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Full Employment and Free Trade: Polanyianism, Keynes and the present

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Abstract

In 1945 Michael Polanyi wrote **Full Employment and Free Trade**, an economic work whose main objective was to convert Keynesian theory into a common-sense subject, establishing a parallel with the atomic theory of chemistry, which requires that it be simpler and clearer. This text is an introduction to the Portuguese translation of Eduardo Beira to the original of Polanyi.

Keywords: Michael Polanyi, Keynes, *Polanyianism*

INTRODUCTION

In the preface to Full Employment and Free Trade, Polanyi sets out his aim: to turn Keynesian theory into *a common-sense subject*[1], paralleling the atomic theory of chemistry, which requires it to be *simpler and clearer*[2]. Taken as it were, it would be a rather modest, almost purely pedagogical objective: to make Keynesian theory clearer so that it can become the *common property of all thinking citizens*[3]. He does not claim for his work either originality or absolute fidelity to Keynes's thought or to previous interpretations. Keynes' contribution, which would have made it possible to understand the functioning of the capitalist system, *is indeed quite simple ... a veritable egg of Columbus*[4], *necessitating an adequate method of presentation [which] may greatly accelerate its understanding*[5].

We believe, however, that Polanyi's work has considerably greater scope than the author attributed to it, both in terms of the concepts presented in chapter I and following. The specific contribution of Polanyi's work can be clarified in two different dimensions. First, through the evaluation of its intrinsic value, and then through the establishment of the main differences in this interpretation against the one proposed by Keynes.

The rest of the text is organized in three parts, in addition to this introduction and the conclusion. In the first part, we try to characterize the conceptual and operational framework of Polanyi, which we consider to be *sui generis* enough to be called *Polanyianism*. In the second part, we analyse the main differences and similarities of Polanyi's thinking via-a-vis Keynes's ideas, essentially set out in his work *The General Theory of Employment, Interest and Money*[6], to which Polanyi claims to be intellectually indebted. Finally, in the last part, we identify some aspects of Polanyi's work with a clear flavour of modernity, in the sense of its timeliness and the role they have played in the functioning of the Western economies.

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[1] All quotations without additional reference concern Eduardo Beira's translation and that in this text we call Polanyi. All words in **bold** included in the text are our responsibility. Polanyi, p. 1.

[2] Polanyi, p. 2.

[3] Polanyi, *ibid.*

[4] Polanyi, p. 14.

[5] Polanyi, *ibid.*

[6] Keynes (1973[a]).

THE CONCEPTUAL FRAMEWORK OF POLANYIANISM

Polanyi's main concern was the re-foundation and preservation of the capitalist system in the face of the conceptual and political advances that economic planning advocates had made, particularly in view of the dramatic consequences of the 1929 crisis. Polanyi finds in Keynes a credible and legitimized author who defends public intervention not as a manifestation of economic planning but as an essential mechanism for the unequivocal preservation of capitalism, private enterprise, free competition and international trade. However, Polanyi realized how Keynesian thinking was being used by proponents of economic planning and socialism; for Polanyi, the line separating the use of Keynes's thinking by capitalists and socialists is too fragile and illusory. In other words, what brings him closer to Keynes is less than that what alienates him from the remote possibility of socialist thought and economic planning. This way, not wanting to take any risk on the association of his ideas with economic planning, he develops a framework of thought that we can, as a form of internal coherence, designate *Polanyianism* and which we will try to characterize briefly.

The functioning of the economy is presented to us in the form of a circuit where production, employment and consumption have a monetary circuit underlying what Polanyi means by *money belt* or level of money circulation. The equilibria between production, income and employment are thus determined by the level of money circulation, *the main conception to fix upon is the variable money belt determining the variable levels of employment: the level of production expanding or contracting with the rise and fall of national income expressed in money*[7]. It is the supply of money that is decisive here, as Polanyi recognizes by drawing on Keynes[8]. *We must accept the fact discovered by Keynes that the supply of money is determined by a mechanism which may very well keep it at an insufficient level and that in the modern Western world the tendency is definitely for a chronic lack of circulation and a correspondingly depressed level of employment*[9]*.* Unemployment, for example, is a consequence of insufficient monetary circulation which, if corrected, leads to successive variations in income, expenditure, production and the corresponding level of employment.

The next step is to understand the channels and corresponding mechanisms that can affect the circulation of money, since they are decisive for the expansion or contraction of employment. The view in terms of circuit is also

[7] Polanyi, p. 26.
[8] This Polanyi's interpretation will be clarified later.
[9] Polanyi, p. 220.

affirmed in the analysis of savings and their relationship with the currency in circulation*. Whenever a consumer sets aside some of his income, rather than spend it in the market, he reduces to that extent the circulation of money. (...) The obvious counterpart to saving is the expenditure of sums previously saved and set aside in the bank*[10]*.*

The size of the circulation does not change as long as savings are fully offset by new investments[11], thus linking today's investment to the savings of the past, a notion that clearly has a pre-Keynesian flavour. Therefore, savings and investment are the two aggregates associated with the dynamics of monetary circulation. Savings (carried out by households, governments, and businesses) are associated with declining money in circulation - monetary contraction - leading to successive decreases in employment, production and income, while investment (business and government) - monetary expansion - leads to variations in the opposite direction.

Saving and investing work like two pumps, one takes out money from circulation and the other injects money into circulation. However, these are indispensable actions for the functioning of the economic system. They are simultaneous actions with opposite effects, manifestly independent (in relation to the motivations and decisions of the agents that conduct them) and, consequently, not synchronized in time and space. As Polanyi (p.29) states, *therefore, if the two pumps are not in step, there will be expansion or contraction. Excess of saving will drain the circulation, narrow down the money belt, reduce employment and depress the level of national production. Excess of investment will replenish circulation, widen the money belt, increase employment and raise national production; and if it continues to operate beyond the stage when full employment is reached, it will cause inflation and a fall in the value of money*.

He then refers to the ***two*** savings and investment *pumps*, establishing, as in Keynes, the relationship between these two variables at two levels: equilibrium/adjustment and the level at which this equilibrium is achieved. Thus, the concept of a gap, the difference between saving and investment, which can produce both contraction (Saving> Investment) and economic expansion (Saving <Investment), emerges. These gaps have self-correcting mechanisms which, over time, cancel each other out, albeit at different levels of income and production compatible with the one that would drive the

[10] Polanyi, p. 26-7.

[11] *Here is the process that normally balances savings so long as the money which is removed, day by day from circulation through the process of saving, is balanced by sums, which are continuously flowing into new business investments, the width of the money belt will remain unchanged.* (Polanyi, p. 28)

economy to desired levels of employment. Having said that, and starting from an unemployment situation in the economy, this can only mean that there is a gap that needs to be filled. The solution is to increase money circulation to adjust the two pumps and this must be done with normal public expenditure financed by budget deficit.

In Polanyi's words, *the problem of maintaining full employment can now be seen to consist in the task of filling this GAP. In other words, to achieve full employment it is necessary to fill the GAP at full employment - the GAP by which savings exceed new commercial investments when full circulation is maintained*[12]*.* And what is the mechanism to sort out this issue? *I have suggested that the Government should remit taxes and create a budget deficit to a sum equalling the GAP at full circulation, the necessary cash being issued by the Central Bank and used to meet normal public expenditure to the extent of the proposed deficit*[13]. He adds that if public indebtedness is undertaken to expand monetary circulation, then there should be no financing costs[14].

The public deficit must cover the gap. *My suggestion is that the state should fill the "GAP" by expenditure from loan. In other words, that there should be maintained a budget deficit of a magnitude equalling the difference between the flow of new commercial investment and the flow of savings prevailing at full circulation*[15]*.*

Therefore, there does not appear to be difficult to cause a deficit to restore *full circulation* without any sacrifice. Polanyi categorically rejects policies that seek to eliminate the gap by stimulating investment or by discouraging savings. In his own words: *I am opposed to all policies of this kind. I think it is unreasonable that real wealth, or any other real advantages, should be sacrificed, and real burdens of any kind should be shouldered for the purpose of putting money into circulation*[16]*.*

An important aspect of this reasoning is to understand the channels and the pace at which the gap must be filled and the time this public expenditure takes to reach the economy. Polanyi poses the question as follows: *Should new money be issued indefinitely*?[17] The answer is disconcerting: *can this continue*

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[12] Polanyi, p. 53.

[13] Polanyi, p. 66.

[14] *Whence, in these circumstances, the idea that the government is borrowing money? Whence the notions of a financial burden shouldered, of an interest charge incurred? Whence the warnings come that the dictates of sound finance must be observed by recognizing these burdens?* (Polanyi, pp. 66-7). There are many other similar passages throughout the text. Given this framework, it is perhaps not surprising that Polanyi makes few references to the question of public debt and its potential impact on the policy of full employment.

[15] Polanyi, p. 56.

[16] Polanyi, p. 55.

[17] Polanyi, p. 71.

indefinitely, without limit? Indefinitely - perhaps; without limit - certainly not[18]*.* With the creation of money, financial security is achieved. *And gradually, as the cash balances of the public approach a final level, the rate of saving will fall to the point at which it no more exceeds current investment*[19]*.*

It is clear to the author that the cause of persistent unemployment is excessive saving, which will eventually be lowered through the persistent injection of money, with no difficulty in achieving full employment of the economy through deficit and monetary creation. Polanyi believes that there are many reasons why people do not accumulate money indefinitely, since there will be a time when, having reached a certain financial security, they will certainly enjoy life and *then the GAP vanishes - and we have, in the end, savings balancing at full circulation, without any kind of intervention by the government*[20]*.*

The author notes that *it would be idle to speculate how long it will take for the public of Britain or the United States to accumulate requisite level of cash balances*[21], although he suggests *perhaps no more than 10-15 years*[22]. Thus, nothing prevents the State (government/central bank) from achieving, at no cost, the full use of society's resources. A modern budget determines the level of employment and income of society. The f*ixing of the desired level of employment and the corresponding level of national (money) income ought, strictly speaking, to be made in conjunction with the decisions on collective expenditure incorporated in the budget*[23]*.*

Lastly, Polanyi acknowledges that this proposal for monetary issuance may raise some objections, namely regarding its inflationary danger. The danger of inflation is treated in the Keynesian way. When expansion approaches full employment, the risk of *bottleneck* increases, creating self-accelerating processes with regard to prices and wages, for which reason … *circulation will eventually become unstable and monetary expansion will degenerate into unlimited inflation*[24]*.* He admits that the government can be laxist by printing currency instead of resorting to taxes, but he underestimates this possibility. The answer is clear, and comes almost by definition: *if the money is being*

[18] Polanyi, p. *ibid.*, Examining Beveridge's proposal (p.220), Polanyi explicitly states that *I agree that Route III is to be rejected, but not essentially because it leaves many social ills to unremedied, but because it* ***attempts to fix the level of public expenditure, which is not, in my opinion, a matter to be included in a programme for full employment.***

[19] Polanyi, p. 72.

[20] Polanyi, *ibid.*

[21] Polanyi, p. 73.

[22] Polanyi, *ibid.*

[23] Polanyi, p. 80.

[24] Polanyi, p. 139.

issued for the purpose of supplementing a deficiency, this cannot mean the creation of an excess[25]*.* The fear comes from the policy of governments to avoid taxes. It is only necessary to exercise democratic control over their functions. *The government could not undertake any but authorized expenditure; and its powers to issue money would be guided and checked by its responsibility to maintain the stability of monetary circulation*[26]*.*

At this point, Polanyi made all the concessions that his conceptual and analytical framework allowed him in the face of public intervention in the economy, and introduced two principles, one implicitly and one explicitly, which ensured that, theoretically, public intervention cannot mean control of the economy or at least *an invitation to such universal wire-pulling as that would inevitably reduce public affairs to a state of confusion and corruption*[27]. The first we call the *principle of equivalence* and Polanyi designates the second by *principle of neutrality*.

These two principles have undesirable consequences in terms of the conceptual and operational coherence of P*olanyianism*, as we shall see in some of these specificities.

The *principle of equivalence* seeks to ensure that business and public investments financed by budget deficits have precisely the same effect in terms of injecting money into the economy. Some justification for this statement may be indirectly sought. Polanyi identifies a set of factors - capital saturation in more developed economies, lowering the marginal rate of saving and chronic depression – as a direct consequence, p. 49, which indicate an uncomfortable and disturbing trend in the author's ideological framework. They underpin the growing importance of state intervention in the economy as a way of guaranteeing the normal functioning of capitalism. In times of crisis, private investment is reduced or even non-existing and it is necessary to replace it, giving the government the responsibility to increase the circulation of money in the economy, since the rate of investment has a determining role in the variations of national income. This substitution by public expenditure (financed by budget deficit) will have higher levels of public and political acceptance, even if it is supported by the *principle of equivalence*. Can one ask whether, without the explication of the *principle of equivalence*, such a solution would be taken as an inevitability? If it is

[25] Polanyi, p. 74.
[26] Polanyi, p. 75.
[27] Polanyi, p. 55. A new public expenditure programme (public works) is a case of Polanyi's position. See, for example, his analysis of the British White Paper on employment where he states that *a policy of enormous public constructions, undertaken regardless of any appreciable need, would in fact inevitably stimulate a reckless and arbitrary mood of administration, bringing lawlessness and corruption in its wake.* Polanyi, p. 198).

inevitable, how to ensure that it does not produce social havoc, leading to a discretionary and controlling power of government? Let us now submit it to the *principle of neutrality*!

On the other hand, the *principle of equivalence* removes the turbulence and uncertainty associated with entrepreneurial investment of the process of injecting money into the economy, particularly in times of economic depression. Polanyi admits that *clearly, the smaller the amount of private investment is going on, the less will be the uncontrollable and unforeseeable fluctuations of such investments and the easier it will be to counteract the monetary consequences of such fluctuations*[28].

However, reducing the impact of turbulence and uncertainty is also to exclude from *Polanyianism*, for a considerable period, some dimensions without which it is not possible to understand the functioning of a market economy, namely the relation between interest rate and investment, the dynamics associated with the marginal efficiency of capital and, in short, the entire economic dimension of supply.

Finally, the equivalence between investments tells us nothing about their operating mechanisms, both in time and space. For example, will public spending of one billion dollars take the same time to create employment, whether it is done by current public spending or by the structure of the private and business economy? Likewise, is the structure of public services and their location the same in central areas and in depressed areas?

When it is stated that the effect is similar, it is not clear which mechanisms produce this effect, and may even lead the reader to assume that they are identical. This is not a minor issue, since, ultimately, we may be moving at a rapid pace towards a socialist economy without any private initiative (if only the effects are decisive)[29]. It should be noted that, in addition, this principle contradicts a reduced size of the state and its functions, a quality any liberal wants. However, the smaller the state, the longer and more asymmetrical time it will take to diffuse the effects of the increase in the circulation of money throughout the economy (via the budget channel), with a particular impact on the rate of job creation (which can be admitted being first public and only then private, increasing the size of the state).

The *principle of neutrality* is more difficult to understand though easier to justify in the light of the author's ideological conceptions. In Polanyi's words (p. 56) ... *the process undertaken in order to create sufficient circulation must*

[28] Polanyi, p. 76.
[29] Polanyi's analysis of Soviet Russia in chapter II clearly illustrates our concern.

involve no material sacrifice to speak of. It should be, and can be carried out in a neutral form, i.e. in a way requiring no materially significant economic or social action to accompany it. In this respect, Polanyi takes an especially optimistic position: *I suggest that there is no difficulty in remedying a defective currency circulation without having to incur real sacrifices for this purpose*[30]. This is a guiding principle for fiscal and monetary policy aiming at full employment. This principle seeks to ensure that the policy of combating unemployment is conducted without distortion in the real economy, which is difficult to understand and even more difficult to enforce. Despite its conceptual relevance, Polanyi never clarifies the meaning and functioning of this principle. There are indications that it is how to obtain the money needed to fill the gap (money issuance without financing costs), but also one is certain that the principle concerns the execution of the efforts to fill the gap[31]. One gets the idea that the application of this principle (its content) would lead, for example, to multiplying all budget headings by a scale, an amount corresponding to the gap! This position seems unreliable and unsustainable. How is it ensured that doing more of the same is an economically and socially rational decision[32]?

Polanyi introduces some hope in the understanding of these two principles - namely their articulation - when he mentions that *we have shown previously that a budget deficit produces exactly the same monetary effects as would result from a flow of new private investment; we can take it therefore that the proposed measure, if carried out, would be fully effective. But can it be carried out? And if so, can it be carried out in accordance with the "principle of neutrality", i.e. without involving any real sacrifice?*[33] Unfortunately, at the end of this section one has just a slight idea that the measure can be carried out, since the government can spend money. This analysis to the effectiveness of the *budget* channel to take the amount of the gap, through the issue of currency, to the economy is surprising. Note, once the government is able to

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[30] Polanyi, p. 55-6.

[31] See, for example, Polanyi's revealing argument about James Mead's proposal (1938). On his work, *Consumer Credits and Unemployment*, Polanyi (p.189) states that Mead *expounded this method here with unsurpassed clarity, but failed to round off the picture by* ***but failed by adding to it the principle of neutrality****. His suggestion to distribute money as a supplement to social services in amounts compensating for circulatory deficiencies is in sharp conflict with this principle. It grants to certain classes of people a dividend on economic depression which they have done nothing to deserve.*

[32] Polanyi's comments on the proposals in the British White Paper on employment are particularly revealing. Polanyi (p.192) points out that *it would then be clear that the budget deficit, being the effective factor of the proposed measure, needs only to be planned to compensate for fluctuations in private investment. However, once this position is reached, government proposals prove to be - at least in their present form - obviously irrational.* ***Needing a budget deficit, why start with the job of having to find new spending items on which to spend it?*** *And why spend it only on "building" and non-current items? There is no answer to these questions.*

[33] Polanyi, p. 56.

run its budget - run expense - then the *budget* channel is effective to run more spending! In other words, if more money is made available to the government, it is perfectly capable of spending it (since it has already shown competence in this area previously). Polanyi confirms this interpretation when he writes that there is little taxation left, either central or regional, which could not readily be replaced by newly issued money and the scope of public expenditure, undertaken on its own merits, thus appears amply sufficient to serve as a channel for newly issued money to fill the GAP[34].

The fear of centralized government and associated economic planning is such that it leads Polanyi to enunciate proposals that depart considerably from any economy in which we live. Taking the economy as a framework to support the dichotomy of a society dominated by the tension between market and planning, Polanyi plays it safe and introduces the two principles that assure him - in a world in which we do not live - that the necessary public intervention in the economy is sufficiently aseptic and anodyne, in order not to lead to social deviations. In Polanyi's own words ... *the points still open in our scheme can give rise to no serious doubts about the feasibility of a **"neutral" policy of full employment**[35].*

POLANYI AND KEYNESIAN THOUGHT

In the light of the foregoing discussion it becomes difficult to understand Polanyi's strangely modest position on his work whose aim would be confined to a mere exposition of Keynesian thought.

Polanyi *shares* with Keynes a *'foretaste'* that the capitalist system does not have automatic mechanisms to persistently ensure full employment, accompanying Keynes in the criticism of orthodox theory and the consequent need for a regulatory intervention of the state, i.e., the path to public policy is open and indispensable.

He also shares with Keynes the firm rejection of the gold standard monetary system, on which he wrote: *Never in history was there a method devised of such efficacy for setting each country`s advantage at variance with its neighbours as the international gold (or formally, silver) standard*"[36] and advocates the need for an equilibrium in the trade balance against Keynes' more "nuanced" position. *For a favourable balance, provided it is not too large,*

[34] Polanyi, p. 88.
[35] Polanyi, *ibid*; where the **paradox** inherent in what is designated by a **neutral policy** is evident.
[36] Keynes (1973[a], p. 349).

will prove extremely stimulating; whilst an unfavourable balance may soon produce a state of persistent depression[37].

Polanyi is also *formally* aligned with Keynes's thinking, accepting a *central principle of Keynesian economic theory*, as he wrote, according to which the equality between saving and investment is obtained through the variation of income. This alignment is only *formal* because the status of savings is substantially different in the two authors. *Suppose that savings are in excess of investment. As the ensuing sucking effect drains circulation, depresses employment, strangles production and reduces the national income, the people will set aside less money from their shrunken incomes ... eventually incomes forced down to the point where the rate of sucking has become equal to the rate of squirting, the GAP between the two having vanished*[38].

There are essentially three questions here: the existence of the GAP, the saving dynamics - whose *excess* reduces income - and the adjustment time. *The process of self-sealing occurs* (automatically) *fairly quickly. On account of this fact, the time involved in the process is, more often than not, altogether left out by economists, and the self-sealing nature of the GAP between savings and investment is then expressed as a necessary identity of both these magnitudes. This is rather misleading and should preferably be avoided*[39]. Even because the author notes that *current investments are always practically equal to current savings*[40].

Polanyi is probably thinking and criticizing Keynes when using the *necessary identity* expression. In fact, Keynes, after some hesitation, eventually abandoned any relation between current investment and past savings, to focus exclusively on current investment and current or ex-post savings. Keynes clearly states[41] that:

Income = value of output = consumption + investment.

Saving = income - consumption.

Therefore saving = investment.

Thus, there is no *gap* in Keynes between savings and investment. The existing *gap* in Polanyi is certainly related to the comparison of ex-ante savings with ex-post investment, although later when dealing with chronic gap, the relationship is between the predictable savings associated with full employment and current investment, lower than full employment. It turns

[37] Keynes (1973[a], p. 338).
[38] Polanyi, p. 30.
[39] Polanyi, p. 31.
[40] Polanyi, p. 37.
[41] Keynes (1973[a], p. 63).

out that the relationship Polanyi establishes between excess savings and income reduction is totally unrelated to Keynes's thinking, who imposes private investment as the decisive *key macroeconomic variable* in income variations, with savings having no relevance: *saving, in fact, is a mere residual*[42]*.*

The reason for Polanyi to call on this point what he defines as the *central principle of Keynesian economic theory* corresponds to the idea that Keynes considers that the equality between savings and investment is achieved through the variation of income. *…the novelty in my treatment of saving and investment consists, not in my maintaining their necessary aggregate equality, but in the proposition that it is, not the rate of interest, but the level of income which …ensures this equality*[43]. However, a careful interpretation of this statement should be associated with a double development. First, the need for an interest rate theory different from the orthodox theory, where it is viewed as the adjustment variable between savings and investment, and, secondly, the introduction of a principle of causality that makes investment the dynamic element of changes in employment and income and, consequently, makes savings a mere residual. To use the terminology associated with hydraulics, there are no two pumps in Keynes, only one: investment.

It must be acknowledged, however, that in addition to the status of savings and method, Polanyi does not follow Keynes also in some fundamental analytical components, underlined by authors like Patinkin, such as: *…the theory of effective demand, the theory of the liquidity preference and the marginal efficiency of capital*[44] and. we would add, the propensity to consume, considered by Keynes himself as a *fundamental psychological law* and deemed simply irrelevant by Polanyi.

First, like Keynes, who intends to develop the theory of a monetary economy (of production) [45], Polanyi also finds himself in a monetary economy, developing a circuit analysis that moves away from the considerably more orthodox terrain of market analysis developed by Keynes, where demand and supply are confronted, even if in a perspective of aggregated and anticipated amounts[46], often known as the principle of effective demand.

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[42] *The decisions to consume and the decisions to invest between them determine incomes.* (Keynes (1973[a]: p.64).

[43] Keynes (1973[b], p. 211).

[44] Patinkin (1976, p. 48).

[45] *I am saying that booms and depressions are phenomena peculiar to an economy in which – in some significant sense… – money is not neutral* (Keynes, 1973[a]: p. 408).

[46] *It follows that…the amount of employment…depends on the amount of the proceeds which the entrepreneurs expect to receive from the corresponding output.* (Keynes, 1973[a]: p. 24).

Polanyi's analysis, in terms of the monetary circuit, entails a fundamental danger, to which we have already made a brief reference: to underestimate the importance of supply and production conditions, as well as the behaviour and role of agents associated with them, both internally and externally.

Keynes favours the demand side, of course, but his analysis unequivocally includes the supply dimension *...the volume of employment is determined by the point of intersection of the aggregate supply function*[47] *with the aggregate demand function*[48] and insufficient demand determines a lower level of equilibrium than full employment.

On the other hand, Polanyi associates the *chronic lack of circulation* with the fact discovered by Keynes *of an insufficient level of money supply*. For Keynes, the problem does not lie in the money supply, but in the demand, i.e., in the preference for liquidity. In these circumstances, manipulation of the amount of money may not be sufficient to lower the interest rate to the level necessary to achieve full employment[49].

The importance of interest and the theory of interest for the analysis of the capitalist system is fundamental in Keynes, which is why he dwells extensively on this subject throughout Chapters 13, 14, 15 and 17 of the *General Theory* and summons it to the title of his work. Just as Keynes saw the classical interest rate theory as constituting the *fatal flaw* of orthodox theory, so too the lack of importance given to interest and interest theory constitute an obvious departure from Polanyi regarding Keynes's analysis. Without it the whole book IV, perhaps the most important of *General Theory*, is marginalized.

In addition, any reference to the marginal efficiency of capital, central to Keynes's theory of employment[50], finds no echo in Polanyi, probably because the author understands that public deficit has the same effect on circulation as private investment and the instability effect attributed to the latter. It *seems obvious, in fact, that a flow of new commercial investments represents a more clumsy and ungovernable method for the recirculation of savings*[51].

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[47] *The aggregate supply function, however, which depends in the main on the physical conditions of supply, involves few considerations which are not already familiar... But in the main it is the part played by the aggregate demand function that we shall devote Books III e IV.* (Keynes, 1973[a]: p. 89)

[48] Keynes (1973[a], *ibid*).

[49] *In chapter* 13, Keynes presents his interest rate theory associated with the preference for liquidity. *...the quantity of money is the other factor, which, in conjunction with liquidity-preference, determines the actual rate of interest in given circumstances.* (Keynes,1973[a]: p. 168).

[50] On this matter: *...the collapse in the marginal efficiency of capital may be so complete that no practicable reduction in the rate of interest will be enough*, thus questioning the `*purely monetary* solution (Keynes, 1973[a]: p. 316), while stressing the importance of the psychological aspects associated with investment: *...It is the return of confidence, to speak in ordinary language, which is so insusceptible to control in any economy of individualistic capitalism.* (Keynes, 1973[a]: p. 317).

[51] Polanyi, p. 78.

Unlike Keynes, for Polanyi private investment is one more problem (due to turbulence and associated uncertainty) rather than a solution for the unemployment issue.

Polanyi does not accept the distinction between cyclical and structural unemployment. In his view, the, *difference between them is above all a matter of degree*[52], considering cyclical unemployment equally as transitory, with the difference lying only in the time between one job and another. This concept of transience in employment is close to the theory of *job search*, which has a strong neoclassical flavour, moving away from Keynesian analysis[53].

On the other hand, it focuses on the idea that a certain level of unemployment, which he calls residual, is inevitable in the economy. This is the *natural rate of unemployment*. *When choosing a level of circulation to aim at. ... the public will have to resign itself to a certain residue – perhaps an important residue - of unemployment will have to be tolerated in order to form a dam against a runaway inflation*[54]. This concept is very close to the concept of the NAIRU[55] dear to modern neoclassical thinking (which we will examine in the last part).

Unlike Keynes, Polanyi is especially worried about residual unemployment. In democratic countries, it is the Parliament that determines tolerable unemployment. In democracy, the public informed through parliament must find the balance between tolerable unemployment and other disadvantages. In a dictatorship, residual unemployment (3-4%) may be further reduced by the fact that a higher level of inflation can be accepted. The idea of an implicit political arbitrage between unemployment and inflation is close to the later analysis of William Phillips and Paul Samuelson (among others), *since if we are not prepared to approach inflation then we have to give up full employment*[56].

Polanyi is undoubtedly a courageous author and seeks to particularize and analyse a relevant set of aspects essential to his approach, namely in chapter IV and following. It is very curious how Chapter IV - *Internal Problems of Full Employment* - unintentionally helps to understand some of the major weaknesses of *Polanyianism*. One notes that in the presentation of each of the problems of full employment Polanyi identifies gives increased realism to his approach. However, the analysis of his proposals (inherent to each of the

[52] Polanyi, p. 140.
[53] Moreover, the Keynesian demand defined by the "level of demand for money" is not correct, because Keynesian demand is defined in real terms, measured in units of wages, i.e. in hours of commanded labor.
[54] Polanyi, p. 139.
[55] *Non-Accelerating Inflation Rate of Unemployment.*
[56] Polanyi, p. 75.

problems) leads to a recognition, without any room for doubts, of the role and growing confidence in governments to solve these problems, something difficult to achieve in the presence of the *principle of neutrality*. These include, for example, the fixing of the level of circulation - which must guarantee the financial stability of the system - the danger of inflation[57], the challenges posed by inevitable residual unemployment[58], the existence of depressed areas, or in monetary policy, with the *new responsibilities for government economists*.

In short, we are led to conclude that Polanyi's analysis is thus far beyond the simple dissemination of Keynesian theory, presenting important differentiating features that define an intrinsically specific contribution from a conceptual and analytical point of view – hence our proposal for *Polanyianism* – and which lead to immoderate optimism in public policy through a purely monetary path, equally distant from Keynes's view. Despite these important differences, stands the idea that the regulatory hand of the state becomes indispensable to make the capitalist system work at an acceptable level of activity and socio-economic environment.

POLANYI WITH A TASTE OF MODERNITY

Throughout Polanyi's work, it is possible to find some modern ideas that can find adherence in the present, which show the lucidity and the reach of his thought and of many of his proposals, mainly in face of the period and the context in which he presented them. We would like to draw attention, without any hierarchy of relevance, to some of aspects that we find most interesting.

Polanyi attaches paramount importance to residual unemployment, giving it a connotation that brings it strongly close to the **NAIRU concept**, dear to today's dominant economic thinking on both sides of the Atlantic. *Unless it is clearly realized that a minimum of unemployment of this kind of magnitude is absolutely unavoidable, there cannot be established the necessary consensus and mutual confidence among people.*[59]. This residual unemployment is more difficult to compress in a free state than in a totalitarian state. *By forcing people to accept an inflationary state of an intensity which would not be freely tolerated, the totalitarian state can maintain a higher level of employment.*[60] Simultaneously, he assumes the

[57] *This brings us back to the* ***severe restrictions of a full employment policy*** (Polanyi, p. 144).
[58] *Which leads us to the third factor determining the residual level of unemployment, which is the* ***ability of the government to control the negative effects of unemployment*** (Polanyi, p. 148).
[59] Polanyi, p. 151.
[60] Polanyi, p. 150.

inverse relationship between unemployment and inflation contained in the Keynesian world, giving it the meaning of an arbitration in terms of public policy[61]. In this perspective, he is much closer, as mentioned in the previous section, to **Phillips' analysis**. *In order to prevent a runaway expansion of circulation* (and consequent inflation), *the government must restrict the spending of money. At the point where these restrictions become intolerable, the practical limit of circulation and of employment is attained*[62].

Polanyi also stresses, in a prescient way, the **Uncertainty** associated with the Capitalist System, inevitable consequence of the competition and the economic and technological progress implicit in its operation, which is a characteristic of the system in which we live. *Such a system offers no happy abode to a generation that values security above everything else. It cannot be run by businessmen who will not take risks or operated by workers who will not face the chance of losing their jobs*[63]. He notes that there is no magical planning to avoid this reality and that the primitive economies and Soviet socialism that could avoid this problem are unacceptable to the populations of the West. *This is an essential feature of our civilisation. An economy based on widely divided labour in which a hundred thousand plants are engaged in turning out millions of different articles, while all these plants are sharing a wide variety of resources gathered for them in a single pool, or market - such an economy cannot remain stationary for long in any of its details*[64].

The need to have **Unemployment Benefit** at a moderate level is an assumed consequence of Polanyi's approach. *I have assumed implicitly that unemployment benefit could be so much less than the normal wage that the material gain of finding employment, together with the moral satisfaction of doing something useful, would constitute a sufficiently strong inducement for seeking and retaining a job should be a strong enough incentive to seek and retain a job ... Since, as I shall explain in a moment, I do not believe that such compulsion can be exercised rationally, it follows that unemployment pay should be fixed low enough to permit the lawful choice of idleness of those who prefer it.*[65]

Considering that compulsion can only be exclusively economic, at least in *normal times*, Polanyi introduces the curious justification for unemployment benefit according to which *payment may be justified as representing their*

[61] In a democracy, the level of circulation can ultimately be determined by an informed public opinion. (Polanyi, p. 150)
[62] Polanyi, p. 149.
[63] Polanyi, p. 143.
[64] Polanyi, p. 142.
[65] Polanyi, p. 154.

share in the dividend from the commonly inherited national capital[66]. Something similar, although less general, than the income attributed to all, as income from the land pre-existing to mankind, suggested by Thomas Paine in his work of 1797, *Agrarian Justice*.

Although he is not the first author to defend the economic importance of a **Moderate Inflation** (see, for example, John Law's positions), one should emphasize his clarity and timeliness in a period of low inflation, perhaps lower than what would be desirable to fuel the functioning of the contemporary economic system.

Finally, we should cease to regard inflation as something in the nature of a bottomless abyss into which the economic system may suddenly stumble and become irretrievably engulfed. There are many degrees of expansion and of inflation and, as I shall explain at a later stage, it is quite possible that people in future people, at least for some time to come, may prefer to live in a situation which may be termed mild inflation. Whether this is sensible or not is an issue that does not concern us here; I am mentioning it only as an illustration for the view that the state of full circulation is not defined by a sharp line at the edge of a precipice, but lies within a broad zone, in which various levels may more or less equally appear as ideally suited to the requirements of society[67].

In addition to advocating a strong redistribution of income, Polanyi explicitly and courageously assumes the **Abolition of Inheritance** as an important way of promoting social justice and economic dynamics. *In fact, the modern form of industrial property owned in shares of low-denomination would make a quick rotation dispersal of ownership at the death of each owner quite easy. Far from being repulsive to a system of competitive private enterprise, a rapid redistribution of property would represent the most perfect embodiment of its principles; by equalizing opportunities completely, it would provide an ideal field of free competition for all talents.*[68] The idea of creating the conditions for some equality at the outset (even as a way of assessing inequality on arrival) is a brave and socially advanced idea, making a strong contribution to building a society where it is desirable to attain and the necessary trade-off between efficiency and equity.

The role that Polanyi assigns to the **territory** – as a dimension of the subnational area that has a political body associated with it - in the effectiveness of its full employment policies is remarkable. Polanyi's concern

[66] Polanyi, p. 154.
[67] Polanyi, p. 78.
[68] Polanyi, p. 219.

on this matter is particularly evident and innovative in two parts of the text: the discussion in the first chapter on the division between *local finance* and *national finance*, and in chapter four, where he devotes a section to the problem of *depressed areas*.

Concerning the first question, Polanyi centres his concerns on the insufficiency of national spending channels[69] and the legitimacy of local governments to control part of the national money issuing[70]. Concerning the second question, the problems of *depressed areas* and their consequences are dealt with in Chapter 4 as one of the *internal problems of full employment*. Of interest is Polanyi's (still poorly understood by orthodox economics) perception that the existence of depressed areas – now addressed in terms of regional asymmetries or regional development asymmetries – can create significant difficulties in the adjustments necessary for full monetary circulation, thus hampering the dynamics of job creation.

Although he examines both issues always from a functionalist perspective of the territory and the solutions are markedly in line with the economic orthodoxy (through the mobility of labour and capital, the reduction of wages, the construction of road infrastructure, etc.)[71], his awareness that the existence of political-administrative regions and regional asymmetries in terms of level of development can condition the channels of monetary circulation and, thus, influence a policy of full employment, is one of the most innovative aspects in Polanyi.

Finally, the discussion of these aspects has not only an interest *per se*, but also acts as a means (and we would say essentially) for Polanyi to generalize[72] his results for the treatment of *depressed countries* in the field of international dynamics among nations, a matter dealt with in detail in chapter V – *Full Employment and International Trade*. In sum, this importance given to the territory as a differentiating element, the origin of multiple interdependencies that need to be managed politically as a way of

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[69] *It is clearly undesirable to limit the infusion of money for employment purposes to the channels of expenditure that are open to the central government.* (Polanyi, p. 86)

[70] *Local authorities should be jointly given a legal claim to an appropriate part of the annual issue of new money.* (Polanyi, *ibid*)

[71] *Measures that favour, for example, industries facing difficulties in depressed areas ... create a sense of economic achievement where there is no right to it and they undermine the fundamental honesty of people's lives (...) they penalize industries which prefer to prosper by work, economy and enterprise - in favour choose rather to profit by government favours.* (Polanyi, p. 153)
The following passage, bitterly accurate about Portugal, is curious: *if the citizens of a stricken country would not or cannot live on what they earn in their present occupation at the existing state of demand (and these earnings may be zero or negative), they must as a rule find a new occupation, if necessary abroad, where their labours will produce results which can earn them a livelihood.* (Polanyi, 165-6)

[72] *The problem is very similar to the problem of a "depressed area" within a territory of a country.* (Polanyi, p. 165).

conferring efficacy on economic and social policy is certainly one of the most visionary aspects of Polanyi's thought, and is now one of the main pillars and objects of public policy, particularly at European level.

The virtuous relationship between international cooperation, the stability of the economic and financial system, and world peace is established as the background to the generalization of Polanyi's perspective. In addition to criticising the standard gold system, Polanyi assumes a firm defence of the *free market*, extended to international capital flows, although these may be associated with some difficulties that make him state that it is *questionable* that the stability of the international monetary system *can be given to the free market* only. In fact, the international capital movements cause serious deviations of the exchange rate in relation to purchasing power parity, which would correspond to the balance of trade. In this regard, it is sometimes desirable for the exchange rate to be set to values other than parity, to avoid sharp fluctuations in the value of currencies, in one direction or another, caused by loans and their international payments.

Polanyi doubts that markets can spontaneously take account of this need, making international conciliation paramount. *The legitimate interplay of these various group interests can find no expression in the operations of a market in foreign exchange, and hence the process of free trade may require to be supplemented by concerted international agreement*[73]*.* The development of common internal policies and international cooperation, through the World Bank, may mitigate this effect. The World Bank, supported by all countries, now gains its theoretical space of intervention and can facilitate the adjustment of international payments. *We realize that the division of the world into national territories with separate currencies may necessitate considerable government intervention for the purpose of maintaining international circulation*[74]*.*

With the currency resources of the different countries, the World Bank can avoid excessive movements of exchange rates. *It would assist the cancellation of these balances by gradual sale to the public at a suitable rate*[75]*.* At the same time, the development of common internal policies vis-à-vis employment would make it possible to minimize disruptions inherent to the modern economic system and provide a peace-friendly environment[76]. As an entity,

[73] Polanyi, p. 178-9.
[74] Polanyi, p. 179.
[75] Polanyi, p. 180.
[76] Thus, an economy based on the rational manipulation of money can maintain the doctrine of free trade with the outside in the same way as it does internally, favouring peace. *Once each country is*

the World Bank thus embodies the vision of an interdependent and co-managed global society through a space of conscious and shared political agreement.

Finally, if we were asked to suggest the main contribution of Polanyi's work, it would certainly be his deep understanding of the need for **public policy intervention** in the feasibility and sustainability of the modern economic system, both nationally and essentially internationally. The following passage unambiguously shows this understanding: *Compulsion, it would seem, is rational first, if the authority giving orders is in a better position than the person receiving orders to judge the personal interests of the latter. Anybody standing at a street crossing is really invested with the authority to wave on cars because it is recognized that he can see along two lanes crossing each other, while the drivers cannot see around the corner. The doctor is willingly given authority by the patient over himself because the doctor can judge in the patient's interest better than he. Compulsion seems rational, secondly, when the social interest must be enforced against the personal interests of the individual. Roughly speaking, all forms of authority exercised by the State are based on the latter plea.*[77] Associated with this strong relevance of public policy arises the affirmation of the importance of the **profession of Economist**. The new responsibilities for government economists are expressed in the following terms: *They will practice the art of economic government within the framework of the employment policy accepted by Parliament, while their performance will be controlled and guided by the judgement of the professional opinion of their fellow-economists*[78].

Conclusions

Polanyi takes us for more than 200 pages along fragile and delicate paths that seek to shape a compromise between the unquestionable preservation of capitalism and the role of public intervention in that goal. The truth is that the reader always feels that there is a contradiction intrinsic to his approach, which the author seeks to resolve throughout the text: either in general terms – the entire first chapter is a good example of this – or the growing importance (and the inherent confidence) of public intervention in the preservation of capitalism and the market economy is evident. Moreover, this importance and the necessary confidence in the public power is a direct consequence of

provided by its Government with sufficient money to maintain full employment, there is no reason left for any to press for a surplus of money receipts from abroad. (Polanyi, p. 173-4).

[77] Polanyi, p. 155-6.

[78] Polanyi, p. 158.

Polanyianism. The *principle of equivalence* and the *principle of neutrality*, the cornerstones of *Polanyianism*, inevitably lead us to this result. Sometimes, we are even led to see in Polanyi a formal and unequivocal recognition of the relevance and inevitability of public policy in the management of the economic system in general[79], although his fear of the (acknowledged) excesses of the various governments did not allow him to say so; however, this would have been an effort that would certainly lead to a better understanding of his ideas, simply by letting go, even slightly, the *principle of neutrality*.

From the economic point of view, perhaps Polanyi really liked (to be able) to be Keynesian; on the other hand, perhaps his intellectual capacity and his phobia (certainly justified) of economic planning and public intervention in the economy did not allow him such proximity. It is a bit as if a courting couple who at a moment of mutual rapture decide to marry, but when the moment comes is not able to do it, since the differences between both persons is greater than the charm they feel at the sweet moment they thought united them, although the gleam in their gaze endured. In short, two liberal thinkers depart with a similar understanding of the problem, but arrive at very different outcomes, both conceptually and in terms of nature and public policy reach as an instrument. For Keynes, intervention is necessary, as the monetary channels are not enough and private initiative and business investment are fundamental; while for Polanyi not only public intervention is necessary and inevitable, but also the monetary channels are the only effective channels to enforce it and the responsibility is fully attributed to the government and its ability to execute the budget.

This result is not without a taste of irony, since for someone who completely rejects government intervention in the economy, he ends up proposing a solution that places all the responsibility and trust on the sphere of public decisions, supporting his views only on a principle, very fragile from all points of view, the *principle of neutrality*.

Despite everything, Full Employment and Free Trade is an invaluable contribution that Polanyi leaves us, essentially in his defence of the relevance of public policy in the modern management of the national and international economic system.

Finally, whereas Polanyi used some conceptual and analytical eclecticism to respect his objective statement of converting Keynesian theory into *a matter of common-sense*, establishing a parallel with the atomic theory of chemistry,

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[79] See, for example, the very enlightening references on pp. 156-7.

which requires it to be *much simpler and clearer*, it is also true that he fully fulfilled what he promised in his preface, where he stated that his approach to the subject *neither can it be said to represent exactly what Lord Keynes or any other economist has definitely said before*.

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