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Great Transformation**

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## **ABSTRACT**

Polanyi's book on The Great Transformation provides an analysis of the emergence and significance of capitalist economic structures which differs radically from those currently universally taught in economic textbooks. This analysis is based on a methodological approach which is also radically different from existing methodologies for doing economics, and more generally social science. This methodology is used by Polanyi without explicit articulation. Our goal in this article is to articulate the methodology used in this book to bring out the several dimensions on which it differs from current approaches to social science. Among the key differences, Polanyi provides substantial scope for human agency and capabilities to change the course of history. He also shows that the social, political and economic spheres of human existence are deeply interlinked and cannot be analysed in isolation, as current approaches assume.

*JEL Classifications:* B31, B41

*Keywords:* Methodology, Social Science, Capitalism, Liberalism

## 1. INTRODUCTION

Meier (2008) writes that “A list of the most seminal works in political economy of the twentieth century would have to include Karl Polanyi’s *The Great Transformation*”. Similarly, in his foreword to the re-publication of Polanyi (2001, 1944), Stiglitz testifies to the continuing importance and contemporary relevance of the book. Nonetheless, the methodology adopted by Polanyi in his analysis of the “*The Great Transformation*” is radically different from existing methodologies in Economics, both orthodox and heterodox. Our goal in this article is to explicitly articulate several components of this methodology by showing how Polanyi uses them. A word of warning is in order. Polanyi operates at a meta-theoretical level. That is, he analyses the emergence of theories as an attempt to understand emergent historical situations. These theories, which may vary across social classes, are frequently wrong. They are nonetheless used to understand historical experience, and to shape a response to it. This has several radical implications:

- (1) Wrong theories, representing misunderstanding of historical experience, shape history.
- (2) The analysis of emergence, evolution, and replacement of theories cannot be understood by studying the relation of these theories to the “Truth”. Rather, we must study theories in their historical context, to understand how they functioned to protect and further interests of certain classes, and harm others.
- (3) The methodology of science, which requires separation of the observer and the observed phenomena cannot be utilised in social sciences. Theories formulated by observers shape their understanding of their experience, and their responses to this experience, directly affecting history. Thus understanding social phenomena requires simultaneous consideration of the observer and the observed.

A meta-theoretical analysis is necessarily complex and multilayered. We start with the basic layer of historical experience. At the second layer, we analyse how this experience impacted on contemporaries, and what theories were formulated to understand it. Thirdly, different groups respond to this experience differently, in light of their understanding based on these theories. Fourthly, these theory-mediated responses affect the course of history. The meta-analyst must attempt to stand outside this stream. Many critiques of Polanyi, are based on

fundamental misunderstandings of what Polanyi was saying; for examples, see Mayhew (2000). Our re-construction of the methodology of Polanyi is also multi-layered, and multiple elements have to be considered together to be properly understood. It is important to state at the outset that our goal is to present the methodological approach used by Polanyi, and not the main ideas of the Great Transformation—summaries from different perspectives are available in Mayhew (2000) and Zaman (2010).

## 2. AN INSTITUTIONAL PERSPECTIVE

Polanyi's (p. 3) book opens with the following statements:

*“Nineteenth century civilisation rested on four institutions. The first was the balance-of-power (...which prevented...) long and devastating war between the Great Powers. The second was the international gold standard.... The third was the self-regulating market which produced an unheard-of material welfare. The fourth was the liberal state.”*

This opening makes it clear that these institutions will play a central role in the analysis that follows. More explicitly, Polanyi (p. 4) states that *“Ours is not a historical work; what we are searching for is not a convincing sequence of outstanding events, but an explanation of their trend in terms of human institutions.”* As promised, the book traces the emergence, evolution and extinction of many different institutions, not just the four listed above—this shows the institutions are not exogenous invariants, to be used as a basis for explanations. In other words, Polanyi does not treat institutions as the final cause, in the Aristotelian sense. This leads to a puzzle: how can institutions play a central role in explaining history, when they are themselves born, shaped, evolve and die as a result of other forces? We provide an answer in the next section.

## 3. THE SPIRIT OF HISTORY

Hegel argued that the Spirit of History realises the principle of rational freedom in the world through the mechanism of human history. Thus history is shaped by larger forces which impel it in certain directions leading to the realisation of greater freedom and rationality. Polanyi also uses certain global forces and ideas to explain the progress of history, but these are concrete and explicable, rather than abstract and metaphysical. To illustrate, Polanyi considers the collapse of the Gold standard as a turning point in history. At the same time, the event is considered as a manifestation of hidden social forces at work. For example, he writes that the collapse of the gold standard, and the accompanying collapse of the international system (political and economic) was caused by deeper social forces at work, which were not understood by contemporaries [Polanyi, p. 25]. Similarly, the rise and fall of nations or groups may depend on whether or not their institutions are aligned with the underlying process of social

change [Polanyi, p. 27]. The underlying process is often hidden and misunderstood by contemporaries, as we will further clarify later.

Polanyi (p. 262) writes that “*Institutions are embodiments of human meaning and purpose.*” Collective human will to achieve some goal can lead to the formation of institutions necessary to the achievement of that goal. If such institutions are not formed, then these purposes and goals remain ineffective. Polanyi (p. 8) writes that “*Interests, however, like intents, necessarily remain platonic unless they are translated into politics by the means of some social instrumentality.*” Specifically, even if a vast majority of human beings collectively desire peace, this desire will remain unrealised unless an institution emerges to translate it into reality. This provides a resolution of the puzzle raised before. The spirit is a collective will—basically a goal which inspires and motivates a large community of people—and the institutions represent the embodiment of the will, which is the mechanism by which this will operates in the real world. As the metaphor of body and spirit suggests, the spirit cannot effect actions without an embodiment; at the same time the body is dead without a spirit, and cannot be understood in isolation, separately. This is how institutions are central to the story of Polanyi, without being the final cause of changes which take place. The capabilities and structure of the institutions shapes and limits the ways in which any given goal of the spirit is materialised in the real world. This is why institutional analysis is necessary to understand history.

#### 4. METHODOLOGICAL COMMUNITARIANISM

This neologism is formulated to express the antithesis of methodological individualism. It rests on two premises:

- (1) Individual behaviour and motivations cannot be understood outside of his community and his social and historical milieu. Our actions as individuals are strongly shaped by social norms which are prevalent, and taught to members, of any given community.
- (2) History is shaped by groups; individuals are too small to affect the streams of history. Of course, individuals can create and inspire communities with a common vision, thereby impacting history.

In subsections below, we provide textual support to confirm Polanyi’s use of these principles in his analysis.

##### 4.1. Individual Behaviour Shaped by Society

In support of the first premise of methodological communitarianism, we offer the following quote from Polanyi (p. 54):

*Broadly, ... all economic systems known to us up to the end of feudalism in Western Europe were organised either on the principles of reciprocity or redistribution, or house holding, or some combination of the three. These*



*principles were institutionalised with the help of a social organisation which, inter alia, made use of the patterns of symmetry, centricity, and autarchy. In this framework, the orderly production and distribution of goods was secured through a great variety of individual motives disciplined by general principles of behaviour. Among these motives gain was not prominent.*

There is substantial additional textual evidence that Polanyi thinks individual motives are shaped by larger social forces. Indeed, one of the central theses of Polanyi is that working for profits or money is not ordinarily a powerful motive within human beings, and the market economy must strengthen this motive in order to be able to function. Polanyi was misunderstood as saying that men in primitive societies were not motivated by self-interest. Some anthropologists and economists then attacked this idea by arguing that men everywhere are “rational”—motivated by self-interest; see Mayhew (2000). In order to avoid a repetition of this error, we clarify Polanyi’s position below.

Firstly, Polanyi (p. 48) argues that humans are social beings, and that this is an invariant: *“For, if one conclusion stands out more clearly than another from the recent study of early societies it is the changelessness of man as a social being. His natural endowments reappear with a remarkable constancy in societies of all times and places; and the necessary preconditions of the survival of human society appear to be immutably the same.”*

It is clear that Polanyi does not think that the nature of man varies, or has changed, due to the emergence of the market society in modern times—even though some passages from the text could be mis-interpreted in this way. However the fundamental motivation of humans, which is invariant across societies, is to protect and enhance social standing: *“The outstanding discovery of recent historical and anthropological research is that man’s economy, as a rule, is submerged in his social relationships. He does not act so as to safeguard his individual interest in the possession of material goods; he acts so as to safeguard his social standing, his social claims, his social assets. He values material goods only in so far as they serve this end.”* [Polanyi, p. 48]. Now the link between social standing and material goods can be redefined within different societies. In particular, the market society must strengthen this relationship, since it forms the basis for economic activity within such a society. However, all societies other than market societies protect themselves by promoting generosity as a marker of social standing: *“The premium set on generosity is so great when measured in terms of social prestige as to make any other behaviour than that of utter self-forgetfulness simply not pay. Personal character has little to do with the matter. Man can be as good or evil, as social or a social, jealous or generous, in respect to one set of values as in respect to another.”* [Polanyi, p. 49].

## 4.2. History is Shaped by Groups

Once we view history as the history of society, which embeds within it political, economic and social relationships, it is almost tautological that history is shaped by actions of groups. Social change requires changes in networks of social relationships, emergence, destruction, or alternations in relationships between different classes, inevitably requiring involvement of large numbers of people. As Polanyi (p. 159) writes: “*The essential role played by class interests in social change is in the nature of things ... hence only when one can point to the group or groups that effected a change is it explained how that change has taken place.*”

Below we cite just one passage which shows Polanyi (p. 162) using varied interests of different groups as potential explanations for changes in society:

*The spread of the market was thus both advanced and obstructed by the action of class forces. Given the need of machine production for the establishment of a market system, the trading classes alone were in the position to take the lead in that early transformation. A new class of entrepreneurs came into being out of the remnants of older classes, in order to take charge of a development which was consonant with the interests of the community as a whole. But if the rise of the industrialists, entrepreneurs, and capitalists was the result of their leading role in the expansionist movement, the defense fell to the traditional landed classes and the nascent working class. ...*

The passage continues in this vein, referring to group interests as an explanation for different types of social change. Furthermore, this is the fundamental explanatory principle, used everywhere throughout the book, by Polanyi. He analyses historical changes in terms of how they affected the interests of different groups, and also the institutions available to embody and translate these interests into practice.

Nonetheless, there is a very important caveat, explicitly mentioned by Polanyi. Even though actions of groups lead to historical change, these actions are not exogenous. These actions are often responses to external challenges: “*Yet the ultimate cause is set by external forces, and it is for the mechanism of the change only that society relies on internal forces. The “challenge” is to society as a whole; the “response” comes through groups, sections, and classes. Mere class interests cannot offer, therefore, a satisfactory explanation for any long-run social process.*” [Polanyi, p. 152]. Again, this is similar to the idea of institutions as the embodiment of a spirit. Here the process of change is set into motion by external forces which act upon the society as a whole. However, the process is carried out by groups responding to these changes in different ways, sometimes in harmony and other times in conflict.

## 5. BEYOND CLASS STRUGGLE

While Marx took class struggle as the fundamental driving principle of history, Polanyi (p. 160) argues that “*mere class interests cannot offer a satisfactory explanation for any long-run social process.*” Just as institutions are central to Polanyi’s story, but they are not drivers of change, so class struggle is an important component of Polanyi’s story without being the driver of long run social change. To understand this correctly, it is essential to focus on the qualifier “long-run”. In the short run, within a stable social structure, dynamics of the change process may be driven by class struggle. However, in the long run, this is not the case. In one of his few clear articulations of methodology, Polanyi (p. 159) explains why this is so:

- (1) The process in question may decide about the existence of the class itself; that is, the process of social change may create or destroy classes.
- (2) The interests of given classes determine only the aims and purposes toward which those classes are striving, not also the success or failure of such endeavours.
- (3) The chances of classes in a struggle will depend upon their ability to win support from outside their own membership, which again will depend upon their fulfilment of tasks set by interests wider than their own.
- (4) Challenges for society as a whole are created by external causes, such as a change in climate, in the yield of crops, a new foe, a new weapon used by an old foe, the emergence of new communal ends, or, for that matter, the discovery of new methods of achieving the traditional ends.

On the basis of these considerations, Polanyi (p. 159) writes that “*Thus, neither the birth nor the death of classes, neither their aims nor the degree to which they attain them; neither their co-operations nor their antagonisms can be understood apart from the situation of society as a whole.*” We illustrate by providing examples of these principles from the text.

### 5.1. Emergence of a Group Interest

The gold standard served to link economies and provide a vehicle for international trade. Paper currency with fractional backing can be used domestically within a nation, as it is backed by government writ. However, international trade requires more solid ground. Reliance on the theory of free trade led to substantial interdependence of economies, and the gold standard appeared to all to be the only guarantee of free trade. Polanyi (p. 19) write about how this external circumstance created a new group interest:

*Budgets and armaments, foreign trade and raw material supplies, national independence and sovereignty were now the functions of currency and*

*credit. By the fourth quarter of the nineteenth century, world commodity prices were the central reality in the lives of millions of Continental peasants; the repercussions of the London money market were daily noted by businessmen all over the world; and governments discussed plans for the future in light of the situation on the world capital markets. Only a madman would have doubted that the international economic system was the axis of the material existence of the race.*

This is an illustration of the first point, that external circumstances can create new classes and new class interests. In this particular case, with widespread trade in necessities like grains, sustaining foreign trade became a common interest cutting across classes, and their private interests. Even though maintaining the gold standard impacted adversely on certain classes and on certain nations, the commitment to free trade (viewed as a necessity by all) over-rode these narrow class interests. This again illustrates the need for going beyond class interests in historical analysis.

## **5.2. External Circumstances may Determine Outcomes**

Polanyi documents across the board, universal agreement, on the necessity of the gold standard, for reasons already discussed. He goes on to write that:

*Indeed, the essentiality of the gold standard to the functioning of the international economic system of the time was the one and only tenet common to men of all nations and all classes, religious denominations, and social philosophies. It was the invisible reality to which the will to live could cling, when mankind braced itself to the task of restoring its crumbling existence.*

*The effort, which failed, was the most comprehensive the world had ever seen. The stabilisation of the all-but-destroyed currencies in Austria, Hungary, Bulgaria, Finland, Romania, or Greece was not only an act of faith on the part of these small and weak countries, which literally starved themselves to reach the golden shores. [Polanyi, p. 27].*

Despite tremendous efforts made by diverse groups, often acting against narrow self-interest, the gold standard collapsed when USA went off the standard in 1933. There is a detailed and complex explanation provided by Polanyi of inherent contradictions in the system which led to the failure of the gold standard. Flaws in the monetary system are not our concern here. Methodologically, what this illustrates is that the combined striving of all groups—which can also be called the spirit of the age—did not lead to the desired outcome. The outcome was determined by technical and economic external factors, which are taken as the final cause in the analysis of Polanyi.

## **5.3. Acting Across Class Interests**

The third point states that typically, no class has sufficient power to enforce its desired outcomes on all others. This leads to the necessity of building

coalitions, and of acting in ways which serve broader interests, in order to achieve successful outcomes. Coalitions and compromises may require acting against narrowly defined class interests. This is illustrated in the discussion by Polanyi (p. 5) of the 100 years of peace: “*The nineteenth century produced a phenomenon unheard of in the annals of Western civilisation, namely, a hundred years’ peace—1815-1914.*”

After documenting what he means by this phrase, namely no major war between major European powers (accompanied by ‘*almost incessant series of open wars into the domains of outworn cultures or primitive peoples*’, Polanyi (p. 6) proceeds to provide an explanation of it. He shows that the 100 years of peace, contrary to past experience of continuous wars between European powers, was produced by a new factor—the emergence of an acute peace interest. He documents that prior to this era, wars were universally accepted part of statecraft. However, “*After 1815, the change is sudden and complete.*” [Polanyi, p. 7]. Whereas in late 18th century, Rousseau had condemned trades-people for their lack of patriotism in preferring peace to liberty, leading thinkers of 19th century Europe called patriots ‘*the new barbarians.*’ In creating this change in public sentiment, and in redefining the range of acceptable policies for state and church, the group benefitting most from peace played an important role. This was the group of feudals and dynasts whose trade interests were threatened by wars. The crucial point, the focus of this section, is that this group did not have enough power to enforce its will on numerous other groups and powers in existence. Nonetheless, it succeeded in achieving its goals by co-opting leading thinkers into creating a new common interest, and by persuading other classes with different interests to yielding to this common interest instead of pursuing narrow class interest. The following paragraph illustrates the wide variety of methods used to achieve this newly created common interest over the course of Polanyi’s (p. 6) century of peace:

*Yet every single one of these conflicts was localised, and numberless other occasions for violent change were either met by joint action or smothered into compromise by the Great Powers. Regardless of how the methods changed, the result was the same. While in the first part of the century constitutionalism was banned and the Holy Alliance suppressed freedom in the name of peace, during the other half—and again in the name of peace—constitutions were foisted upon turbulent despots by business-minded bankers. Thus under varying forms and ever-shifting ideologies—sometimes in the name of progress and liberty, sometimes by the authority of the throne and the altar, sometimes by grace of the stock exchange and the check book, sometimes by corruption and bribery, sometimes by moral argument and enlightened appeal, sometimes by the broadside and the bayonet—one and the same result was attained: peace was preserved.*

It was one of the interest of a powerful group—the feudals and the dynasts—to preserve peace. They gained the most from a functioning international trading system. Prior to the emergence of a powerful faction interested in preserving peace, wars occurred almost constantly in Europe. This means that wars served the interest of several other powerful classes in European society. Nonetheless, the group interested in peace was able to utilise the institutional structures and co-opt other powerful social groups to achieve their desired goal, using a wide variety of mechanisms.

Similarly, the gold standard benefitted some groups, and harmed others. Nonetheless, the groups benefitting from the gold standard were able to persuade other powerful factions to abandon narrow class interest in favour of what was perceived to be a common social interest.

This idea of Polanyi has several consequences which are of great importance. One of the important mechanisms available to a powerful class, to bring other classes on board, is false theories. For example, the theory of free trade and comparative advantage was used as weapon by the advanced economy of England against Europe. Success would have reduced Europe to a raw material producing hinterland for British industrial products. Friedrich List was able to counter this ideological attack by developing a theory for protection. His theories served as a basis for the protectionist policies which allowed the European economies to develop without threat of competition from England; see Bairoch (1995) for a more complete description.

A second consequence has to do with the necessity of looking deeper than observable manifestations, to arrive at real causes of change. The influence of logical positivism has been so great that many political scientists have disavowed the idea of looking deeper into the (unobservable) motivations, and content themselves with an analysis of the observable political processes. However if a large number of different mechanisms utilised to achieve peace are all manifestations of a single underlying peace interest, it will be impossible to achieve a unifying understanding of the political process without analysing the motivations and capabilities of different groups within a given institutional structure.

#### **5.4. External Causes Drive Social Change**

This principle is illustrated in Polanyi's book by many different examples, of which we just select two.

Polanyi (p. 42) writes that the invention of machines which enable large scale industrial production is central to understanding the market economy: "*We do not intend to assert that the machine caused that which happened, but we insist that once elaborate machines and plant were used for production in a commercial society, the idea of a self-regulating market was bound to take shape.*" Thus the invention of heavy and expensive machinery for mass production was an external

factor that was an important driver of the process of social change leading to the industrial revolution. Indeed, the “Great Transformation” of the title, which transformed social, political and economic structures of European society, was triggered by this external change.

As another example, consider “*The connection between rural poverty and the impact of world trade was anything but obvious.*” [Polanyi, p. 93] Again the external factor of a large increase in world trade led to a process of social change, which created the phenomenon of pauperism in both rural and urban areas of England. Efforts by various classes to deal with this new social problem led to the generation of theories about poverty, changes in social structures, as well as attitudes towards poverty. In other words, an external stimulus led to emergence of new classes, re-configuration of class interests, changes in economic structures, and other social change.

## **6. INTERLINKAGE OF SOCIAL, POLITICAL AND ECONOMIC SPHERES**

Throughout his analysis, Polanyi demonstrates the close linkages between these three major spheres of human existence. In fact, he also discusses the connections with the geological sphere, Earth, which has become extremely important recently. These linkages make it impossible to analyse them in isolation, contrary to the assumptions embodied in current disciplinary boundaries between the three. We provide a few examples of these linkages from the text.

Polanyi starts by arguing that while markets may have existed since time immemorial, they have not been the central mechanism for the production and distribution of goods in any society other than our current modern one. He argues that “*the control of the economic system by the market is of overwhelming consequence to the whole organisation of society: it 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. ... society must be shaped in such a manner as to allow that system to function according to its own laws. This is the meaning of the familiar assertion that a market economy can function only in a market society.*” [Polanyi, p. 60]. The Great transformation of Polanyi’s title is the transformation from a traditional society to a market society which dramatically impacted on political and the social spheres. “*Machine production in a commercial society involves, in effect, no less a transformation than that of the natural and human substance of society into commodities. The conclusion, though weird, is inevitable; nothing less will serve the purpose: obviously, the dislocation caused by such devices must disjoint man’s relationships and threaten his natural habitat with annihilation.*” [Polanyi, p. 44]. As Polanyi prognosticated, disruption of natural social relationships, and the environmental catastrophe which beckons, are consequences of spread of market-based values.

A second example discussed in great detail by Polanyi is the linkage between a stable international trading system and peace. He writes that “*In the absence of stable exchanges and freedom of trade the governments of the various nations, as in the past, would regard peace as a minor interest, for which they would strive only as long as it did not interfere with any of their major interests. First among the statesmen of the time, Woodrow Wilson appears to have realised the interdependence of peace and trade, not only as a guarantee of trade, but also of peace.*” [Polanyi, p. 23]. He explains both world wars as a consequence of disturbances in international trading systems.

The following passage by Polanyi also shows the strong relationships between the economic sphere and the political and social spheres: “*In the early thirties, change set in with abruptness. Its landmarks were the abandonment of the gold standard by Great Britain; the Five-Year Plans in Russia; the launching of the New Deal; the National Socialist Revolution in Germany; the collapse of the League in favour of autarchist empires. While at the end of the Great War nineteenth century ideals were paramount, and their influence dominated the following decade, by 1940 every vestige of the international system had disappeared and, apart from a few enclaves, the nations were living in an entirely new international setting. The root cause of the crisis, we submit, was the threatening collapse of the international economic system. It had only haltingly functioned since the turn of the century, and the Great War and the Treaties had wrecked it finally.*” [Polanyi, p. 24].

The book is replete with examples of direct relationships between the economic, political and social spheres of human existence. The few examples listed above should suffice as a sampler.

## **7. THEORIES AND LEARNING FROM HISTORICAL EXPERIENCE**

Whereas the naïve view is that experience leads to knowledge, Kant is more accurate: “*Experience without theory is blind, but theory without experience is mere intellectual play.*” Experience is merely knowledge of a sequence of events, but learning from this experience requires an interpretation of this experience in light of some theories about causality. By re-interpreting the causal relations, the same experience can be made to support many different theories. This difficulty is fundamental and cannot be overcome, since Hume correctly observed that causal relations cannot be deduced from observational data. Thus causal theories must be imposed upon experience in order to learn from it. If the causal theories are wrong, then experience can lead to ignorance and error, instead of leading to knowledge. Polanyi provides many examples of this type of problem in his book. For example, he writes that: “*A hundred years’ peace had created an insurmountable wall of illusions which hid the facts. The writers of that period excelled in lack of realism. The nation-state was deemed a parochial prejudice by*



A. J. Toynbee, *sovereignty a ridiculous illusion by Ludwig von Mises, war a mistaken calculation in business by Norman Angell. Awareness of the essential nature of the problems of politics sank to an unprecedented low point.*” [Polanyi, p. 198].

An interesting example central to the theme of the book is the variety of theories coined to explain a sudden rise in pauperism in England in early nineteenth century. Polanyi (p. 94-95) writes that:

*“Where do the poor come from?” was the question raised by a bevy of pamphlets which grew thicker with the advancing century.... On one point there appears to have been general agreement, namely, on the great variety of causes that accounted for the fact of the increase. Amongst them were scarcity of grain; too high agricultural wages, causing high food prices; too low agricultural wages; too high urban wages; irregularity of urban employment; disappearance of the yeomanry; ineptitude of the urban worker for rural occupations; reluctance of the farmers to pay higher wages; the landlords’ fear that rents would have to be reduced if higher wages were paid; failure of the workhouse to compete with machinery; want of domestic economy; incommodious habitations; bigoted diets; drug habits. Some writers blamed a new type of large sheep; others, horses which should be replaced by oxen; still others urged the keeping of fewer dogs. Some writers believed that the poor should eat less, or no, bread, while others thought that even feeding on the “best bread should not be charged against them.” Tea impaired the health of many poor, it was thought, while “home-brewed beer” would restore it; those who felt most strongly on this score insisted that tea was no better than the cheapest dram. Forty years later Harriet Martineau still believed in preaching the advantages of dropping the tea habit for the sake of relieving pauperism.*

Polanyi offers the explanation that a new factor had entered the scene which contemporaries were not aware of. This was an erratic increase in foreign trade with an upward trend. This led to increasing employment in industries, but also unemployment when sudden drops in demand led to widespread layoffs. The point here is not to discuss right and wrong, but to note that theories are often designed to explain emergent and unusual situations. For example, Keynesian theory was designed to explain the Great Depression. It would not be at all surprising if contemporary explanations miss factors which may become clearer with hindsight, and with perspective offered by time and more experience. Another example which is part of the core arguments of the book is the formulation of economic theories in response to the Speenhamland episode. Polanyi argues that this effort to provide a guaranteed minimum wage to workers failed for complex reasons, special to those times. However, this special failure was generalised into wrong theories.

*The complicated economics of Speenhamland transcended the comprehension of even the most expert observers of the time; but the conclusion appeared only the more compelling that aid-in-wages must be inherently vicious, since it miraculously injured even those who received it.* Polanyi (p. 86).

Polanyi proceeds to *survey the consequences of the fact that the foundations of economic theory were laid down during the Speenhamland period.* He argues that *First, the economic theory of the classical economists was essentially confused.* He provides examples and brief explanations of some of these confusions. *Second,* he argues that the economic system under observation of the classical economists was a mix of premarket and market economies, which was the source of the confusion. *Third,* economists borrowed natural laws from biology and elsewhere to explain observed economic patterns. This had far reaching consequences in terms of denying the viabilities of alternatives and suppressing the role of human agency in the economic system. [Polanyi, p. 130].

These examples suffice to show how Polanyi explains the emergence of wrong theories as an attempt to understand complex emergent phenomena by contemporaries.

## **8. FALSE THEORIES SHAPE OUR FUTURE**

When foreign trade was small, and limited to luxury items, self-sufficiency was the norm for all societies. The Industrial Revolution created the possibility of production of huge amounts of surplus for the first time in human history. What was to be done with this surplus? It is no surprise that theories of free trade and comparative advantage originated in England, after this event. Colonised countries (and others), would sell grains and essentials to buy luxury goods for the rich. The theory of comparative advantage justified this as an operation which benefits all. Surplus production led to increasing importance of trade and markets and eventually to a market society. Similarly, large amounts of domestic and international trade led to an increasing importance of money. This is in line with the idea that an external stimulus led to changes in social, political and economic structures of a society. Some of the action in the process of change is carried out by classes pursuing their interests. Generally speaking, classes do not have enough numbers or power to enforce their agendas, and must win cooperation of others to succeed. A variety of mechanisms can be used for this purpose, but one of the most important is the creation and propagation of theories which define a common interest, cutting across classes. Our goal in this section is to trace the emergence of such theories, and show how they have impacted on history.

Polanyi (p. 42) writes that *“The Industrial Revolution was merely the beginning of a revolution as extreme and radical as ever inflamed the minds of sectarians, but the new creed was utterly materialistic and believed that all human problems could be resolved given an unlimited amount of material commodities.”*

Whereas nearly all societies and religions have warned against the pursuit of wealth, the industrial revolution created the capability for production of vast amounts of wealth, and also generated ideologies which would justify this production as beneficial for all. For example, Keynes argued that even though greed was a “disgusting morbidity,” it must nonetheless be allowed to prevail in society, since that would lead to the accumulation of wealth. This wealth would solve all social problems in the long run. Nelson (2001) has documented how this creed became widely believed among economists.

### **8.1. The Commodification of Human Lives**

A perfect illustration of the methodological point under study is the Speenhamland episode, regard by Polanyi (p. 87) as pivotal: “*study of Speenhamland is the study of the birth of nineteenth century civilisation*”. As Polanyi explains, emergence of a market economy requires three artificial commodities—land, labour and money. Of the three, the most traumatic to natural human society is the commodification of labour—another name for human lives. Land and money had already emerged as commodities, but the social catastrophe created by Speenhamland Laws led to the emergence of the labour market, and the birth of the market economy. Our point of focus in this section is that these major events were mediated by false theories which were based on a wrong analysis of the Speenhamland episode by contemporaries. These false theories continue to guide policies to this day. We explain this in somewhat greater detail below.

Social conflicts and land appropriations via enclosures had led to the emergence of poverty on a large scale, a necessary first step for the emergence of a labour market:

*(the process of social change created by trade and industrialisation) wrought unprecedented havoc with the habitation of the common people. Before the process had advanced very far, the labouring people had been crowded together in new places of desolation, the so-called industrial towns of England; the country folk had been dehumanised into slum dwellers; the family was on the road to perdition; and large parts of the country were rapidly disappearing under the slack and scrap heaps vomited forth from the “satanic mills.” Writers of all views and parties, conservatives and liberals, capitalists and socialists invariably referred to social conditions under the Industrial Revolution as a veritable abyss of human degradation. [Polanyi, p. 41].*

Repeal of the Settlement Act allowed the poor to move across counties, creating the pool of labour required by the increasing industrial production in support of increasing sea-trade. However, this was countered by the Speenhamland laws, which guaranteed a minimal living wage to all—regardless of whether or not they

worked. Polanyi (p. 82) writes that “*Speenhamland led to the ironical result that the financially implemented “right to live” eventually ruined the people whom it was ostensibly designed to succour.*” Although it was not intended as such, the law was used to force all the poor to work, but the difference between industry wage and the minimal living wage was paid by the county. On surface, this was a brilliant solution—the industry would get a massive pool of labour at low cost, while everyone would get a living wage. This combination of the pre-capitalist norms of social responsibility proved to be incompatible with the demands of the emerging market economy. The provision of a living to the poor interfered with incentives to labour under miserable industrial conditions, and led to declining production, as well as dehumanisation of the poor. The complex economics of this situation was not understood by contemporaries, and was exceptional in any case, being a combination of pre-capitalist and emergent capitalist conditions. The attempt to understand the Speenhamland experience so as to create change for the better led to three important consequences.

### **8.1.1. Creation of Theories Justifying Indifference to Poverty**

One consequence was the understanding that poverty was necessary to the functioning of society. That hunger was the only goad that could be counted upon to get labourers to produce, and without production, everyone would be worse off. Leading statesman Burke is quoted by Polanyi (p. 123): “*When we affect to pity as poor those who must labour or the world cannot exist, we are trifling with the condition of mankind.*” Polanyi (p. 123). Similarly Malthus (1809) argued that excessive procreation of the poor led to increase in the numbers of the poor. Supporting them would only increase poverty by increasing their numbers. The only solution to poverty was to stop the poor from procreating, or even to allow them to die of plague and famine.

It was in the background of such false theories, based on wrong lessons learned from Speenhamland, that the policies enacted in England were formulated. Relief was designed to be humiliating and degrading partly because the poor were responsible for their own poverty, and partly because providing extensive and comfortable relief would interfere with the production process. This came to be widely believed, and was responsible for the abolishment of poor relief, as the following passage from Polanyi (p. 132) indicates:

*That the Poor Law must disappear was part of this certainty. “The principle of gravitation is not more certain than the tendency of such laws to change wealth and vigour into misery and weakness . . . until at last all classes should be infected with the plague of universal poverty,” wrote Ricardo. He would have been, indeed, a moral coward who, knowing this, failed to find the strength to save mankind from itself by the cruel operation of the abolishment of poor relief. It was on this point that Townsend, Malthus and Ricardo, Bentham and Burke were at one.*

### 8.1.2. *Natural Laws of Poverty*

Speenhamland laws created an obstacle to formation of the labour market necessary for capitalism. However they had a disastrous effect on the poor that these laws were meant to help. The reason for this failure identified by Polanyi was the conflict and incompatibility between the mechanisms of a paternalistic and regulatory economy, and the emerging capitalist economy. However, contemporaries who analysed the experience came to the view that there were iron laws governing the economy, which operated outside the sphere of human free will.

*“Essentially, economic society was founded on the grim realities of Nature; if man disobeyed the laws which ruled that society, the fell executioner would strangle the offspring of the improvident. The laws of a competitive society were put under the sanction of the jungle. The true significance of the tormenting problem of poverty now stood revealed: economic society was subjected to laws which were not human laws.” [Polanyi, p. 131].*

Many authors have since realised that the economic realm is not subject to natural laws. Social, political and government interventions of all kinds, small and large, distort the operations of the free markets, and produce desired results of various kinds. In particular, there is no iron law dictating the existence of poverty. If thinking had not been conditioned by false theories regarding the operations of the labour market, the era of plenty which followed would have been enough to eliminate poverty. As it happened, these false theories, and the interests of the emerging capitalist class, provided the basis for the later action. These theories created the possibility of taking shocking and inhuman steps against the poor:

*The Poor Law Reform of 1834 did away with this obstruction to the labour market: the “right to live” was abolished. The scientific cruelty of that Act was so shocking to public sentiment in the 1830 and 1840’s that the vehement contemporary protests blurred the picture in the eyes of posterity. ... Never perhaps in all modern history has a more ruthless act of social reform been perpetrated; it crushed multitudes of lives while merely pretending to provide a criterion of genuine destitution in the workhouse test. Psychological torture was coolly advocated and smoothly put into practice by mild philanthropists as a means of oiling the wheels of the labour mill. Yet the bulk of the complaints were really due to the abruptness with which an institution of old standing was uprooted and a radical transformation rushed into effect. [Polanyi, p. 86].*

As evidenced by the quotes from Burke and Malthus, the enactment of these policies not only de-humanised the poor, belief in these theories also de-humanised the rich. Understanding this impact of economics on the social sphere is essential to correct understanding of anti-poverty policy to this day.

### 8.1.3. *Extreme Faith in the Liberal Creed*

The deliberate crushing of multitudes of lives of poor as an essential offering to the emerging gods of capitalism required a strong faith in the liberal creed. Faint hearts would revolt at the magnitude of misery to be inflicted on the poor. As Polanyi (p. 141) writes:

*Economic Liberalism was the organising principle of a society engaged in creating a market system. Born as a mere penchant for nonbureaucratic methods, it evolved into a veritable faith in man's secular salvation through a self-regulating market. Such fanaticism was the result of the sudden aggravation of the task it found itself committed to: the magnitude of the sufferings that were to be inflicted on innocent persons as well as the vast scope of the interlocking changes involved in the establishment of the new order. The liberal creed assumed its evangelical fervour only in response to the needs of a fully deployed market economy.*

It is worth re-emphasising the complexity of the methodology in use by Polanyi. Emergent puzzling and urgent economic circumstances led to formulation of theories and explanations. These theories posited iron laws necessitating poverty as essential for functioning of an economy, and also put the blame for poverty on the poor. Economic policy conducted in light of these policies affected society by weakling bonds of responsibility and compassion, which affected all social structures. There were also political consequences which are analysed elsewhere by Polanyi, demonstrating further the strong inter-linkages of these three spheres of human existence.

## 8.2. **Commodification of Land**

The idea that land, labour and capital are factors of production was introduced by Adam Smith and the classical economists, and continues to be a key element of contemporary economic theory. One of the key insights of Polanyi is that labour, land and money are “fictional” commodities. Mathematically, the familiar production function  $Y=f(K,L,N)$  represent the idea that we can use these commodities as inputs into the production process for goods. However, labour and land represent human lives and their habitats, which cannot be treated as commodities for many reasons. Commodities are homogenous and can be produced at will. Each human life is infinitely precious, in the sense the no amount of wealth can reproduce it once destroyed. Similarly, each piece of land is unique, and converting it into a habitat for human lives requires patient work over time [Polanyi, p. 193]. If the production process damages human lives, or uses up natural resources or destroys the environment, flora and fauna, this cannot be undone—we cannot produce these “commodities” at any cost. The market subordinates society—human lives and living places as well as social relations—to the demands of organising production. Polanyi (p. 74) writes that “*the change*

*from regulated to self-regulating markets at the end of the eighteenth century represented a complete transformation in the structure of society.”*

In this section, we aim to show that false theories shape our futures, and that this is one of the methodological concepts used by Polanyi in his analysis. This is expressed clearly in the following prescient passage from Polanyi (p. 76).

*“Nevertheless, it is with the help of this fiction that the actual markets for labour, land, and money are organised; they are being actually bought and sold on the market. Now, in regard to labour, land, and money such a postulate cannot be upheld. ... (if land is treated as a commodity then) ... Nature would be reduced to its elements, neighbourhoods and landscapes defiled, rivers polluted, military safety jeopardised, the power to produce food and raw materials destroyed. Finally, the market administration of purchasing power would periodically liquidate business enterprise, for shortages and surfeits of money would prove as disastrous to business as floods and droughts in primitive society.”*

It is the spread and dominance of false theories regarding natural resources and wealth which creates the social possibility of chopping down unique wonders of the world for the production of timber, and the destruction of coral reefs to support production processes. These false theories generate indifference to heart-breaking tragedies like millions of deaths from hunger and malnutrition, and the extinction of rare species. Conventional economic theory ignores the fact that we live on a finite planet with limited resources, and the biological resources have been produced by processes taking millennia, and cannot be reproduced. Because of these false theories equating these to homogenous manufactured commodities, we have to the brink of an environmental catastrophe, without even sufficient recognition of the fact.

## **9. DYNAMICS OF SOCIAL CHANGE**

The main theme of Polanyi’s book is to describe the great transformation which took place in social, political and economic structures of society, as a result of the replacement of a paternalistic and regulatory economic system by a self-regulated market system. In this paper, our goal is to study the methodology used by Polanyi to study this process of social change.

To begin with, we note that Polanyi’s methodology offers a solution to the problem of historical specificity, discussed at book length by Hodgson (2002). If history is to be more than a chronological list of facts, we need to be able to deduce some generally applicable laws from these facts. Yet it seems clear that there can be no significant economic laws which apply equally to the American Indians, Incas, colonial India, and contemporary Europe. Contemporary economics is based on the assumption that self-interested human behaviour is universal. However, there is strong empirical evidence that this is not true; see Karacuka and Zaman (2012) for a survey.

Instead of self-interest, Polanyi argues that human act to maximise social standing. Social standing is defined in different ways in different societies, allowing for substantial variation in behaviour across time and place. The process of social change is triggered by external stimuli. For the great transformation under discussion, this was the invention of machines, which led to the development of industry. This external stimulus locates the discussion within the context of history, making it historically specific. The effects of this innovation, which led to the production of vast amounts of surplus goods, impacted in different ways on different groups. The process of social change, as traced by Polanyi, is built around three different components.

**Theories:** As external stimuli create social change, observers develop theories to analyse the reasons for these changes. Often the novelty of the changes and lack of historical perspective leads to development of wrong theories. For instance the Speenhamland episode led the British economists to believe that poverty was an inevitable accompaniment of progress, and necessary for proper functioning of the production process. Some theories become widely believed, and become part of the spirit of the age. Such theories are adhered to and acted upon by large segments of society, cutting across more narrowly defined class interests. For instance the creed that all problems of mankind could be solved with material resources came to be widely believed. Many other examples of widespread wrong beliefs are provided by Polanyi in his analysis. These theories provide an analysis of changes and prescribe potential solutions. These ideas are translated into practice by two means.

**Classes:** Social classes, groups with aligned interests, act to achieve their goals. To the extent that interests of certain classes are aligned with the spirit of the age, they can achieve power and also help to propagate theories which conform to their interests. In fact, classes can be created and destroyed by external events. The industrial revolution brought a new class of producers into existence, and also doomed the “Squirearchy”—a powerful class of rural landlords. This is because the power of this latter class was based on land and the rural population, both of which became factors of production in the industries. Conflicting as well as aligned class interests create one of the dynamics for social change. But there are many other dynamics that must be taken into account. One that is stressed by Polanyi is the necessity for combined action, cutting across narrow class interests, to achieve change. Widely believed theories create universally appealing social goals, and allow for such coalitions.

**Institutions:** At the social level, all change must be mediated through institutions, which provide a concrete and operational mechanisms for the achievement of social goals. Institutions have different characteristics and capabilities, which must be taken into account to understand their effectiveness. For instance, the gold standard was an institution that permitted international trade. This was beneficial to the traders, as well as the rich and powerful. However, normally occurring trade imbalances would lead to fluctuations in



general price levels. In a highly interlinked system, a fall in the price of exports could lead to bankruptcy for exporters, seriously disrupting the global trading system. Many methods were devised to resolve this problem, but the first world war created such huge imbalances that gold standard could not be maintained by the leading countries. The collapse of the gold standard was an external shock which created its own dynamic for further social change. These changes are traced by Polanyi. The methodological point being made here is that although institutions can (and often do) serve certain class interests, their effectiveness and failure can depend on exogenous events as well as technical issues relating to the environment (social, political, and economic) within which they operate.

## 10. CONCLUSIONS

It should be obvious from the discussion above that the methodology used by Polanyi is radically different from those currently in use, at least within economics, but also more generally within the social sciences. One of the key elements of the methodology is the interaction between the observer and the observed, which allows for human agency in shaping history. History is not subject to laws which propel it in certain directions. Rather human attempts to understand historical experience are represented by theories. These theories shape responses to this experience, which then become part of history. Because theories are formulated to understand historical experience, they must be evaluated within the context of this experience.

If theories are not universal invariants, as is widely believed, then the current theory about Polanyi's methodology must also be evaluated within its historical context. This is easy to provide. After the global financial crisis of 2007, there has been widespread discontent with conventional economic theories, which did not provide any warning signs. The failure of economic theory was so obvious that a Congressional committee was formed to investigate it. In written testimony for this committee, Nobel Laureate Solow stated that "A thoughtful person, faced with the thought that economic policy was being pursued on this basis (DSGE models), might reasonably wonder what planet he or she is on." Dramatic failures of conventional methods lead to search for alternatives. This research is part of the effort, being made on many different fronts, by many different researchers and groups, to find satisfactory alternatives.

One of the key contributions of Polanyi is to demonstrate the close linkages between the political, social and economic spheres of human existence. This is exemplified by the main theme of his book, which is the transformation of social and political systems which resulted from economic changes produced by the Industrial Revolution. As another example, he argues that the global trading system based on gold created a powerful peace interest. Breakdown of the gold standard led to autarchic economies, which became a root cause of World War II. The methodological point here is that such causal chains cannot be contemplated

within the framework of current discipline boundaries between politics and economics. For example, ignoring political, social, and environmental consequences lead to highly misleading evaluations of the costs and benefits of economic growth, as shown in Zaman (2014). Polanyi's methodology offers us new ways of looking at the world around us.

To some extent, a methodology may be assessed by asking whether or not it leads to the right conclusions. Thus we could ask if Polanyi's analysis in the "Great Transformation" correct? This is far too big a question to be handled within the confines of a short article. Its perennial popularity and the high praise the book has received certainly suggests that the methodology underlying the analysis is worth contemplating. Some critics have faulted Polanyi for the wrong prediction that World War 2 was the end of an era, and some new economic system would have to be devised. Although there were no radical changes, Keynesian economics came to be nearly universally accepted. This provides a theoretical basis for supporting workers and the unemployed which is absent from the classical economics. Keynesian theory created protection for the society from the harms caused by the commodification of labour. This can be considered as a partial fulfilment of Polanyi's prediction.

Another virtue of Polanyi's methodology is that it offers solutions. Recent wars have cost trillions, sufficient resources to assure everyone on the planet of a comfortable living standard. Polanyi argues that the underlying spirit of the market economy is pursuit of wealth and luxury, which is not compatible with the goals of peace and freedom. He writes that "*We will have consciously to strive for them (peace and freedom) in the future if we are to possess them at all; they must become chosen aims of the societies towards which we are moving.*" [Polanyi, p. 263]. The right of an individual to a job should be at the top of the list of rights needed for ensuring freedom. If Polanyi's ideas about social change are correct, the first step should be creating global consensus cutting across class interests on the goals of peace and freedom. The second step should be creations of institutions necessary to translate this spirit into effective action. On this account, heterodox economists should focus on creation of consensus and effective institutions to bring about social change.

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