

Michael Polanyi's Full Employment and Free Trade in the Context of the Second World War¹

by

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EXTENDED ABSTRACT

Historical Context and Free Trade

The book *Full Employment and Free Trade* started to be written in 1942 and was finished in 1945 (Polanyi, 1945). With this chronology, thinking about the international historical context of the Second World War is difficult to avoid.

One could believe that war tactics and the development of the war itself was the only objective of governments involved during the war years. Nothing further from reality. Thinking about political economy in the middle of the war was crucial. The president of the United States of America, Franklin Roosevelt, and the prime minister of the United Kingdom, Winston Churchill, celebrated an encounter in the Atlantic Ocean in 1941, in the middle of the war. The purpose of these meeting was discussing the principles under which the economy would rule and the positions the governments would take in the international sphere once the war was over. This meeting was extremely influential. The document that came out of this bilateral meeting was the *Atlantic Charter*, basis of the foundational document of the United Nations.

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There is a lot of economic policy in the *Atlantic Charter*. Despite its brevity, barely one page, it presents 8 principles that were not to be taken as a formal treaty, but rather as a declaration of intentions. They “...deem it right to make known certain common principles in the national policies of their respective countries on which they base their hopes for a better future for the world.” (Atlantic Charter, 1941). The majority of these 8 principles refer to abrogate territorial invasions and commit to disarmament, which are maybe the most well-known and do have direct connections to the economy. But it does not stop here. What maybe many people do not know is that the fourth, the fifth, and the seventh principle make explicit reference to free trade, one of the pillars of Polanyi’s writing during the wartime.

The fourth principle of the Atlantic Charter is free trade. As it reads,

“...they will endeavor, with due respect for their existing obligations, to further the enjoyment by all States, great or small, victor or vanquished, of access, on equal terms, to the trade and to the raw materials of the world which are needed for their economic prosperity.” (Atlantic Charter, 1941).

Indeed, this principle is promoting free access to international markets. It is something new, especially thinking now of the old great British Empire, which traditionally defended anything but free trade. So agreeing to this principle was quite remarkable.

In my opinion, we need to understand this change in a context of an already globalized world, in which sticking to the old monopoly and monopsony powers imposed by the use of force would no longer pay off. Think of the large cost that sustaining not only the troops and fortresses but also the over dimensioned bureaucratic apparatus would suppose for the old metropolis. Would it make sense to continue sustaining these huge costs in a world where everyone could go and buy either final products or raw materials in a free market at a competitive price?

The fifth principle of the Atlantic Charter was aimed at establishing minimum international standards in the labor market. It reads

“...they desire to bring about the fullest collaboration between all nations in the economic field with the object of securing, for all, improved labor standards, economic advancement and social security” (Atlantic Charter, 1941).

In my personal view, the interest in establishing international labor standards evidences the interest in spreading to other countries, economically speaking, in a business context. The mid-twentieth century was the *époque* of diffusion of the multinational companies as an organizational form. In order to achieve the diffusion of this new organizational form, achieving a minimum standard for the worker's conditions in the receiving countries seems if not absolutely necessary at least desirable or facilitating.

Along the same lines sketched in the fourth principle goes the seventh principle of the Atlantic Charter. "...such a peace should enable all men to traverse the high seas and oceans without hindrance." (Atlantic Charter, 1941). Such a poetic principle makes reference to the necessity to be able to traverse the seas and oceans without obstacles in order to achieve free trade around the world. In other words, this would be the idea we now have of the concept of international waters.

The other inflation point of the economic policies promulgated during the war was the United Nations Monetary and Financial Conference. This conference is most remembered as the Bretton Woods conference, which was held in this American locality in 1944, one year before the end of the war and the conclusion of the book writing by Polanyi. This conference was a multilateral international summit held to agree upon the economic principles that would govern the world economy after the war. The most important supranational institutions that establish the dictates of the international economy today, like the precursor of the World Bank or the International Monetary Fund, were designed in this conference.

Although 44 countries were represented in the Bretton Woods summit, the two most influential economists were Harry Dexter White, economic adviser to the president of the United States of America; and John Maynard Keynes, the British counterpart. It is a fact that they did not have coinciding ideas with respect institutional design for the world after the war. On the one hand, Mister White defended free movement of capital, monetary discipline, and an organism with a reduced financing capacity. On the other hand, Mister Keynes proposed greater exchange rate flexibility, exchange policy autonomy for every nation, and the creation of an organism with greater financing capacity and equally shared responsibility for all nations (Nemiña, 2010).

The divergence of ideas corresponds to the divergence in economic interests of their respective nations. On the one hand, the United States was the main exporter of the time. This position was already visible during the First World War, and was yet reinforced during the Second World War. It was therefore the issuer of the main reserve currency, and had the largest world reserves of gold. This puts the United States into a strong position in the negotiations' table. On the other hand, the interest of the United Kingdom was promoting flexibility to a larger extent because they needed to reconstruct their economy, damaged by the war. Not only the United Kingdom, but most of the European countries, had large war debts and an alarming dollar gap that they needed to overcome in order to reconstruct their economies. At this respect, Keynes was defending not only the economic interests of the British but also of most European nations. What ended up happening was something much closer to White's plan, still with a lot of elements of Keynes' ideas, which have been very influential throughout the twentieth century and still today.

Polanyi the disseminator

One of the greatest defenders of Keynes' ideas was Michael Polanyi. This fact is clearly illustrated in the book *Full Employment and Free Trade*. Polanyi's pretention is not to bring Keynes' theories further but rather to disseminate them so that they become common knowledge (Polanyi, 1945: v). He was a disseminator. This is also seen in the film "Unemployment and Money", a diagrammatic film that explains the price-specie-flow mechanism to the average citizen (Polanyi, 1940). Polanyi's objective is to speed up the understanding of Keynes' theory of unemployment (Polanyi, 1945: xii). It is for this reason that he made the film, personally demonstrated it to a hundred audiences, and wrote the book *Full Employment and Free Trade*. In fact, he used his experiences with the film audiences in order to write the explanation of Keynes' theory in the book. In this sense, the film was the exploratory preparation for the book. In here we can see the interactive character of Polanyi's works. He once more, expresses his interest in bringing the basics of economic science to the general public.

But he still goes one step further. Polanyi is considering the opening of a "democratic process of discussion on Keynesian conceptions" (Polanyi, 1945: xii). He does not go

further in the explanation of what should this democratic process of discussion be. We could read from this that he was thinking of a forum, in one platform or another, where citizens could have exchanges of ideas on Keynes' conceptions. So Polanyi's will to disseminate Keynes' ideas goes deep into the core of society.

Previous History and Unemployment

In the book, Polanyi shows his concern about the return of unemployment that the end of the war will bring (Polanyi, 1945: vi). Knowing about the horrors of the Great Depression in the United States of America and its spread to other parts of the world including Britain, who came from suffering high rates of unemployment throughout the 1920s as well, the greatest fear is returning to the same situation of the previous decades. Bear in mind that the capitalist economies had been characterized by its *laissez-faire* economic policy during a much extended period of time, culminating with the so-called First Globalization. In this period, European investors, excited with the capital earnings from the Industrial Revolution, ventured their capital abroad, and the US economy had the greatest attraction power of all. On the one hand, there were the push factors for European Economies: Demographic pressure was starting to create a downward tendency in wages. This will create a push to emigrate. As for the capital factor, the industries once pioneers of the Industrial Revolution were no longer so up-to-date in the old continent. On the other hand, we have the pull factors: These are factors of attraction to the new world, which was offering a brand new set of opportunities both for international investors and for immigrants. The latter were attracted by the wage gap existing between the cramped old continent and the new world, with much lower population densities. Firms were designing plans to attract workers, and unemployment was the last of the worries. This was all happening around the turn of the twentieth century.

Under these context of economic prosperity, few would think of restricting the economy, which was left to the most liberal capitalism. The First World War was a serious disruption of the globalization process, but the US economy still came out economically benefited from it. Its gross domestic product would not stop growing and it was the only country in the international sphere with no difficulties to return to the

gold standard after the war. Direer consequences had the Great Depression, which hit the economy as no other crisis of the capitalist system had done before.

It is from this context that we can understand the serious concerns of Polanyi about returning to unemployment, and its emphasis in divulging Keynesian ideas, linked to mitigating the effects of economic crisis in general and unemployment in particular. Indeed, Keynes has been the most influential economist of the twentieth century at this respect. At the time of writing the book, Polanyi was concerned about how long it took for Keynesian ideas to spread, and was full of a sense of urgency (Polanyi, 1945: vi).

It is striking to realize how Polanyi was aware of the sense of responsibility that should lie on the United States of America at the end of the Second World War. He points out that the United States should undertake modern employment policies in order to avoid the next Great Depression (Polanyi, 1945: vi). And in fact history confirmed that this was the case. 1947 was the year in which Secretary of State General George Marshall gave the famous speech that led to the European Recovery Program (1948-1952), most known as the Marshall Plan. Not that Polanyi envisaged such a plan, but yes to the fact that he realized the power of the United States.

But not only for America, he also envisaged that Europe would be affected by the unemployment swirl. However, the desperate economic situation of Europe right after the war was not due to an American economic crisis engulfing the European capitalist countries, as Polanyi seems to imply. The European situation was due to the direct consequences of the war, which had been the most destructive war ever so far.

Who needed who? Was it that Europe needed the United States to help them recover from the war? Or was it that the United States needed Europe? We could claim that both situations are true. Polanyi realizes the economic interdependence between the United States and Europe at the time of the war, and warns the readers.

From Unemployment to Full Employment

If there is one program famous for bringing a nation to full employment, this is the *Arbeitsbeschaffungsprogramm* of the nazi Germany. “There were six million registered unemployed in Germany when Hitler took power in 1933; (...) within two years that

figure was reduced to one-third” (Polanyi, 1945: 79). One of the pillars to this massive employment program was rearmament and preparation for self-sufficiency in wartime. A lot of attention has been devoted to this particular program for the Nazi Germany. However, the Germans were not the only nation preparing for war. Britain started its rearmament program in 1937. By 1939 the two countries reached full employment. This coincided with the outbreak of the war. Polanyi claims that the British rearmament policy stimulated employment in the United States, which soon was involved into armament production as well (Polanyi, 1945: 79). Actually, 1939 is considered to be the year of full recovery from the Great Depression for the United States of America.

Once more, Polanyi is a defender of the Keynesian policies applied in these three countries during rearmament. In all these cases we can observe some budget deficit. Polanyi claims that this is the real reason to economic recovery and full employment, not the paradigmatic fascist policies, such as price-fixing schemes or rationing (Polanyi, 1945: 80). He argues that a similar expansion of the economy would have happened should the same funds been spent privately instead of on behalf of the public sector.

The Creation of a World Bank

As a result more of the First World War than of the Second, Europe was eventually divided into multiple national territories with different currencies. This poses extra difficulties to international money circulation. With the idea of supporting international circulation of money, Polanyi proposes the creation of a World Bank, which would act to solve imbalances in the international economy. This bank would have a twofold objective: First, foresee the imbalances in the balance of payments between countries and handle them by direct intervention in the exchange market. And second, ease regional economic depressions by means of loans and subsistence allowances.

At the same time, Polanyi thought there was a great distance between this theoretical setup to the practical implementation of such an institution. Polanyi saw “scarcely reasonable to set up new institutions and to discuss their future policy at international conferences” because he did not believe in the favorable position of the United States, who were strict in their balanced budget policy at the time (Polanyi, 1945:122).

Paradoxically, Harry White as representative of the United States of America in the Bretton Woods conference presented the White Plan, which proposed the creation of such an institution. And this is how the International Monetary Fund came to be. In fact, Harry White is considered to be the father of the International Monetary Fund (IMF). The IMF was created as a supranational monetary regulatory authority that would supervise the newly created international monetary system and intervene when necessary. It was created with the intention of granting short term loans to nations that suffered temporary imbalances in their balance of payments with other nations. Precisely what Polanyi's World Bank had to do.

What we today know as The World Bank was created as the International Bank for Reconstruction and Development (IBRD). Its role was different from Polanyi's World Bank, which is much closer to the initial goals of the IMF at its creation. The IBRD was created with the intention to grant long term credits to nations that were in need to reconstruct from the war; and also for those nations that were in their way to economic development. Meanwhile, the IMF was in charge of the surveillance of the international monetary system.

With the fall in the early 1970s of the international monetary system enacted at Bretton Woods, the IMF deemed no longer necessary as policemen of a system that no longer existed. In the last decades, the role of the IMF has been moving more towards overlapping the tasks initially designed for the IBRD.

References

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