

MEASURING PROSPERITY AND PRESERVING FREEDOM: AN ECONOMICS EDUCATION WITH MICHAEL POLANYI



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ABSTRACT

In a time of heightened economic and political insecurity, sustained prosperity is a reasonable public goal. But it is not sufficient on its own as a bulwark against the misguided economics of collectivist regimes, nor can it easily resist what in the past have been their stunning descents into tyranny. Michael Polanyi argued that the collective purpose of the community had to be based on something other than mere class struggle or civil unrest. Raising the bar for the common man to comprehend the logic of the trade cycle, and to appreciate the macro-dynamics of unemployment in the face of curtailed demand, was one small, but highly significant, step towards the prevention of civil war and the promotion of prosperity with justice and freedom. The present is surely as good a time as any to renew Polanyi's call for an economics education for the common man, and to reassert the moral principles upon which it rests.

“Is it, then, time for Liberalism to return to charge with the fervor of its early intransigence, which it professed up to about seventy years ago, before beginning to give way to the growing claims of collectivist ideas? I believe this to be justified to [a] certain extent.”

—From: “Collectivist Planning,” a talk given in April 1940 by Michael Polanyi (*SEP* 138).

At the time of writing this essay, the world finds itself at a crossroads of global economic uncertainty, notable for its great disparities in wealth and access to resources; for large-scale movements of displaced persons, often fleeing from mortal ideological struggles; and for widespread anxiety about the very preservation of “western” or liberal values and freedoms. This is a place we have been before, but where many had somehow believed, or perhaps just hoped, we would not arrive again. What better time then, than to revisit the ferment of economic thinking that emerged in the 1930s and 40s in response to world war and a global economic crash of then-unparalleled scope. In particular, what can we learn from that episode about the connections between economic policy-making, political movements, and the standard of living?

What follows are the reflections of an economic historian of another period altogether (medieval and early modern Europe), but one who is concerned about the tools we use to measure the standard of living, as well as eager to discover how this measure might be improved upon, and to understand those things that might derail its progress. Here we ask in particular how all of these questions were understood in the crucible of war, tyranny, and global depression in the first half of the twentieth century. The central character in this exploration is Michael Polanyi, known to many for his path-breaking research and teaching in physical chemistry up to the middle of the 1930s, to even more for his path-breaking contributions to the field of the philosophy of science in the post-war period, and to only a relative few for his remarkable insights into the functioning of the macro-economy, which was the focus of Polanyi’s incisive analytical mind during the brief period between the latter years of the 1930s and the immediate aftermath of WWII. But before we can address the critical questions raised by the turmoil of that period, we are well served to start our investigation even earlier in the eighteenth century at the onset of “liberal” economic thought.

Adam Smith grounded his famous 1776 critique of the political economy of mercantilism on the charge that it was a system inimical to advancing the material and social welfare of people. Instead of looking primarily to the needs of the consumer, mercantilism privileged the financial interests of those who produced and sold goods, and by extension the interests of those with the power to tax that production. In what was for the late eighteenth century a remarkably bold and unusual claim, Smith pictured a very different kind of economic system. He argued that “consumption is the sole end and purpose of all production; and the interest of the producer ought to be attended to, only so far as it may be necessary for promoting that of the consumer” (Smith 1976 2:179). Looking back on this statement from the vantage point of more than two centuries of economic development, it is easy to overlook what a radical departure this assertion represented from the dominant thought of Smith’s day, and certainly from the economic expectations of all those who had come before him. For his was a claim that was itself a product of the already significant economic achievements of the late

pre-industrial period in England and a harbinger of what would eventually come to be known as modern economic growth. Without the sustained growth of goods and services that came to outpace even sizable increases in population, a political economy based on the needs and wants of the general consumer would not have even been conceivable.

Writing in the half century after the publication of *The Wealth of Nations*, Thomas Malthus still conceived of a world governed strictly by the iron law of population. According to the rhetorical premises of Malthus' political economy, the consumption possibilities of the common man were not of themselves a good even worth striving for. Not only did Malthus believe that population would always outstrip any advance in productive capacities, but he was also not terribly concerned about the implications of that (ultimately dubious) fact for the quality of life for the mass of poor people. The stark difference between the dismal world of the Reverend Malthus and the hopeful vision of Adam Smith is captured remarkably well by an exercise I do regularly with the undergraduate students in my European economic history survey course. We begin with the cost of outfitting Columbus' first voyage in 1492 and attempt to make a price index that will allow us to estimate the cost of the same voyage in contemporary dollars. What the students discover is that the choice of metric matters a great deal. When the expedition is priced out using labor costs (building wages from the late 15th century compared with those of a carpenter's assistant today) the current cost appears to be on the order of 30 to 200 times more expensive than if we utilize the price of gold (with the highest relative cost of the available comparison commodities), silver (the lowest), or wheat (in between the two metals) as our standard of comparison.¹ We find that the relative remuneration of labor, even unskilled labor, has increased many times faster than the price of any given commodity during the centuries that separate us from the voyages of Columbus. This is, of course, just another way of saying that economic development has taken place. For development is fundamentally about being able to set great value on human beings and the labor power and human capital they embody, not just for an elite few, but for many, most, or ideally even all.

By the early decades of the 20th century this process of development had already yielded a tremendous increase in the average standard of living, at least in the parts of the western world that were the first beneficiaries of the industrial revolution and the crucible for the "liberal" economic ideals that were its companion. Yet despite the overwhelming rise in the material living conditions of the majority of Europeans that had transpired since the time of Adam Smith, and despite the unprecedented rise in population that occurred over the same period without the predicted Malthusian consequences of total immiseration, Europe had nevertheless split into three distinct systems of political economy, only one of which was compatible with a free and open commercial and intellectual life, what Michael Polanyi would come to call in his 1966

publication *The Tacit Dimension*, “a free, dynamic society” (82). The other two systems that had taken root early in the twentieth century—communism and fascism—despite their ostensible antagonisms with each other, both feared and suppressed intellectual freedom, and in response to that fear shut down the marketplace, along with the material gains to be had from it.

Polanyi’s critique of collectivist economic systems was much deeper though than just a lament for the loss of the material gains of open commerce. As he articulates very clearly in his 1940 lecture on “Collectivist Planning,” the costs of “planning” extend to every niche of human experience.

In an ordered society every activity which affects the community is either subordinated to an authoritative scheme or is, on the contrary, stimulated to individual manifestations under the protection of public supervision. As long as certain guiding principles—of truth, of justice, of religious faith, of decency and equity—are being cultivated, and as long as commerce is protected, the sphere of supervision will predominate and planning will be limited to isolated patches and streaks. Conversely, if comprehensive planning were to prevail, this would imply the abolition of both the cultivation of guiding principles and the pursuit of commerce, with all the liberties inherent in these forms of life. Hence collectivist revolution must aim at the destruction of liberty, and in particular must suppress the privileges under which Universities, Law Courts, Churches, and the Press are upholding their ideals, and attack the rights of individual enterprise under which trade is conducted (*SEP* 129).

For Polanyi, the arts, history, literature, philosophy, science, and theology, not to mention justice and morality, were all equally the victims of the tyrannical economic systems of the Soviets and the Nazis that he believed were the most poisonous fruits of his era. This was a theme that remained central to his later, and much better known work on what he called “the tacit dimension” of scientific knowledge. In the final essay of the 1966 book of the same title, Polanyi writes:

Take once more the example of science. I have spoken of the principle of mutual control through which each scientist independently plays his part in maintaining scientific traditions over an immense domain of inquiry of which he knows virtually nothing. A society of explorers is controlled throughout by such mutually imposed authority” (*TD* 83-84).

If one were to change just a few of the nouns in this passage it would sound remarkably similar to Adam Smith's description of the invisible hand that coordinates for the benefit of all, the otherwise autonomous activities of individual economic agents. This felicitous harmonization is achieved even though each individual has only very incomplete knowledge of what is in fact a complex system that functions so as to meet their needs and desires.

Both science and the economy, work on the same principles. Both seek an absolute good. For science this is what Polanyi believed was "the presence of a hidden reality" (*TD* 82), and for economics it was prosperity for the many. Both require independence of individual action, but under the "supervision" of "guiding principles—of truth, of justice, of religious faith, of decency and equity" (*SEP* 129). And both have the potential to yield human betterment, or what he calls in *The Tacit Dimension*, "moral progress" achieved "by the exercise of power and aiming at material advantages" (*TD* 86). That moral advance requires the "taint" of otherwise base social mechanisms was a fact, he asserted, that "we must accept" (*ibid*). Here the easily heard echo for an economic historian is to Bernard Mandeville and his infamous *Fable of the Bees, or Private Vices, Publick Benefits* of 1714, an expansion of the poem published in 1705 in which he argued that "Bare Virtue can't make Nations live in Splendor." Only the cultivation of private self-interests could do that.

What was it then that led so much of Europe after the turn of the twentieth century into the error of collectivist planning, and for Polanyi, the inevitable tyranny and material deprivation that accompanied it? Surely, he claimed, it could not be a divergence in the tastes of the people. After all, as he notes in his 1937 lecture "On Popular Education in Economics," the items actually desired by people were in fact remarkably consistent across societies, with "modern dances, motor-cars, birth control and a hundred other new customs ... all spreading regardless of frontiers, and producing everywhere the same changes" (*PE* 19).² How could so many hundreds of thousands of people end up living under systems that were so disastrously inimical to their self-interest, to say nothing of their liberties? And if we could understand from whence communism and fascism had emerged, what would it take to shore up, or rescue outright, the liberal ideal that Polanyi held in such high regard? This was a puzzle indeed.

Ironically, Polanyi begins his search for answers with a variation on the very theme he held to be the highest good of both the liberal economy and later free science: complexity. Here though it is framed as a problem, the problem of perplexity. In one of his earliest lectures on economic questions, the June 1936 lecture titled "The Visual Presentation of Social Matters" delivered to the Association for Education in Citizenship, he develops a remarkable argument in a section titled the "Perplexity of Rats and Dogs."

Even rats and dogs cannot live in perplexity. Take three sets of rats: give one set a meal a day; give the other set the same meal only every second day; and restrict the third group to a meal on every third day. All three groups will thrive; the rich, the middle-class and the poor will get on equally well. But take a fourth set of rats and feed them at periods varying irregularly between one and three days and you will see the rats of this set die. They get more than the poor rats, yet while those prosper on their meager diet they perish because their organism is thrown into a state of confusion, all their reflexes of digestion are dislocated, they die of perplexity (2014/15, 14).

The passage goes on to discuss Pavlov's famous experiments with dogs, and then with full conviction to connect that research to the confusion of his own times.

The misery of this dog lies beyond the scope of utilitarian principles and so does the misery of our times. I believe that the twenty-two years of wars and revolutions which lie behind us have been mainly caused by a mental derangement arising from a state of continued perplexity—a perplexity which is so fatal to society because it not merely relates to food as that of the dog, but involves the very basis of moral relations from man to man (2014/15 14).

The very system that Adam Smith had so confidently proclaimed in *The Wealth of Nations*, and that had so effectively outwitted the dire predictions of the Reverend Malthus, bore in itself the seeds of its own undoing. As Polanyi put it rather simply, "In the past two centuries an economic system has developed that we fail to comprehend" (ibid). Or as it appears in an even stronger statement to this effect in his lecture of the following year: "Man was not intelligent enough to understand the economic system which he brought forth in the nineteenth century. In consequence, when he tried to apply his aims and endeavors of justice, freedom and prosperity to economic life, the results were to a great extent futile or ruinous" (PE 19). The invisible hand was too invisible for its own good. Its success, spectacular as it was in the material realm, was nevertheless overshadowed by the uncertainties to which it gave rise. Indeed, for Polanyi, the depths of its incomprehensibility were such that actual mental disorder on a broad scale was the result, the manifestations of which were communism and fascism, and the simple but deadly 'truths' they purported to offer.

How then might one save the liberal project so as to secure for the future the already-demonstrated benefits that come when autonomous economic actors work together in complex interactions for the mutual good? How could society embrace the

virtues of the invisible hand without succumbing to the perplexity to which it seems to have given rise? How might society resist the temptation for easy, even if terribly wrong, answers? Reasonably enough, Polanyi argued that if the problem was a failure of the common man to understand, then the solution had to involve the human capacity for understanding. Liberalism could only be saved if it could find a way for the common man to emerge from his perplexity. Understanding the economy could no longer be just the preserve of the economists, but instead a general prerequisite for citizenship. Only an economics education could offer a lifeline of sanity for every person who produced or consumed and had to engage in trade to make both possible. In short, economics had to be for everyone.

But what kind of an education, exactly, could meet the need? What principles had to be learned, or perhaps unlearned? Would it be enough if everyone could understand the theories of Adam Smith, or perhaps even more to the point of his intellectual heirs, the so-called “utilitarians” for whom the price mechanism in labor, commodity, and capital markets, was all that was needed to achieve their desired state of “maximum efficiency” (PE 20)? Polanyi did not think so. Indeed, it was precisely the “great mistakes” of the utilitarians that had led to the present crisis in the first place. His interpretation of this failing is worth quoting in full.

The utilitarians, however, made the following great mistakes:

1) They failed to see that the just reward of the factors of production did not lead to a just reward of the people disposing of these factors. Their philosophy never produced an idea as to how the just reward of the various people should be assessed.

2) The utilitarians overestimated the idea of the free market. They thought it to be applicable to all human relationships and, therefore, opposed all legislation regulating labour conditions and objected to free services by the community, as for example, free education. They failed to produce an idea as to the limits to which human affairs should be regulated by buying and selling.

3) The utilitarian economic theory gave no reasonable account of the trade cycle. It left the unemployed in the depression without even an intellectual consolation and objected to any action to improve their lot.

4) The general weakness of utilitarianism, which includes the above particular failures, is this: that its philosophy makes self-seeking the supreme principle in economic life and assumes that people are happy if seeing their blind acquisitiveness is transformed into a maximum efficiency (PE 20).

Remarkably, with the distinct exception of point number three to which I shall return below, these mistakes are in essence all moral failings, not economic ones. They are the result of misplaced values, not faulty logic, or a misguided trust in the workings of the invisible hand in the marketplace. They are about justice, and the reasonable limits to the arenas in which self-seeking behavior is appropriate, not a condemnation of self-seeking in general. According to Polanyi then, utilitarianism made itself an easy target for the superior-sounding moral claims of nineteenth century communist rhetoric. Indeed, as he goes on to argue, “political dictatorship arose firstly as a result of class war, then [was] perpetuated to insure the subjection of economic activity to collective aims” (PE 23). The proverbial baby was thereby thrown out with the bath water.

The problem for political economists, of course, is that it is actually very difficult to avoid doing just that. Once you start making distributional claims on the grounds of justice, which of necessity will sometimes override the distribution as meted out by the market, it is very hard to avoid invalidating the benefits of the market altogether. How do you strike the balance between enough self-seeking to promote growth in the economy, but not so much that it leaves you vulnerable to attack on precisely the grounds that first communism and then fascism were able to attack economic liberalism? Polanyi’s answer to this dilemma in his 1937 lecture is a bit slippery. He does a better job of saying what must happen than he does of specifying how to make it happen: “If this analysis is right it follows that if we wish to avoid dictatorship we must revise utilitarian economics by some other means than civil war and must, in particular, find some means to make the community conscious of its collective purpose by means other than dictatorial regimentation” (PE 22).

The firmest ground on which he can stake an actual policy prescription concerns the third mistake of his critique, the alleged failure of the utilitarians to educate the public on the mechanics of the trade cycle. This offered one place where a concrete bulwark against the collectivist system might be constructed. But why the trade cycle, per se? Why privilege the concerns of macroeconomics over those of microeconomics?

First, we must remember that Polanyi only turned to a serious study of political economy well into the decade characterized by global depression and soul-shattering unemployment. In this context, he developed a keen appreciation for the work of John Maynard Keynes, an appreciation he still felt strongly in the second half of the 1940s, even after the employment boom spurred by a half-decade of world war. The Keynesian principles that had been refined in the crucible of global depression were in Polanyi’s opinion still the right ones to guide the organization of the economy going forward. Of Keynes’ theory he says, “At last we have before us a fundamental criticism of liberal economics which avoids the mistakes of Communism” (PE 23). This is also the core message of his 1945 publication, *Full Employment and Free Trade*. Here we are introduced to concepts such as “The Money Circle,” “Capital Saturation,” “The Trade

Cycle,” “The Gap at Full Employment,” “A Modern Budget,” and “Wartime Finance as a Counter Example,” among others.³ All of these constructs live in sharp contrast to the Soviet manipulation of the collectivist economy or Hitler’s so-called “abolition of unemployment,” both projects that ended in disaster, whether economic or political or both.

Even more important though for the education of the actual common man than a treatise published by Cambridge University Press could ever be, was the documentary film he made in 1940 titled, *Unemployment and Money: the Principles Involved*. Here we find the first appearance of “The Money Circle,” along with the cartoon workers, housewives, and investors who populate the model, and the factories, shops, and banks where they carry out their daily activities. The film depicts hundreds of autonomous actors, each making decisions on the basis of their own needs and desires, yet working inadvertently in concert with each other in a system that is capable of self-regulation and balance.

Moreover, when we circle back from the film to the 1937 lecture that laid the groundwork for it, we realize that the film is itself a deeply moral project. As Polanyi argues so eloquently at the close of his lecture, “the spiritual advantage of dictatorships lies in their enforcement of an idea of economic life. Democracy can satisfy this craving for economic consciousness by creating a popular understanding of economic matters. It is the only way to obtain economic consciousness while preserving freedom of thought” (PE 23). This educational project then, comprised of simple concepts presented in straightforward and repetitive language, enacted by cartoon figures, and utilizing popular film—the true medium of the masses—was fundamentally tasked with a deeply spiritual mission, to restore “consciousness” to the masses but in such a way so as not to compromise their freedom.

Prosperity is an excellent end, but it cannot stand alone as a bulwark against the misguided economics of the collectivist regimes, nor can it hold against their stunning descents into tyranny. As already noted, Polanyi believed that the collective purpose of the community had to be based on something other than class struggle or civil unrest. Those were the sure road to dictatorship. Raising the bar for the common man to comprehend the logic of the trade cycle, and to appreciate the macro-dynamics of unemployment in the face of curtailed demand, was one small, but highly significant step towards the prevention of civil war and the promotion of prosperity with justice and freedom. In short, it offered the rescue of the baby from the bath water. As we face our own moment of dangerously heightened global and national inequality, of reactionary political responses to unemployed and displaced persons, and the seeming disintegration of liberal principles, there is much to commend a renewed commitment to Polanyi’s economics education for the common man, and the moral principles upon which it rests.

ENDNOTES

¹These calculations can vary considerably from one year to the next depending on fluctuations in the spot prices of gold and silver, along with future prices for wheat. However, the order of magnitude never changes. Costing out the voyage in contemporary carpenter's wages makes a modern version of the same voyage financially ruinous.

²References to "Popular Education" will use the page numbers of the version found in this issue of *TAD*.

³These are all section titles from Chapter One, "The Elements of Full Employment."

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