

“Financialization and Society’s Protective Response: Reconsidering Polanyi’s Thesis”

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Abstract: Financialization challenges Polanyi’s thesis that efforts to extend the market evoke efforts to protect humans and nature from market forces. The financialization represents efforts to channel household income and assets into corporate profits. Financialization rests on the transition from corporeal property that underlies Polanyi’s thesis, to intangible property. The social legislation of the late nineteenth and early twentieth centuries largely protects human beings from starvation, and corporeal property generally; it does little to protect household assets. Fed intervention to protect financial institutions suggests a bifurcation in Polanyi’s thesis: the government protects financial institutions, while doing little to protect households. Market capitalism represented the attempt to organize commodities on the basis of economic rationality. Similarly, the twentieth and twenty-first century capitalism represents the effort to organize society according to the value of intangible assets on the basis of economic rationality. Both efforts failed, indicating the continued relevance of Polanyi’s thesis.

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Financialization challenges Polanyi's thesis that efforts to extend the market evoke efforts to protect humans and nature from market forces. The social legislation of the late nineteenth and early twentieth centuries largely protects human beings from starvation. The social legislation does little, however, to protect household assets, assets that offer households some protection against illness, emergencies, lack of retirement income, and so on. Appearing consistent with Polanyi's thesis, the Fed has extended its protection to financial institutions by restoring balance sheets, reducing interest costs, and providing liquidity.

Hence, we have a bifurcation in Polanyi's thesis: the government protects financial institutions, while doing little to protect households. In part, the bifurcation reflects the working rules that the Fed must follow. Anne Mayhew's observation applies readily to the implications of financialization. "Polanyi's concept of the double movement is powerful in explaining change in the late nineteenth century United States, but needs modifications to explain events in the late twentieth century" (1989, 560-61).

Polanyi criticizes nineteenth century capitalism for attempting to transform land, labor, and money into commodities. The transformation represented an effort to organize society on the basis of economic rationality. The effort, however, interfered with the process of social provisioning, which spontaneously evoked a counter movement.

Employing the concepts of corporeal, intangible, and incorporeal property sheds new light on Polanyi's thesis. Following the classical economists, Polanyi's critique assumes that property is corporeal, that is, property represents the ownership of things. With the emergence of the modern corporation, the late nineteenth, early twentieth centuries witnessed an extension of property to intangible assets, defined as the present value of prospective income; and incorporeal property, defined as debt (Commons [1934]1961). This extension laid the basis for the

financialization of the American economy. "With the rise of incorporeal and intangible property, the financial markets became a key institution in capitalism. These steps led us into the credit economy that we are trying to understand today" (Atkinson 2009, 436).

The change in the concept of property provided the basis for the financialization of households, which reveals itself in the evolution of consumer credit culminating in the financial crisis of 2008. The financialization of the consumer represents efforts to channel household income and assets into corporate profits. Credit involves exchanging purchasing power in the present for payments in the future. Credit circumvents the constraints imposed by limited or declining incomes, thereby increasing spending. The evolution of credit rests on innovations that allow the liquefaction of previously illiquid assets, innovations including consumer installment credit, credit cards, home equity loans, and so on.

If the nineteenth century represents the effort to rationally organize land, labor, and money as commodities, the twentieth and twenty-first centuries represent efforts to rationally organize society based on the value of intangible assets. Land, labor, and money are themselves transformed into intangible assets. In the sense that both efforts failed, Polanyi's thesis remains relevant:

The Rational Organization of Land, Labor, and Money as Commodities

Karl Polanyi in his book *The Great Transformation* criticizes nineteenth century capitalism for transforming labor, land, and money into commodities.¹ Polanyi's conception of market

¹ "Social history in the nineteenth century was thus the result of a double movement: the extension of the market organization in respect to genuine commodities was accompanied by its restriction in respect to fictitious ones. While on the one hand markets spread all over the globe

capitalism generalizes Max Weber's concept. Weber conceived capitalism as the "rational capitalistic organization of (formally) free labour." (Weber 1978, 21).² As Weber notes, "Exact calculation—the basis of everything else—is only possible on a basis of free labor" (Weber 1978, 22). Free labor means the freedom to buy and sell labor, which requires transforming labor into a commodity. Freeing both labor and land is requisite to subjecting them to market forces. *"The rise of the market to a ruling force in the economy can be traced by noting the extent to which land and food were mobilized through [market] exchange, and labor was turned into a commodity free to be purchased in the market"* (Polanyi 1968, 156).

The transformation attempts to sever human beings and nature from their social and ecological contexts. From the perspective of the market system, human beings only have value as laborers in the production process; nature only has value as lumber to build, land to develop, or ore to mine; output only has value if the possibility exists that it can be transformed into gold. The attempted severance involves subjecting human beings and nature to market forces. Severance assumes that the economic system works independently of society and nature.

Subjection is required if society is organized as a market. In turn, this assumes everyone is a merchant or, in Adam Smith's words, if everyone displays a "natural propensity to truck, barter, and exchange one thing for another" ([1776]1937). Polanyi, of course, disagrees with Smith. "The true criticism of market society is not that it was based on economics—in a sense, every and nay society must be based on it—but that its economy was based on self-interest" (1944, 249).

and the amount of goods involved grew to unbelievable proportions, on the other hand a network of measures and policies was integrated into powerful institutions designed to check the action of the market relative to labor, land, and money" (Polanyi 1944, 76).

²This differs from the rational pursuit of profit, which has characterized business for centuries.

Nevertheless, the creation of a market-economy necessarily involves "a change in the motive of action on part of the members of society"(Polanyi 1964, 41). The motive of self-interest replaces the motive of subsistence. The ideal of rational economic man upon which the market rests assumes that human beings are motivated by the pursuit of pleasure and the avoidance of pain. Malthus made avoiding pain part of God's divine plan,³ sanctioning the use of hunger to motivate the poor. Poverty results not from the rational organization of society, but from human frailty. Society itself becomes nothing more than "an adjunct to the market" (Polanyi 1964, 57). Polanyi continues:

Instead of economy being embedded in social relations, social relations are embedded in the economic system. The vital importance of the economic factor to the existence of society precludes any other result. For once the economic system is organized in separate institutions, based on specific motives and conferring a special status, society must be shaped in such a manner as to allow that system to function according to its own laws. This is the meaning of the familiar assertion that a market economy can function only in a market society. (1944, 57)

Hence, instituting a market system requires restricting democracy to the political sphere. "A self-regulating market demands nothing less than the institutional separation of society into an economic and political sphere"(Polanyi 1944, 71). Separating the economic from the political

³ "Evil exists in the world not to create despair but activity. We are not patiently to submit to it, but to exert ourselves to avoid it. It is not only the interest but the duty of every individual to use his utmost efforts to remove evil from himself and from as large a circle as he can influence, and the more he exercises himself in this duty, the more wisely he directs his efforts, and the more successful these efforts are, the more he will probably improve and exalt his own mind and the more completely does he appear to fulfill the will of his Creator" (Malthus 1798).

sphere requires making private property inviolable. It establishes rights without responsibilities. As expressed in the invisible-hand doctrine, the classical economists implicitly assumed that in the exercise of individual rights responsibilities would be fulfilled.

Polanyi emphasizes land and labor because they are central to the process of social provisioning, regardless of cultural differences. Hence, land and labor are fictitious commodities in that they are not produced for sale. The centrality of labor to the provisioning process further manifests itself in the classical view that labor, or more generally costs of production, is the source of value. As Adam Smith acknowledged, “Labor is the original purchase price paid for all things” ([1776]1937). Transforming land and labor into commodities, however, interferes with social provisioning by attempting to eliminate interference from non-market institutions, which offered people some protection from market forces. Transforming money into a commodity limited both the ability of businesses to transform outputs into money and the ability of the monetary authorities to provide liquidity in times of crisis.

As Polanyi notes, the effort to create a purely market economy was a utopian endeavor. The reality of unemployed workers, environmental destruction, and failing businesses created a counter movement to protect labor, land, and business from market forces. In brief, Polanyi’s thesis presents a critique of the organization of land, labor, and money based on economic rationality. Extending the market represents the “rational” organization of all aspects of society. To do so would mean the annihilation of society itself.

Extending the Market: From Corporeal Property to Intangible Property

As noted, efforts to extend the market by transforming land, labor, and money into commodities evoked a counter movement to protect human beings, nature, and business from market forces.

The social legislation of the late nineteenth and early twentieth centuries provided some measure of protection against starvation. The change in the concept of property from corporeal to intangible property, however, created new opportunities to profit, effectively side-stepping Polanyi's protective response.

Polanyi's thesis represents a critique of the classical view of property. The classical economists uncritically accepted the concept of property, uncritically because they failed to inquire into its origins. Conceptually, the corporeal concept of property or property as use value originated with Locke. For Locke, property in things stemmed from "mixing labour with nature." Locke conceived property as a natural right, which he used to counter Robert Filmer's defense of feudal rent. Locke's theory also provided the justification for the Glorious Revolution of 1688, which limited the ability of the government to tax private property establishing the separation of sovereignty from property. Smith accepted Locke's corporeal view of property, defining productive labor as one that creates a vendible commodity in addition to providing a surplus for the capitalist.

Historically, private property originated in England with the enclosure movement of the 16th century. The enclosure movement marked the origin of a "free" labor force, free in the sense that the enclosures forcibly separated the serfs from the land (See Marx [1867]1967, Part 8). The right of the former land lords to forcibly remove the serfs established rights independent of social obligations. Labor, however, continued to be "protected" by various forms of legislation including the Act of Artificers, the Act of Settlement, Speenhamland Law, and so on until its "emancipation" in 1840, in which it became dependent on market forces.

Property as an intangible asset originated with the emergence of the modern corporation in the late nineteenth century. Corporations were no longer valued by the costs of production or

replacement costs. Instead, value is measured by the present value of prospective income, by the present value of the anticipated income flows, which as noted is the definition of intangible property. According to Commons, an important aspect of intangible property is that its value results from negotiation, that is, it is determined by the market.

Property as an intangible asset was discovered almost simultaneously by Veblen and the Supreme Court. Veblen arrived at the conclusion noting that businesses could increase their profits by restricting output (Veblen [1904]1975). For Veblen, property as an intangible asset stems from the power to withhold property, from economic sabotage. As Commons noted, Veblen “distinguished intangible value, or intangible capital, as the purely pecuniary valuations by business men, according to their strategic power of holding up the community and “getting something for nothing”” (Commons [1934]1961, 650).

The Supreme Court arrived at a similar conclusion from the point of view of reasonable value. The court decided that State of Minnesota’s decision to reduce railway rates constituted a taking of property, a taking forbid by the 14th amendment without due process. Forcibly reducing railway rates constituted a taking of intangible property.

Property as an intangible asset ushered in the credit economy, what Keynes called the monetary economy, an economy “in which changing views about the future are capable of influencing the quantity of employment and not merely its direction” (Keynes 1964, vii). In Keynes’ view, “changing views about the future” are largely influenced by changes in effective demand. Value no longer stems from producing commodities in the present; instead, value depends on expectations, a change which opened the door for the financialization of the household.

Financialization of the Consumer

Financialization of the consumer represents the transformation of household income and assets into corporate profits by extending credit to consumers. Financialization involves “the increasing importance of financial markets, financial motives, financial institutions, and financial elites in the operations of the economy and its governing institutions, both at the national and international levels” (Epstein 2001, 3). Palley makes a similar point, defining financialization as “a process whereby financial markets, financial institutions, and financial elites gain greater influence over economic policy and economic outcomes” (2007, 2).

From the corporate point of view, the problem may be posed as follows: how to increase revenues without increasing costs? The answer lies in extending households credit. Historically, extending credit to households involves innovations that remove liquidity constraints that limit consumer spending. Those constraints include overcoming the cultural taboos of the Protestant Ethic against credit; overcoming the lack of collateral by establishing installment credit; overcoming the lack of income by providing the universal credit card, effectively liquefying the prospective income of households; removing institutional prohibitions against credit internationally (See Watkins 2000).

Financialization of the American household begins with the durable goods revolution of the late nineteenth, early twentieth centuries. The durable goods revolution introduced a series of innovations that revolutionized the role of the consumer, replacing household production with the mass production of household goods. The durable goods revolution introduced two important innovations: the automobile and electrification, which in turn made possible a plethora of new products. The durable goods revolution also saw innovations in retail outlets: the department store, the automobile dealer, and the sales finance companies. There were also innovations in

techniques used to sell the products, notably advertising and installment credit.⁴ The accumulation of consumer assets as durable goods evolved alongside the evolution of consumer credit.

During much of the nineteenth century, the only asset that people owned was their labor-power. This limited consumer purchases to incomes earned. Banks limited loans to commercial endeavors. Their sanctimonious refusal to make consumer loans reflected the Protestant bias against prodigality. The Protestant values of hard work and thrift served well an economy trying to accumulate capital; for an economy producing an abundance of consumer goods, Protestant values became an anathema. As Calvin Coolidge perceptively observed that "(m)ass production is only possible when there is mass demand" (Coolidge quoted in Olney 1991, 135).

The evolution of consumer credit reflects a process of financial innovation, a process that both creates and liquefies household assets. Corporate inroads into consumer credit begin with installment credit. Installment credit was first issued by Singer to sell sewing machines. Singer pitched the purchase as a time-saving investment.

Corporations extended credit to consumers using the item purchased as collateral. From the point of view of retailers and manufacturers, installment credit promised rising sales and an increase in their intangible assets. From the financier's viewpoint, expanding installment credit

⁴ "Installment selling is not new. It is known to have been used in this country in the sale of furniture as early as 1807, or one hundred and thirty years ago. Sewing machines have been sold on installments since 1856, or for eighty-two years. Pianos and encyclopedias have been so sold for about the same length of time. Installment selling was certainly practiced in Europe before it was introduced here. It is said to have been used in Rome and in Mesopotamia more than two thousand years ago. Installment selling is inherently applicable to the sale of things which have a relatively long life and which cost more money than the purchaser can conveniently spare at one time." (Ayres 1938, p. 121)

promised additional interest payments. The consumer's failure to repay could be mitigated by repossessing the collateral. From the consumer's point of view, installment credit represents the exchange of purchasing power in the present for payment in the future. In purchasing the good on credit, the consumer receives a corporal property, the retailer an intangible asset, and the financier an incorporeal asset.

The universal credit card came into its own during the 1960s as a result of the Marquette decision that undermined state usury laws. Credit cards extend credit based on the individual's prospective income. Hence, extending people credit cards rests on creating an intangible asset based on the present value of a household's anticipated income.

Consumer credit played an important role in fostering the economic boom of the 1920s, and the subsequent depression. Peter Temin suggests that the depression resulted from a collapse in consumer demand. "At the current stage of our knowledge, the unexplained fall in consumption is larger than the part we can explain, but the magnitude of the total fall is incontrovertible. The large decline in consumption expenditures for both durable and nondurable goods in 1930 had a profoundly depressing effect for the economy" (Temin 1976, 172). Paul Kubik suggests that the source of the decline was over indebtedness of households (Kubik 1996). The inability to meet debt obligations in turn impaired the ability of businesses to earn profits.

From Commodity Money to Fiat Money to Super Fiat Money

As noted, Polanyi focused on the transformation of land, labor, and money into commodities. From a business point of view, however, obtaining money involved transforming the inputs into outputs, outputs into commodities, and commodities into money, which is itself another commodity. The nineteenth century view of money as a commodity, as gold, severely

constrained the ability of business to transform commodities into money. The problem with commodity money stemmed from deflation

Since deflation happens through credit restrictions, it follows that the working of the commodity money interfered with the working of the credit system. This was a standing danger to business. Yet, to discard token money altogether and restrict currency to commodity money was entirely out of the question, since such a remedy would have been worse than the disease (Polanyi 1944, 194).

As Polanyi notes, the collapse of the nineteenth century civilization also meant the collapse of the gold standard. The introduction of fiat money expanded the ability of the central bank to provide liquidity in times of crisis.

Polanyi focuses on the failure of businesses to transform commodities into money. Polanyi did not consider the opportunities created by intangible property. The change in how businesses are valued shifts the focus from production to effective demand. Hence, assets are valued not on cost, but on prospective earning capacity. Transforming the determination of the value of an asset from the costs of physical commodities to intangible assets opens new means of making money, which has accelerated over the past thirty years.

As noted, financial innovation involves finding ways of inducing households to exchange purchasing power in the present for a stream of payments in the future. This payment stream together with the fees that financial institutions charged for buying and selling financial assets have increased dramatically over the past fifty years. Clearly, providing credit to households in lieu of raising wages represents one of the great success stories of corporate America.

The financialization of the US economy resulting from changes in financial institutions increased the flow of income from those in the lower four quintiles to those in the upper quintile.

As a percentage of GDP, household debt had more than doubled from 1959 to 2007.

Correspondingly, financial profits as a percentage of GDP rose from 1.3% in 1965 to a high of 2.9% in 2005. After falling to less than 1% during the financial crisis, financial profits as a percentage of GDP have rebounded to over 3% as of 2013, thanks to government bailouts and the policies of the Federal Reserve (Bank 2014).

Installment credit that fueled the durables goods revolution in the years that preceded the Great Depression provided credit on the condition that the item purchased can be seized and liquidated. Financial institutions extended subprime loans on the same premise. Hence, both the Great Depression and the Great Recession were characterized by increases in debt, declining asset values, and rising unemployment. The government response, however, differs. Given the widespread hardship, poverty, and starvation that characterized the Great Depression, the social legislation of the 1930s represents efforts to protect human beings from market forces. With the Great Recession, the government response sought to protect the intangible assets of financial institutions, suggesting a difference in the attitude of policy makers from that of the 1930s, and difference in the type of property needing protection.

Despite the increase in inequality, the Great Recession appears to pose a problem for Polanyi's thesis. Why the lack of social unrest? Why has the public acquiesced in bailing out the financial sector? The answer perhaps lies in the non-market institutions that provide some measure of protection. Financialization itself represents the rational organization of intangible assets. This frees the state to intervene to prevent starvation, regulate corporeal property, and so on. But the financialization of the American economy and its implications, the organization of intangible assets on the basis of economic rationality poses its own problem, the solution to which introduces new contradictions.

The limits of financial innovation revealed themselves in the financial crisis of 2008. The crisis recalls the proverbial saying “you cannot draw blood from a stone;” you cannot profit from people who lack both income and assets. Financiers, of course, extended credit to low-income households on the assumption that home values would appreciate.

The Fed’s authority to expand its balance sheet four fold since 2008 appears to represent a radical extension of Polanyi’s protective response.⁵ The radical increase in fiat money might be called super-fiat money, recalling Polanyi’s concept of special-purpose money characteristic of ancient societies. All-purpose money characteristic of modern societies is self-evident: “the money employed in as a means of exchange is endowed with the capacity of performing all the other functions as well, in early society the position is rather the reverse” (Polanyi 1968, 178). Super-fiat money seems to bring back a special purpose: to reduce unemployment. The primary beneficiaries, however, have been financial institutions themselves (Watkins 2014).

The Fed’s response introduces another contradiction. As noted, the value of intangible assets is determined by negotiation, by market participants. Fed intervention in response to the Great Recession means that the value of assets no longer results from negotiation, but Fed fiat. Hence, the Great Recession represents the failure to rationally organize society based on the value of intangible assets.

Aside from facilitating exchange, among the more important function of money is to settle debts. The Fed’s policy of quantitative easing effectively released the debts of financial

⁵ The authority for the four-fold increase in the Fed’s balance sheet rests on Section 13, Paragraph 3 of the Federal Reserve Act. Under “unusual and exigent circumstances,” the Act allows the Fed “to discount for any individual, partnership, or corporation, notes, drafts, and bills of exchange when such notes, drafts, and bills of exchange are indorsed or otherwise secured to the satisfaction of the Federal Reserve bank” (System).

institutions. The limitation of the release of debts to financial institutions reveals the undemocratic nature of the Fed's actions, and hence represents a violation of Polanyi's protective response.

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