

# THE AMERICAN PROSPECT

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## Karl Polanyi Explains It All

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Want to understand our market-crazed era? Rediscover the 20th century's most prophetic critic of capitalism.

In November 1933, less than a year after Hitler assumed power in Berlin, a 47-year-old socialist writer on Vienna's leading economics weekly was advised by his publisher that it was too risky to keep him on the staff. It would be best both for the *Österreichische Volkswirt* and his own safety if Karl Polanyi left the magazine. Thus began a circuitous odyssey via London, Oxford, and Bennington, Vermont, that led to the publication in 1944 of what many consider the 20th century's most prophetic work of political economy, *The Great Transformation: The Political and Economic Origins of Our Time*.

Polanyi, with no academic base, was already a blend of journalist and public intellectual, a major critic of the Austrian School of free-market economics and its cultish leaders, Ludwig von Mises and Friedrich Hayek. Polanyi and Hayek would cross swords for four decades—Hayek becoming more influential as an icon of the free-market right but history increasingly vindicating Polanyi.

Reluctantly, Polanyi left Vienna for London. Two of his British admirers, the Fabian socialist intellectuals G.D.H. Cole and Richard Tawney, found him a post at an Oxford-sponsored extension school for workers. Polanyi's assignment was to teach English social and economic history. His research for the course informed the core thesis of his great book; his lecture notes became the working draft. This April month marks the 70th

anniversary of the book's publication and also the 50th anniversary of Polanyi's death in 1964.

Looking backward from 1944 to the 18th century, Polanyi saw the catastrophe of the interwar period, the Great Depression, fascism, and World War II as the logical culmination of laissez-faire taken to an extreme. "The origins of the cataclysm," he wrote, "lay in the Utopian endeavor of economic liberalism to set up a self-regulating market system." Others, such as John Maynard Keynes, had linked the policy mistakes of the interwar period to fascism and a second war. No one had connected the dots all the way back to the industrial revolution.

The more famous critic of capitalism is of course Karl Marx, who predicted its collapse from internal contradictions. But a century after Marx wrote, at the apex of the post-World War II boom in both Europe and the United States, a contented bourgeoisie was huge and growing. The proletariat enjoyed steady income gains. The political energy of aroused workers that Marx had imagined as revolutionary instead went to support progressive parliamentary parties that built a welfare state, to housebreak but not supplant capitalism. Nations that celebrated Marx, meanwhile, were economic failures that repressed their working classes.

Half a century later, the world looks more Marxian. The middle class is beleaguered. A global reserve army of the unemployed batters wages and marginalizes labor's political power. Even elite professions are becoming proletarianized. Ideologically, the view that markets are good and states are bad is close to hegemonic. With finance still supreme despite the 2008 collapse, it is no longer risible to use "capital" as a collective noun. The two leading treasury secretaries during the run-up to the 2008 financial crash, Democrat Robert Rubin and Republican Henry Paulson, were both former CEOs of Goldman Sachs. If the state is not quite the executive committee of the ruling class, it is doing a pretty fair imitation.

Yet Marx, for all of his stubbornly apt insights about capitalism, is an unreliable guide to its remediation. Polanyi, with the benefit of nearly a century's worth more evidence, has

a surer sense of how markets interact with society. More humanist than materialist, Polanyi did not believe in iron laws. His hope was that democratic leaders might learn from history and not repeat the calamitous mistakes of the 19th and early 20th centuries. Polanyi lived long enough to see his wish fulfilled for a few decades. In hindsight, however, the brief period between the book's publication and Polanyi's demise is looking like a respite in the socially destructive tendencies of rampant markets. In seeking to understand the dynamics of our own time, we can do no better than to revisit Polanyi.

The Great Transformation, written for a broad audience, is witty and passionate as well as erudite. The prose is lyrical, despite the fact that English was Polanyi's third language after Hungarian and German.

Contrary to libertarian economists from Adam Smith to Hayek, Polanyi argued, there was nothing "natural" about the free market. Primitive economies were built on social obligations. Modern commercial society depended on "deliberate State action" by and for elites. "Laissez-faire" he writes, savoring the oxymoron, "was planned."

Libertarian economists, who treat the market as universal—disengaged from local cultures and historic time—are fanatics whose ideas end in tragedy. Their prescription means "no less than the running of society as an adjunct to the market. Instead of economy being embedded in social relations, social relations are embedded in the economic system."

Like Marx, Polanyi begins in England, the first fully capitalist nation. In Polanyi's telling, the slow shift from a post-feudal to a capitalist economic system accelerated in the 18th century, when the enclosure movement ("a revolution of the rich against the poor") deprived the rural people of historic rights to supplement incomes by grazing domestic animals on common land, and the industrial revolution began to undermine craft occupations.

For a time, social cushions left over from feudalism sheltered ordinary people from the turbulence of markets. “England withstood without grave damage the calamity of the enclosures,” Polanyi wrote, because protections guaranteed by the Crown could “slow down the process of economic improvement until it became socially bearable.”

Conservatives understood this better than economic liberals. Polanyi invokes the views of Lord Canning, a Tory who served as foreign secretary and later prime minister, that the poor laws—traditional relief payments that protected the rural working class from periodic destitution—“saved England from a revolution.” But in the early 19th century, the rising merchant class, the emergent Liberal Party, and the ideology of laissez-faire together produced a social order based on a self-regulating market.

The old poor laws were abolished in 1834 in favor of the poorhouse, an institution designed to be so degrading that workers would accept the dismal labor-market wages in William Blake’s dark, satanic mills. Meanwhile, free trade became the norm, meaning lower grain prices in the short run (and depressed wages) but increased volatility in the price of food. In the same period, the rise of a rigidly enforced gold standard limited the state’s ability to temper periodic downturns.

An economy oblivious to social consequences had to engender backlash. The sponsors of protective measures were often conservatives concerned about social stability, such as the English Tory Benjamin Disraeli and the Prussian Iron Chancellor Otto von Bismarck. “The [English] Ten Hours Bill of 1847,” Polanyi writes, “which Karl Marx hailed as the first victory of socialism, was the work of enlightened reactionaries.” But by the late 19th century, periodic financial panics and depressions menaced both society and the market system. This got displaced into nationalism, culminating in World War I.

After that war, the victorious nations tried to restore the trinity of free trade, the gold standard, and unprotected labor markets. Obsessed with sound currency, market ideologues and bankers demanded austerity policies leading to both mass unemployment and episodes of hyperinflation. Given the legacy of war debts and dislocations, all this was more than the economy or society could bear. Market institutions, Polanyi writes, “broke down in the twenties everywhere—in Germany, Italy,

or Austria, the event was merely more political and more dramatic.”

In a few places, politics produced a third way—neither the hegemony of the turbulent market nor the grim security of the total state. Social-democratic Sweden and New Deal America devised a mixed economy that civilized the brute energy of capitalism. At the time Polanyi was writing, others converged on the same aspiration. In Britain, Lord Beveridge was composing his blueprint for a postwar welfare state. Part II, published in 1944, carried the Polanyian title *Full Employment in a Free Society*. At Bretton Woods, also in 1944, John Maynard Keynes and Harry Dexter White were inventing a postwar international financial system that made room for domestic social democracy freed from the pressures of gold and deflation. A few months after Polanyi’s book went to press urging that “rights of the citizen hitherto unacknowledged must be added to the Bill of Rights” including “the right of the individual to a job,” Franklin Roosevelt delivered his “Second Bill of Rights” speech in January 1944, calling for exactly that. Polanyi was not part of the run-up to Bretton Woods; he does not cite Beveridge, nor could he have known about FDR’s coming speech. But in the aftermath of depression, dictatorship, and war, the shared vision of managed capitalism was in the air. Nobody gave it context and gravitas better than Polanyi.

For three decades, the success of a social settlement between labor and capital seemed to vindicate both Polanyi’s critique and his hopes. But the compromise did not stick. The path of capitalism since the 1970s has repeated the 19th-century hegemony of the market and is beginning to resemble the darker history of the 1920s and 1930s.

How did Karl Polanyi become the great non-Marxian synthesizer of the tragic interplay of markets, society, and politics? He was born in Vienna in 1886 during a short era known as the “Great Generation,” when the decaying Austro-Hungarian Empire was a center of intellectual and political enlightenment. His Hungarian father, Mihaly Pollacsek, with a Swiss engineering degree, was a designer of Vienna’s rail system. The family’s surname, of Polish-Jewish origin, was magyarized in the 1890s to Polanyi, and

the family ceased identifying as Jews. Polanyi grew up mostly in Budapest, where his Russian-born mother, Cecile, ran a literary and political salon, and he attended the elite Trefort Street Gymnasium. The illustrious family included his younger brother Michael, a chemist who became a libertarian political philosopher, and Michael's son, John, who won the Nobel in Chemistry, as well as the artist Eva Zeisel.

Expelled from the University of Budapest in 1907 after a brawl in which anti-Semitic right-wingers harassed a popular socialist professor and Polanyi and his friends rushed to her defense, he repaired to the provincial University of Kolozsvár (today Cluj in Romania) to finish a doctor of law degree. While still a student, Polanyi helped found the left-wing Galilei Circle, serving as its first president and editor of its magazine. After a flirtation with Marx, Polanyi was drawn to the more temperate Socialism of Robert Owen, Richard Tawney, and G.D.H. Cole and the British Fabians. In today's language, he was a social democrat.

Polanyi served in the world war as a cavalry officer. He contracted typhus and came home to find Budapest torn between nationalist right and far left. At the time of the aborted Hungarian Soviet revolution of 1919 (which he opposed), Polanyi left Budapest for Vienna. His war experience, illness, and the destruction of liberal Budapest left him frail and emotionally exhausted. But in 1920, he met the love of his life, a petite firebrand named Ilona Duczyńska. Her biographer called their union "a marriage between an anarchist world revolutionary and a reclusive liberal scholar." Ilona was expelled from the Communist Party that year for her independent views. The couple had their only child, Kari, in 1923. Though he had been a student organizer and secretary of the Hungarian National Bourgeois Radical Party, Polanyi seems to have been happiest at home with his wife and daughter or in a library. Soon, Polanyi was contributing to local journals and running an informal economics seminar from the family apartment on the Vorgartenstrasse.

To provide a counterweight to neoliberal dystopia, Polanyi believed the working class needed to be mobilized politically, in a robust democracy. He arrived at this conclusion not merely from theory but from his worker-education efforts at the Galilei Circle and by

living in one of the most successful social-democratic epochs of the European experience, Red Vienna in the 1920s and early 1930s—red as in social-democratic, not communist. There, after World War I, socialist municipal governments in power for 15 years built model low-rent housing financed by taxation. Parents received kindergartens, day care, and a family allowance in the form of a “clothes package.” Gas, water, and electricity were provided by publicly owned utilities. Taxes on the wealthy included surcharges on the use of servants. Generous unemployment insurance strengthened workers’ bargaining power.

Polanyi viewed Red Vienna as a hopeful counterpoint to the Dickensian poorhouse on one extreme and fascism on the other. The perverse reforms of early-19th-century England were products of the weakness of the working class, he wrote, but Red Vienna was a badge of its strength: “While [English poor-law reform] caused a veritable disaster of the common people, Vienna achieved one of the most spectacular cultural triumphs of Western history.” But as Polanyi appreciated, an island of municipal socialism could not survive larger market dislocations and rising fascism. Four months after he departed Vienna in 1933, the right took over.

The nature of the times caused Polanyi and his wife Ilona to be twice separated, first when he moved to England and she stayed behind as part of the anti-fascist underground until 1936 and again for more than a year, when Polanyi backed into a wartime stay in America. He had been on a lecture tour of U.S. colleges, his third such visit. Peter Drucker, a friend from Vienna and later an influential theorist of corporate management, invited Polanyi to spend the summer of 1940 in southern Vermont with him and his wife. With the support of Drucker and another émigré scholar and friend, economist Jacob Marschak, then teaching at the New School, Polanyi applied for a Rockefeller Foundation fellowship to stay at Bennington to complete his book. Among his references were prominent London acquaintances, including a young war correspondent named Edward R. Murrow.

In the 1944 catalog of publisher Farrar & Rinehart, the entry for *The Great Transformation* appropriately compares it to Keynes’s succinct 1919 classic, *The*

Economic Consequences of the Peace. But while Keynes's book was a best-seller, turning its author into a celebrity, *The Great Transformation* sold just 1,701 copies in 1944 and 1945.

The New York Times reviewer, John Chamberlain, was savage: "This beautifully written essay in the revaluation of a hundred and fifty years of history adds up to a subtle appeal for a new feudalism, a new slavery, a new status of economy that will tie men to their places of abode and their jobs." If that sounds just like Polanyi's nemesis, Hayek, it was for good reason. Chamberlain had just written the foreword to Hayek's *The Road to Serfdom*, also published in 1944. While Hayek's book was adapted in *Reader's Digest* and became a best-seller, Polanyi's languished.

By 1946, however, Polanyi had been reviewed, mostly favorably, in major newspapers and social-science journals, and he was slowly attracting a following. At 61, Polanyi was offered his first real academic job in 1947 at Columbia, where he taught until 1953. But in the Cold War chill, the State Department refused to give a permanent visa to Ilona, and she relocated to Canada. After attempting to commute from Toronto, Polanyi spent his final years settled there, returning to an early scholarly interest in economic anthropology.

Temperamentally, he was both a work obsessive and a romantic. His habit of phoning former students at odd hours to discuss arcane ideas was part of his charm. Polanyi's letters to his wife and daughter are filled with tenderness. One of his great essays is on Hamlet, and his last work, published in 1963, was a jointly edited book with Ilona, *The Plough and the Pen*, with an introduction by W.H. Auden, on the struggles of modern Hungary as rendered by Hungarian poets and essayists.

Fred Block and Margaret Somers, both economic sociologists, have been Polanyi admirers for more than three decades. In *The Power of Market Fundamentalism: Karl Polanyi's Critique*, they aim to reintroduce him in an era of resurgent laissez-faire and



political blockage that he could have scripted. “Our focus,” they write, “is on the rebirth in the 1970s and 1980s of the same free market ideas that were widely assumed to have died in the Great Depression.”

Block and Somers provide a thorough reprise of Polanyi for readers new to him and careful analysis for specialists. The best part of their book is its introductory chapter, a well—integrated and brisk summary of the man and his ideas. Other chapters provide useful discussions of what Polanyi’s social history gets right and slightly wrong, as well as astute comparisons of Polanyi with Keynes and Marx.

Unlike Marx, Polanyi viewed the transformation of a more balanced commercial society into a market-dominated one as neither natural nor inevitable. For Polanyi, as Block and Somers observe, “progress could only come through conscious human action based on moral principles.” Though there was a logical pattern to capitalism’s overwhelming social structures, we were not doomed to repeat our mistakes. Polanyi was a huge fan of Roosevelt’s New Deal, which he saw as the sane alternative to laissez-faire dystopia on the one side and totalitarian anti-politics on the other. “The eclipse of Wall Street in the 1930s,” he wrote, “saved the United States from a social catastrophe of the Continental type.”

Polanyi rejected both Marxists and economic libertarians for their shared premise that the state should or could wither away. Marxists assumed the state would be redundant after the workers’ revolution. Libertarians saw (and see) the state as interfering with the genius of the market. Polanyi embraced democratic politics, both as an end in itself and as the necessary precondition for taming the economy. Despite his gloomy rendering of history, Polanyi remained an optimist.

Block and Somers also re-examine Polanyi’s research. A key section of *The Great Transformation* pivots on a local English ordinance known as the Speenhamland law, which Polanyi treats as an emblematic shift in emergent capitalism. Approved by the justices of Berkshire County at a May 6, 1795, meeting, Speenhamland increased the worker protections of the old Elizabethan Poor Law of 1601. With wages falling,

pauperism spreading, unrest increasing, and the English gentry all too aware of revolutionary events across the Channel in France, the law provided that any worker who could not earn enough to feed his family was entitled to supplemental relief from the local parish tied to the price of bread—“a minimum income should be assured to the poor irrespective of their earning.”

But the law, like a badly designed modern welfare program, backfired. Many employers reduced wages, knowing that the parish would make up the difference. Some workers, disdaining the wretched pay on offer, became idlers. Costs to taxpayers increased. The dysfunctional system led to outcries from welfare reformers of the day, culminating in the infamous report of the 1832 Royal Commission, which, in turn, led directly to the reform of 1834 and the poorhouse.

Block and Somers find that Polanyi overstated the ubiquity of the Speenhamland system. In practice, poor-relief formulas in England varied widely. What Polanyi did not overstate was the dislocation of the working poor—first by the enclosure movement, then by the industrial revolution—and the perverse response of economic liberals.

A weakness of the Block-Somers book is that several chapters are based on published journal articles, insufficiently blended into a new whole. As a consequence, the tone is uneven, and the book has a fair amount of repetition. Nor do Block and Somers offer much on Polanyi's personal journey. They include just four pages of summary on his life. The British social scientist Gareth Dale, author of the fine 2010 book *Karl Polanyi: The Limits of the Market*, and Berkeley Fleming of Mount Allison University in Canada are currently working on the first comprehensive Polanyi biographies.

Fortunately, a good deal on the connection between Polanyi's life and his work has already been written by his daughter and literary executor, Kari Polanyi Levitt, an emerita professor at McGill University in Montreal. In Polanyi Levitt's most recent book, *From the Great Transformation to the Great Financialization*, she provides fascinating new material on Polanyi's debate with Mises and Hayek. From the time he worked at the *Österreichische Volkswirt* in the mid-1920s, Polanyi engaged Mises and Hayek both

ideologically and technically, arguing over pricing mechanisms under democratic socialism and the emergent dangers of the libertarian system then strangling Europe's postwar recovery. Polanyi viewed Mises and Hayek as modern counterparts of Adam Smith, David Ricardo, and the social Darwinist Herbert Spencer, punishers of the poor in the name of market incentives. "Inside and outside England," he wrote in *The Great Transformation*, "from Macaulay to Mises, from Spencer to Sumner, there was not a militant [free-market] liberal who did not express his conviction that popular democracy was a danger to capitalism."

Hayek contended in *The Road to Serfdom* that even democratic forms of state planning were bound to end in the totalitarianism of a Stalin or a Hitler. But 70 years later, there is not a single case of social democracy leading to dictatorship, while there are dozens of tragic episodes of market excess destroying democracy. "The fascist solution of the impasse reached by liberal capitalism," Polanyi wrote, "can be described as a reform of market economy achieved at the price of the extirpation of all democratic institutions." Polanyi surely had the better of the argument. But Hayek had more influence over prevailing ideology and practice. Polanyi and Marx might converge on the inference that Hayek's views were more useful to the ruling class.

Though slow to win recognition, *The Great Transformation* became a modern classic. After the neoliberal assault on the grand compromise of the late 1940s, Polanyi seemed not just prescient but prophetic. Because he was a political organizer, journalist, self-taught historian, and economist, Polanyi, in moral philosopher Albert Hirschman's metaphor, could be a trespasser across academic disciplines. Though Polanyi is one of the most cited of social scientists, he is not widely read among economists. The mainstream of the profession has largely stopped teaching the history of economic ideas. Nor do most economists today study the relationship of economics to politics and social history.

Like other free spirits such as Hirschman, Joseph Schumpeter, or John Kenneth

Galbraith, Polanyi had relatively few graduate students, and there is no formal Polanyi “school.” Rather, a wide spectrum of thinkers found their way to him. He’s prized by social historians and economic sociologists, and his brand of inquiry fits squarely into the tradition of American institutional economics associated with John R. Commons and the great debunker of free-market cant, Thorstein Veblen. Since 1988, thanks to the efforts of his daughter Kari and her colleague Marguerite Mendell, there has been an active Karl Polanyi Institute of Political Economy, which holds regular conferences, including an anniversary event planned for this fall.

A 1982 article by the international-relations scholar John Gerard Ruggie helped rekindle interest in *The Great Transformation*. Ruggie, paying homage to Polanyi, refers to the great postwar social compromise as “embedded liberalism,” meaning it squared the circle of a basically capitalist (liberal) economy with plenty of social protections (embedded). A few social scientists of the first rank, including the late sociologist Daniel Bell, political historians Ira Katznelson and Jacob Hacker, and economists Joseph Stiglitz, Dani Rodrik, and Herman Daly, explicitly cite their intellectual debt to Polanyi. Paradoxically, Polanyi also appeals to some Burkean conservatives, with their regard for the social order. John Gray, a recovering Thatcherite and author of the best-selling critique of neoliberalism *False Dawn: The Delusions of Global Capitalism*, is effusive in his praise of Polanyi. Martin Anderson, advising Ronald Reagan on welfare reform, drew extensively (if misleadingly) on Polanyi to warn that the wrong sort of poor relief backfires. Yale political scientist and anthropologist James C. Scott, author of notable books on the failures of grandiose state projects, said in a 2010 interview that he read *The Great Transformation* the summer before starting graduate school, “and I think it is, in some ways, the most important book I’ve ever read. ... The struggle that Polanyi points to is a struggle that we’re still engaged in.”

At the same time, many public intellectuals working in the tradition of Polanyi don’t have him on their conceptual maps. Michael Walzer’s classic *Spheres of Justice*, on necessary boundaries between market and non-market institutions, is quintessential Polanyi, but Walzer never mentions him. Elinor Ostrom, a political scientist whose work on strategies to avoid environmental catastrophe—the modern tragedy of the commons

—made her among the first non-economists to win the Nobel Prize in Economics, echoes Polanyi but doesn't invoke him. In reading the works of Galbraith, the consummate historical and institutional economist of the 20th century, one searches in vain for Polanyi.

As more of us are having second thoughts about the second coming of the primal market, it is as if Polanyi is somewhere in the ether. Rereading Polanyi at a time when events vindicate his vision, one has to be struck with the eerie contemporary ring. Polanyi is startlingly 21st-century in addressing how the private rule of global finance puts public policy in a straitjacket. Back in the era of the gold standard, if a government tried to combat unemployment, Polanyi wrote, "any governmental measure that caused a budgetary deficit might start a depreciation of the currency." That analysis could describe contemporary Argentina or Indonesia, except that the discipline of today's bond market is even more relentless than the classical gold standard.

Polanyi also sounds like today's news when he explains how the state's doing the bidding of private capital (rather than providing a democratic counterweight) undermines politics. In the 1830s, he explains, the British state served the interests of the rising merchant class. The result, he wrote, was "the hatred of public relief, the distrust of state action, the insistence on respectability and self-reliance" on the part of the English working class. He could be describing members of the Tea Party, the same demographic that once voted in large numbers for FDR, and the tendency of citizens throughout the West to give up on governments in the pockets of the rich.

The European Union's austerity follies are recapitulating the perverse policies of the 1920s and inviting the same brand of know-nothing backlash. In the upcoming elections to the European Parliament, voters disgusted with the failure of politics to remedy the prolonged recession are poised to deliver big gains to nationalist far-right parties. In Polanyi's beloved Budapest, where he and Ilona are buried, the right already governs.

His discussion of the influence of ideas, likewise, is all too contemporary. In the 1920s, as in the 1830s, the intellectual dominance of free-market economists gave elites pseudo—

scientific cover to pursue brutal and perverse policies, with a studied myopia about real-world consequences. In our own time, market fundamentalism is again the dominant ideology. The latest great transformation, from a balanced social market economy to a dictatorship of the invisible hand, has weakened the power of the polity to restore balance and undermined the confidence of the working and middle classes in the use of the democratic state to counter market excess. One must hope, with the optimistic Polanyi, that capitalism can be fixed.

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