

Understanding Market Dynamics II

- Polanyi

Introduction

- Divergent perspectives between Adam Smith and Karl Polanyi:
 1. Market
 2. Division of Labor
 3. Motivations for Transaction
- Divergent perspectives on world development according to Smith and Polanyi

Smith on Division of Labor

- Benefits of the division of labor: to increase productivity
- Example: divide the procedures of making a pin into several distinct operations. All are performed by distinct hands
- Where does the productivity come from?
 - 1) improve dexterity through repeating the same task; 2) saving of time; 3) application of machinery, invented by workers or by mechanists

Adam Smith (1723-1790)

- “An Inquiry into the Nature and Causes of the Wealth of Nations” (1776): the founding thesis and doctrine of modern economics
- Background of Smith’s Thoughts: the Industrial Revolution in Western Europe and Britain’s relationship with its colony in North America
- Transition from Feudalism, Commercial Capitalism to Industrial Capitalism (16th.-19th. Centuries)
 - 1) the collapse of the feudal power and the rise of the bourgeoisie (the urban capitalists: revenues from business profits but not from rent)
 - 2) the rise of the absolutist states—mercantilism; commercialization as a national policy
 - 3) the rise of industrial capitalists--industrial revolution

What is the market?

- Marketplaces: the agora, souq, bazaar
- The idea of the self-regulating market (has this idea ever been fully realized?)
- Ordinary “market economies:” some are very free/unregulated, some are more regulated but still essentially market-based

Adam Smith on Market (1): market and the division of labor

- Market—or more concretely, human’s propensity to truck, barter, and exchange one thing for another—facilitates the division of labor
- Motivations of market exchange: self-interest
- The result of market exchange: differentiation and specialization among people
- Application of Smith’s principle on division of labor: the concept of “comparative advantage”

Smith on Market (2): the nature of market

- A self-regulating market: Market price is regulated by the quantity brought to market and the effectual demand
 - When supply exceeds effectual demand: the actual price falls below the natural rate
 - When supply falls short of the effectual demand, the market price rises above the natural price
 - When supply is equal to effectual demand, the market and natural price coincide
- Natural price of a commodity: based on the cost of land, labor and materials
- “Effectual demand” vs. Absolute Demand
 - “Effectual demand”: demand from someone who can afford the commodity
 - “Absolute demand”: demand from all people who want to own the commodity, but not all of them can afford it.

Karl Polanyi



October 25, 1886 - April 23, 1964

Born in Vienna

Best known for - The Great
Transformation

Karl Polanyi (1886-1964)

- His most famous work, “The Great Transformation”, published in 1944 (wrote during the World War II.)
- Background of Polanyi’s Thoughts: the puzzles over the chaotic world war and the rise of Fascist regimes from the 1930s
- The self-regulating market in Adam Smith’s terms, for Polanyi, was a product of a particular political-economic setting during the late eighteenth and early twentieth centuries.
- Under the influence of anthropologist research, Polanyi believes that the understanding of primitive societies would shed light on our understanding of how livelihood should be.

The Great Transformation

- The Four Features of the 19th Century Economic System
 - 1) The balance of power system
 - 2) The international gold standard
 - 3) The self-regulating market
 - 4) The liberal state

The Great Transformation

- The end of the 19th century economic system leads to either fascism (merely responds to dissatisfaction with the malfunction of a market system) or a new conception of liberalism
- Polanyi concludes that the intrinsic processes of the 19th century economic system were the mechanisms of its own destruction
- The utopian dream of the self-regulating market failed, and the future economic order cannot make the mistake of institutionally separating politics from the economy

Critique of Liberalism

- Critiques liberal economic theory, especially two core assumptions:
 - 1. Assumption that the market is a uniquely “natural” form of economic organization of society
 - 2. Assumption that human economic behavior is naturally, inevitably motivated by the goal of maximizing profits

Polanyi on Division of Labor

- “Men’s economy is submerged in his social relationships”. These relationships are integrated.
- Material motives (such as hunger and gain) should not dominate the economy.
- Three components in economic activities (they are also forms of integration):
 - 1. Reciprocity: given-and-take principles (symmetry, regarding two or more axes)
 - 2. Redistribution: the allocation of goods is collected in one hand and takes place by virtue of custom, law or *ad hoc* central decision (centricity, integrating groups at all levels and all degrees of permanence from state itself to units of a transitory character)
 - 3. Market Exchange: (exchange under a price-setting mechanism).

Four Types of Economic Behaviour

Practices

Redistribution

Reciprocity

Householding (œconomy)

Exchange, barter, truck

Patterns

Centralization

Symmetry

Autarchy

Markets

- Economic systems contain these practices in varying degrees and scales.
- An economic system is defined by the most dominant of the practices.
- Early economies were based on Reciprocity, Redistribution and Householding.
- It is only within the last 400 years that market patterns have become dominant.

Pre-Market Societies

- If the market economy is so new, what came earlier?
- Reciprocity and/or redistribution-based economic systems
- Example: Trobriand Islanders of Western Melanesia. Families provide for their own, redistribution takes place through feasts
- Mercantilism: pursuit of national security & power limits international cooperation/trade

How Market Systems Developed

- Barter and exchange did not lead to the establishment of markets, barter and exchange has existed in other societies where reciprocity or redistribution were the prevailing practice.
- Market patterns create their own institutions – markets!

Polanyi on Market (1)

- Market: Markets are not institutions functioning mainly within an economy, but without. They are meeting places for long-distance trade.
- “The societal effects of individual behavior depend on the presence of definite institutional conditions, these conditions do not for that reason result from the personal behavior in question”

Polanyi on Market (2)

Three Elements

- 1) Trade: the actual exchange:
 - Gift trade (i. e. guest friends);
 - Administered trade (i. e., the Canton System in Qing China, 1757-1842)
 - Market trade (exchange is the form of integration that relates the partners to one another)
- 2) Money: the means of indirect exchange (cf. barter):
 - Money is used for payment;
 - Money is used for the equating of amounts of different kinds of goods for definite purposes (e. g., X pieces of pork for Y boxes of tea) *
- 3) Market: the locus of exchange;
 - Market vs. Exchange: exchange at bargaining rates or at set rates
 - Two separate and distinct market elements: supply crowds (those desirous to dispose of goods) and demand crowds (those desirous to acquire goods)—they need not be present together

Polanyi on Market (2)

How is the price set up?

- “Price” is here subsumed under the category of equivalencies.

1) Unlike our conventional understanding of price, it does not fluctuate. It is originally a fixed or set rate.

2) It is the designation of quantitative ratios between goods of different kinds.

Critiques

- Market Economy is based on self-interest and is therefore an unnatural foundation for a society
- The institutional separation of politics and the economy bought a peculiar form of freedom, but did so at the costs of justice and security

“Polanyi’s Critiques on Smith’s Ideas on Market:

- “A self-regulating market demands nothing less than the institutional separation of society into an economic and political sphere.
- Such an institutional pattern could not function unless society was somehow subordinated to its requirements.
- A market economy can exist only in a market society. ...
- A market economy must comprise all elements of industry, including labor, land, and money.....
- But labor and land are no other than the human beings themselves of which every society consists and the natural surroundings in which it exists.
- To include them in the market mechanism means to subordination the substance of society itself to the laws of the market”

How Market Systems Developed

History of how market systems developed:

- Markets developed where there carriers of long distance trade would halt.
- Ports developed at places of transshipment.
- Towns were founded on the sites of external markets.
- Burgess could not prevent capitalists from making markets.
- Capitalists evaded local town rules by trading in other geographical locations.

In market societies, markets control social relations.

- *Instead of the economy being embedded in social relations, social relations are embedded in the economic system.*
- Market systems allow people to accumulate limitless amounts of wealth.

Caution with Centralized Power

- Redistributive power also tends to enmesh the economic system proper in social relationships.
- If there exist unequal relations between people, redistribution will also be unequal.

The Power of Reciprocity

Reciprocity Norm – A social norm by which the receipt of positive from another person requires you to reciprocate, or behave similar in response (Aronson, Wilson, Akert, Fehr, 2010)

Is an innate drive that all humans possess (Saad 2007)

Played an important role in pre-capitalist economies (Polanyi, 2001)

Is an important tool for social influence (Caldini, 1999)

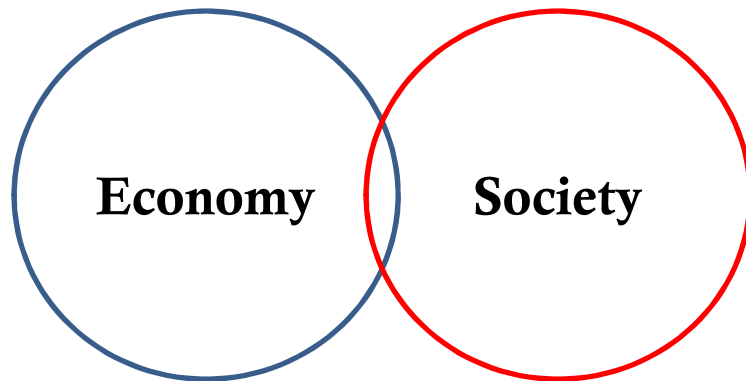
Can we build an economic system based on reciprocity today?

The Great Transformation

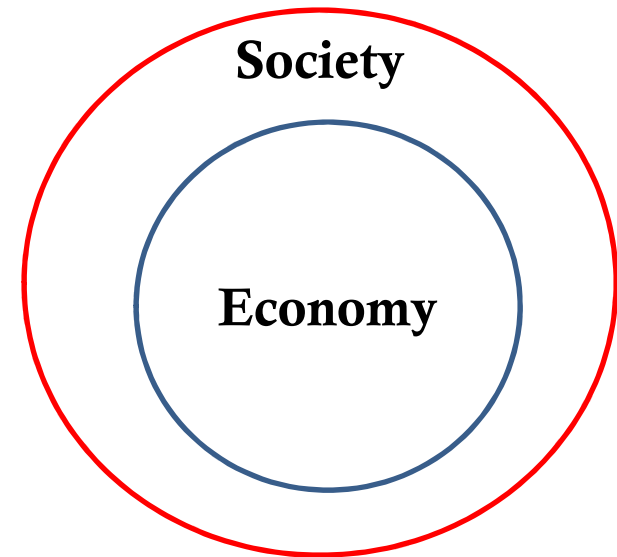
- To the degree the liberal market expanded in industrial Europe, it created counterpressure among the social groups most vulnerable to its excesses, especially labours
- As labours mobilized, it increasingly sought through politics the social protection that the economic order could not provide, but in so doing undermined the market system itself
- A truly self-regulating market will never again be the core of the international order because labour, land, and money have been pulled out of the market

Economic & Social Relations

- In a market economy, economic activities are no longer submerged in social relations. Social relations become submerged in the economy.



Smith



Polanyi

What are Polanyi's assumptions?

- What motive does Polanyi focus on?
- Reciprocal and redistributive systems still feature ritualized exchange, self-interested behavior
- However, Polanyi emphasizes the desire for social status and subsistence vs. the desire for maximum profit & accumulation for accumulation's sake

The Industrial Revolution

- The mechanization of labor changes the context in which policymakers and laypeople make choices
- Far greater productivity becomes possible, but the transition will not be smooth
- This transformation paves the way for the commodification of land, labor, and money: the three “fictitious commodities”

Role of State in Creating Markets

- “Laissez-faire was not a method to achieve a thing, it was the thing to be achieved”
- “Laissez-faire was planned; planning was not”
- Disembedded Economies
- “Our thesis is that the idea of a self-adjusting market implied a stark utopia . . .”
- Labor, Land and Money

Effects of Policies on Society

- The commodification of land, labor, and money cause severe hardships for large groups of people
- Polanyi argues that extreme degrees of deregulation & privatization will always threaten society, provoke social protest

Commodification of Land *Enclosures*

“ Enclosures offer an example. In retrospect nothing could be clearer than the Western European trend of economic progress which aimed at eliminating an artificially maintained uniformity of agricultural technique, intermixed strips, and the primitive institution of the common.”



Effects of Commodification of Land

- Enclosures increased the value of land,
BUT:
- left the common laborer utterly dependent on employment
- Also, conversion of formerly common land to pasturage reduced employment, damaged the land through erosion

Commodification of Money

The International Gold Standard

- Money = another name for a commodity used in exchange more often than another!
- 1844 the Bank Charter Act
- Global Market Place Without Global Government!
- *“Gold standard and constitutionalism were the instruments which made the voice of the City of London heard in many smaller countries which had adopted these symbols of adherence to the new international order”*

Commodification of Labor



-Bracero Program, 1960s

Commodification of Labor

End of the Poor Laws

- The full Commodification of Labor came after land and money
- Poor Laws and Paternalism
 - Tudors and the Stuarts (Stewarts)
 - Speenhamland, 1795
- 1834 Poor Law Amendment
- The Poor Law Amendment represents the starting point of Modern Capitalism!

Effects of Commodification of Labor

- Poor Law reform in decade following 1834 brings about transition to mkt society (or closest example we've ever had).
- Act abolishes the “right to live.” People could move into workhouses, but these were so degrading/full of destitute people that many poor families refused, became homeless and starved.

Effects of Commodification of Money

- Why did the supposedly self-adjusting mechanism of the Gold Standard fail?
- “central banking and the management of the monetary system were needed to keep manufactures and other productive enterprises safe from the harm involved in the commodity fiction as applied to money.”
p. 138

Comparison

What motivates us to work?

What would be the most appropriate way to distribute our products?

Who are eligible to share the products?

How common are markets?

How to put markets into context?

Adam Smith:

- “Economic Men”
- Division of Labor is based on market
- The separation of land, labor and capital

Karl Polanyi:

- “Social Men”
- Division of Labor is based on social relationship
- The integral relationship between land, labor and capital

The Double Movement

“Trading classes had no organ to sense the dangers involved in the exploitation of the physical strength of the worker, the destruction of family life, the devastation of neighborhoods, the denudation of forest, the pollution of rivers, the deterioration of craft standards, the disruption of folkways, and the general degradation of existence including house and arts, as well as the innumerable forms of private and public life that do not affect profits”

**People had to fight back or it would have been the destruction
of Human Society!**

Socialism versus Capitalism in Polanyi

- Capitalism: Utopian vision the state is trying to achieve!
- Socialism: The tendency inherent in an industrial civilization to transcend the self-regulating market by consciously subordinating it to a democratic society

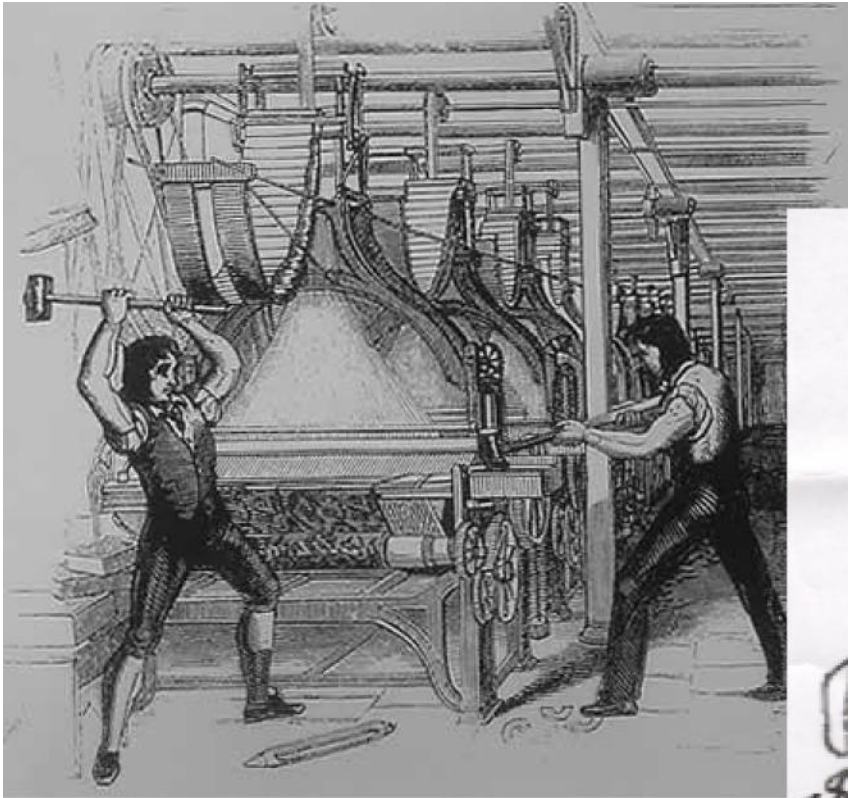
Double Movement: Speenhamland

- Speenhamland: a set of laws implemented in 1795 to protect people from starvation
- People paid based on a scale, irrespective of their earnings and job
- Ended in 1834

“If Speenhamland had overworked the values of neighborhood, family, and rural surroundings, now man was detached from home and in, torn from his roots and all meaningful environment”



Double Movement: Industrial Revolution and Luddites

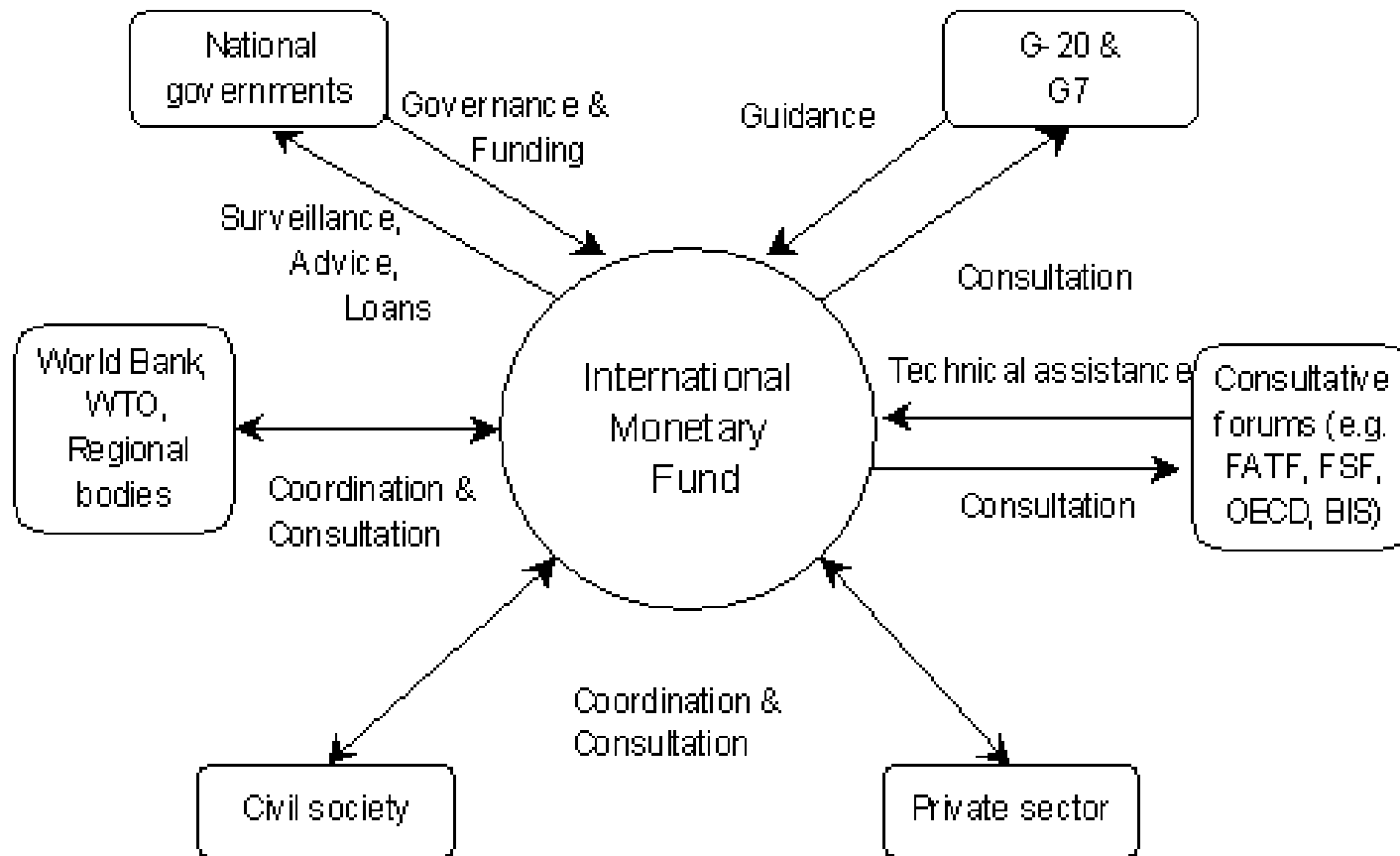


Double Movement: New Deal, Bretton Woods

- Recession, Business Cycle, Keynes
- “New Deal started to build a moat around labor and land, wider than any ever known in Europe.”
- New Intl. Economy: Bretton Woods, 1944

As long as [man] is true to his task of creating more abundant freedom for all, he need not fear that either power or planning will turn against him and destroy the freedom he is building by their instrumentality. This is the meaning of freedom in a complex society; it gives us all the certainty that we need” -- Polanyi

Bretton Woods System



Double Movement: Neo-liberalism and Anti-Globalization





Another Double Movement?

- Does today's financial crisis and the reactions to it this crisis represent another version of Polanyi's double movement?
- Are movements for regulation today strong enough to swing the international political economy away from the neo-liberal ideals that have dominated for the past 30 years?
- Is this the end of classical liberalism?

Should we take Smith seriously?

- Most economists and developmental agendas are based on Smith's ideal.
- Example: the World Trade Organization
 - Reference on WTO and Smith's thesis: Article: ["Who Needs the WTO?" \(Economist, December 2nd, 1999\)](#)

Should we take Polanyi seriously?

- Douglas C. North, the 1993 Nobel-Prize winning Economist does. (Institutional economist on the institutionalization of property rights and economic growth in Western Europe)