of the liberal society (ibid.: 120).

The Gold Standard was the medium by which the market liberals thought to extend the self-regulating market throughout the world (with the addition of international free trade). Each nation's currency being backed by gold, a deficit in the balance of payments of a country would lead to gold flowing out of that nation leading to a contraction in the money supply, rise in interest rates, fall in prices and wages and thus a rise in exports. At least that was the theory. By the 1850s the four institutions of the 19th century could be fully discerned: a balance of power between nations, the liberal state, the gold standard, and the self-regulating market. Polanyi emphasised that 'budgets and armaments, foreign trade and raw material supplies, national independence and sovereignty were now the function of currency and credit' (ibid.: 18).

The 'double movement'

However, Polanyi asserted that as soon as the economy was 'disembedded' from economic life, a counter movement emerged which had diverse origins. The decade of the introduction of the New Poor Law saw the rise of the first working-class political movements, the Chartists. In the 1830s industrialist Robert Owen experimented with new co-operative organisations and in this decade the formation of the modern trade union movement, which arose to protect working-class people, is discernable. Market liberals such as von Mises and 'social Darwinist' and liberal Herbert Spencer identified the decades of the 1870s and the 1880s as those in which the counter-movement became discernible, and they termed them the 'collectivist' decades. The introduction of social insurance in Germany was a response to the rise of the Social Democratic party and trade unions and recognition of the need to protect labour. In Britain, following the defeat of the Chartists the trade union movement was less political than their continental counterpart, but it still achieved official recognition.

Across Europe, from Hapsburg Austria to Republican France, governments and legislative bodies intervened in economic life, to place tariffs on agricultural and industrial goods, and to mitigate the effects of the gold standard (ibid.: 150). The gold standard had proved too difficult for nations to bear - the adjustments to balance of payments were too severe, as wages and prices would suddenly fall. Polanyi also argued that the new imperialist urge came from the needs of businesses to get around the self-regulating market and gold standard; this need created imperial zones protected by tariffs. Elaborate legislation in France, Germany and Britain (and in Ireland) was introduced to protect peasants from losing their land as a result of destitution, or to protect them from eviction. However, this movement, which arose to protect man and nature, also

disintegrated the four institutions of the 19th century (ibid.: 257).

Polanyi contested that the forces of countermovement arose from the mistaken treatment of land, labour and money as commodities and the attempted creation of a self-regulating market and the integration of said 'fictitious commodities' into that market. He identified the 'conservative 1920s' as an era in which governments attempted to return to the pre-war world of the gold standard and free trade. This placed such a strain on society that the counter-movement took the form of fascism, which 'emerged as an alternative solution to the problem of industrial society' (ibid.:250).

Polanyi believed that socialism was the only moral response to the failure of the self-regulating market, and possibly saw the New Deal continuing after the Second World War, providing a basis for a new society. He identified socialism as simply 'the tendency inherent in an industrial civilisation to transcend the self-regulating market by consciously subordinating it to a democratic society' (ibid.: 242). The post-war world in the West was indeed constructed on the basis of a controlled currency system (Bretton Woods), and widespread control of the labour market by means of nationalisation of industry and the creation of the welfare state - though it fell somewhat short of Polanyi's vision.

Conclusion

It is important to remember, given the current crisis, that Polanyi - a refugee fleeing fascism - recognised fascism as offering an alternative to liberal capitalism, but one that rejected 'the postulate of freedom... and of the oneness of mankind' (a tradition he ascribes to Christianity) while '[glorifying] power which is the reality of society' (ibid.: 268). It is worth quoting the final lines of *The Great Transformation*, which could be said to offer a prescient rejoinder to Hayek's *Road to Serfdom* and guidance for today's economic policymakers and politicians:

'Uncomplaining acceptance of the reality of society gives man indomitable courage and strength to remove all removable injustice and unfreedom. As long as he is true to his task of creating more abundant freedom for all, he need not fear that either power or planning will turn against him and destroy the freedom he is building by their instrumentality. This is the meaning of freedom in a complex society; it gives us all the certainty that we need.'

(Polanyi, 2001:268).

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