OTHER THINGS EQUAL

Polanyi Was Right, and Wrong

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The only appearance of economic historians in literature are the hero in Amis' *Lucky Jim* and the anti-hero Tesman in Ibsen's "Hedda Gabler":

Hedda: Tesman is a specialist, my dear Judge.
Brack: Undeniably.
Hedda: And specialists are not amusing traveling companions—Not for long, at any rate.... Just you try it! Nothing but the history of civilization morning, noon, and night.
Brack: Everlasting.
Hedda: And then all this business about the domestic industries of Brabant during the Middle Ages. That's the most maddening part of it all.

Karl Polanyi, whose book, *The Great Transformation* [1944], has continued to have influence inside and especially outside economics, was no specialist. Károly Polányi (1886-1964) was an economic journalist-turned-historian in England from 1933 to 1940 and in Canada and the United States from then until his death. In the chaotic style of Mitteleuropa between the wars Karl was twice a migrant, first from his native Budapest and then his adoptive Vienna. His mother Cecile Polányi was hostess of a salon of revolutionary intellectuals in Budapest during and after World War I. His brother Milály, Michael, was a distinguished physical chemist in Britain, short of the Nobel prize (Michael's son John received it), and a conservative social philosopher.

The chemist Michael, not Karl, has an entry in Bullock and Woodings' *Twentieth-Century Culture: A Biographical Comparison*, but the judgment of cultural influence is mistaken. *The Great Transformation* is a thrilling book, an economic-historical detective story full of purpose and suspense. It inspired the anthropologist Marshall Sahlins, the sociologist Immanuel Wallerstein, the historian E. P. Thompson, the political scientist James Scott, and the economist Douglass North, and gave numerous other intellectuals at least the conviction they knew What Happened in History. It has never been out of print.

The book argues that market economy is an historical novelty, a late comer. In pre-modern societies, Polanyi claimed, transactions were embedded in community relations. Exchange followed the principles of redistribution, reciprocity, and householding rather than Smith's propensity to truck, barter, and exchange (itself,

Eastern Economic Journal, Vol. 23, No. 4, Fall 1997

wrote Smith in Chapter 2 of *The Wealth of Nations,* based on universal human characteristics so basic as the "faculty of reason and of speech"). According to Polanyi , on the contrary, the market was new and artificial and terrible: "there was nothing natural about laissez-faire... . Laissez-faire economy was the product of deliberate state action" [1944, 139-41]. The free market with its corrosion of human relations, Polanyi said, was planned by certain ideologues.

Throughout his scholarly career Polanyi searched for a society without markets. He defines market economy as "an economic system controlled, regulated, and directed by markets alone; order in the production and distribution of goods is... ensured by prices alone" [*ibid.,* 68]. It is in Polanyi's view a rule-driven system which disembeds exchange relationships from their social and moral contexts. The system requires that all commodities, including land, labor, and capital, be traded according to relative prices, set by supply and demand. In particular "the fictitious treatment of labor as a commodity strips man of his physical, psychological, and moral entity" [*ibid.,* 73]. This was his root indignation, as it was Marx's: the alienation of a market in labor. Polanyi argues that an unregulated market economy, with its rigid rules, commodity fiction, its assumptions of scarcity and selfishness destroys society. In the words of his student Abraham Rotstein market economy is a "sociological enormity" [Rotstein, 1990, 100].

"Previously to our time," Polanyi says, "no economy has ever existed that, even in principle, was controlled by markets.... Gain and profit made on exchange never before played an important part in human economy" [1944, 43]. The important word is "important." Polanyi acknowledges that markets existed earlier. But he claims that "market economy" as a self-regulating system did not exist, to an *important* extent. In one of his many repetitions of the claim he puts it quantitatively: "no economy prior to our own [was] even approximately controlled and regulated by markets" [*ibid.,* 44]. He repeatedly makes it an issue of quantity. *How much* market? *How much* profit, gain, Prudence in terms of Price? Says Polanyi, nil.

Polanyi asked the question correctly, but gave the wrong answer. The doyen of African economic historians, Philip Curtin, for example, offers ample evidence that African economies before and during European contact were price economies. And Curtin gives an example from an economy even more remote than Africa from English capitalism's taint [Curtin, 83-84]. Raymond Sidrys and his team of archaeologists of Classic Mayan before 800 AD measured the ratio of weight of obsidian blades to their cutting length. If Mayans lived in gainless, profitless, non-market economy, it would not matter to them how expensive obsidian was. But Sidrys found that the ratio of blade weight to cutting length varied inversely with the distance from the sources of the obsidian. By taking more care with more costly obsidian the blade makers were earning better profits; as they did by taking less care with less costly obsidian. So everywhere that Polanyi has been tried.

Though wrong about the history, Polanyi was right about a lot of other things. He was right for example about the anxieties of 1944. The long peace, the gold standard, the market, the liberal state, as he says on the first page, did then seem one with Nineveh and Tyre.

And Polanyi's main piece of abstract economic thinking was also right. "But in no case can we assume the functioning of market laws unless a self-regulating market is shown to exist" [1944, 38]. An economist reading such sentences—they are frequent—is at first merely irritated. "He's against economics, and ignorant to boot," she says to herself. But then the economist reader takes thought, and after a while it occurs to her that Polanyi's point is not so ignorant after all. The rigorous way to put it is that an economy without every market functioning does not present to its people the correct relative prices. It is the same point made by Coase in 1960, or Lancaster and Lipsey in 1956, or Arrow and Debreu in 1954, or Rosenstein-Rodan in 1943.

Polanyi's assertions about self-regulating markets are identical for example to the So-Called Coase Theorem. The So-Called Theorem (it is not what Coase had in mind as his contribution, but has been universally attributed to him) is that if markets are perfect, nothing need be done. Coase means this old and mathematical proposition in economics to be used as an absurdity only, to show that in any real world something does urgently need to be done, such as defining private property. Polanyi has the same *reductio* in mind. Coase and Polanyi differ only in what they want done: Coase wants more markets, Polanyi less. Polanyi is explicit in this theoretical sophistication before its time. He says for example, "for the merchant this means that all factors involved must be on sale" [*ibid.,* 41], which is to say that markets must be complete. It is the same point made in the General Theory of the Second Best of Lancaster and Lipsey. Are you serious about *proving* capitalism good? Well, then, it better be that the First Best is in fact achieved in every market, for otherwise you can't prove anything on the blackboard in general. It is Polanyi's point against unsupported claims for the goodness of markets. It is the specter that haunts modern blackboard economics with its bizarre fascination with Proof.

But the mistake Polanyi and his school then make is to suppose without evidence that any regulation whatever obviates a market, *quantitatively*. An epsilon degree of social intrusion, they say, makes for No Market. The standard is again that of Arrow-Debreu—flawless markets or nothing. The presence of regulation—informal or legal—does change relative prices across markets. But it does not by itself eliminate market forces. In China at the height of the Cultural Revolution the women of the village secretly purchased produce from farmers and fishers before the watchmen started their day. Supply and demand popped up. How much? That remains for the economic scientist to determine.

Of course this is the mistake that *all* schools of economics make, believing they can prove the economy like proving a theorem in geometry. Proof in the Math Department's spirit—the existence of epsilon, no matter what its measure—is of no use for science, as may be seen in physics and chemistry. For the work of science one must measure (as Polanyi implies in appealing to a quantitative rhetoric). Polanyi is trying to *prove* capitalism false. But in such a matter not "proof," only magnitude matters: *how close* to a perfect market economy does an actual economy have to be before the long-run considerations are to this or that degree admissible? *How much* of a self-regulating market needs to exist before we can assume approximately the functioning of market laws? It is not a matter of on/off, exist/not.

The mathematics is needed to devise measures. The point I am making has really nothing to do with mathematics as a way of organizing quantitative thinking. The point is that proof whether mathematical or verbal, is irrelevant. No proof can *in itself* conclude anything about the world. The Pythagorean theorem is true in logic, but is true in the world only if you happen to be on a plane: in the triangulation of India or the measure of a curved universe it is "wrong," that is, inapplicable. Capitalism is not like a statement connected to other statements, true or false on the basis of this or that axiom. It is like a bridge in the world, more or less stable. Try it out, simulate the load, use math, observe: that's science.

Polanyi's most important claim shows what is wrong with proof mongering. He claimed, and I have come to agree, that economics must in many cases include the "S" variables of sociology if it is to get the "P" variables of Prudence and Price quantitatively right. Rachel Kranton has written a paper recently that illustrates the point. She provides a theorem that Polanyi would have liked, namely, that if a market is big it can erode the "gift exchange" that Polanyi called "reciprocity." Take marriage, for example. If a man can get his dinner easily at McDonald's, and *if marriage is mainly a Prudent exchange of woman-supplied dinners for man-supplied car repair*, then marriage will be eroded by bigger markets in dinners and car-repair. Likewise, Kranton points out, if gift exchange is big, markets will be thin, and it will be unprofitable to start a McDonald's or a Lovetinsky Harapat Auto Repair.

To make her Polanyian point Kranton provides five Propositions and an appendix with three dense pages of proof, which shows she comes from the Math Department, not the Departments of Physics or Engineering. Kranton's theorem is obvious if you think about it as an economist for a while. She is saying that *if there are no S variables on the scene*, then the market's substitute for home-dinners will erode the home and its gift exchanges. We have two *P* variables, home-dinners and market-dinners, and the Theorem follows immediately from the substitutability of the two. Dinner is dinner.

But the theorem breaks down if there are *S* variables. If people marry for love, say, as well as to get dinner and auto repair in reciprocal gift exchanges, then it is no longer obvious that a market will erode the home (or the home erode the market). If you want you can think of Love as a third commodity, and apply consumer theory understood since Hicks and Allen in the 1930s to note that none of the certainty of a 2×2 world survives. Or you can get more serious as a social scientist and observe that for example, market dinners may *raise* the symbolic value of home dinners; or may alter the balance of power within the household; or change the locale of gift exchanges; or become instruments of real gifts, without exchange; or any of twenty other ways of making the Theorem seem a piece of blackboard economics without conclusion in the world.

So Polanyi the non-specialist, for all his charm and insight, anticipated in 1944 the tragedy of economics in the fifty years to come. It is the tragedy of not looking at the world quantitatively. (You say that statistical significance does so? Come, now, my dear: listen with more care.) It is the tragedy of believing that we could get Truth from a piece of chalk. It is the tragedy of a failed science, that needs to start again.

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Other Things Equal, a column by Deirdre N. McCloskey, appears regularly in this *Journal*.