Using Karl Polanyi as a stepping stone for a critique of the new institutionalist orthodoxy

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Abstract

This paper forms a critique of the New Institutional Economics (NIE) of Douglass North, Ronald Coase, Oliver Williamson et al. from the viewpoint of Karl Polanyi's thoughts on markets and capitalism. Contrasting the two approaches to one another, I argue that in their views of markets the two approaches are inherently and fundamentally dissimilar. Polanyi's approach sustains the idea of a history of different market forms, the idea that qualitatively different economic systems have prevailed in human history and that market capitalism is a latter-day product of history, brought about by a "great transformation" in human societal existence. Thereby Polanyi's conception is potentially historical, social and realistic. NIE on the other hand, although it was once conceived in recognition of the problems of the lack of history, sociality and realism in orthodox economic theory, cannot overcome these problems pinpointed by (among others) Polanyi. Hence, contrary to the promise of above all North, NIE remains ahistorical, asocial and non-realistic in its approach. This is so, because with its focus on the market as a universal yardstick, used in order to explain all other institutions, NIE cannot fully allow for a history of different market forms, nor can NIE conceive of the capitalist market system as the product of history, but tends rather to see the market as the very beginning as well as the end of human history. The paper concludes that in light of the continuing influence and spread of NIE, Polanyi remains a valuable and necessary corrective to this "economistic fallacy" of old, in its new disguise.

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I assume, for expositional convenience, that "in the beginning there were markets".
Oliver E. Williamson (1975: 21)

The habit of looking at the last ten thousand years as well as at the array of early societies as a mere prelude to the true history of our civilisation … is, to say the least, out of date.
Karl Polanyi (1957c: 45)

Introduction

This paper considers the New Institutional Economics (NIE) from the viewpoint of Karl Polanyi. As such, as will be shown below, it could almost be described as an exercise in a "clash of paradigms". Although both theoretical outlooks can be seen as "institutional" I will argue that the two are inherently and fundamentally dissimilar as regards the main points about market capitalism, and its history above all. The paper is structured as follows.

Part I contains a summary of the conceptual apparatus of NIE, with specific emphasis on how it differs from neoclassical economics. Part II is an exposition of Polanyi's theory, both his critique of formalist economics, as well as his conceptions of pre-capitalist versus capitalist markets. Also, I consider the conceptions that lead Polanyi to describe market capitalism as a "great transformation". Part III starts the comparison between NIE and Polanyi by giving some examples of how economic orthodoxy has criticised Polanyi's conception of the limited role of markets in pre-capitalist history. In Part IV, using the example of Douglass North, I argue that NIE remains ahistorical, asocial and non-realistic in its conception of economic history, and that therefore Polanyi's main critique and outlook on the matter retain their validity as a necessary corrective to the misconceptions of economic orthodoxy. In short, although the particular form of "market fundamentalism" that Polanyi attacked in the middle of the last century should be deemed out of date, it re-surfaces anew in a new disguise. Hence, the need to reconsider Polanyi too.

I. The Nature of New Institutional Economics

New Institutional Economics (NIE), with main advocates Armen Alchain, Ronald Coase, Harold Demsetz, Douglass North, Oliver Williamson etc., has gained substantial influence within the social sciences. Not least because it is an attempt to make neoclassical economic theory more realistic, more social, and historical in the approach, and hence avoid the charges since long launched against it for its shortcomings in these regards.[1] This is attempted by moving beyond neoclassical economics with an institutional analysis yet at the same time sticking to its basics. Furthermore – due mainly to the works of North – NIE has become an established tradition in economic history in explaining the rise and evolution of market capitalism.

NIE can be defined as a "neoclassical" institutionalism, which is influenced by rather diverse ideas from liberal social thought. On the one hand evolutionary arguments, ideas of selection, of "survival of the fittest", of "the invisible hand" etc. are in various ways developed and elaborated by NIE.[2] On the other hand the concepts of markets, supply and demand, marginalism, factors of production etc. are inherited from neoclassical orthodoxy. As two new institutionalists claim:

> ...[T]he exponents of modern institutional economics apply the analytical apparatus of neoclassical theory (and newer techniques) to explain the workings and evolution of institutional arrangements and thus to expand the scope and predictive power of microeconomics. (Furubotn and Richter, 1997: 2)

Although this is true, the conceptual framework of NIE does deviate from neoclassical theory in various ways. Let us turn to these concepts.

Bounded rationality

More and more new institutionalists reject the "unrealistic" assumptions of perfect information and hence the concept of full rationality in favour of the concept of "bounded rationality". This concept – originating from Herbert Simon – is a disputed one.[3] In the hands of NIE it is taken to include the point that in the presence of uncertainty, information problems, and "transaction costs" (I'll get back to these), economic agents cannot gather all

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1 On the different definitions and descriptions of NIE, see Langlois (1986), Eggertsson (1990), Vromen (1995), Furubotn and Richter (1997).

2 See e.g. Hodgson (1993), Vromen (1995).

the information necessary to calculate, case-by-case, the optimal solution on the market. Individuals are therefore: “intendedly rational but only limitedly so” (Williamson, 1985: 45). Thereby the maximising equilibrium of neoclassical economics is as a rule not attainable.

To minimise the problem of uncertainty economic agents devise rules of thought and action to base their decisions on. They become “rule followers” (Vanberg, 1994). These rules are rather fixed and do not change by the case-by-case calculation. As one observer puts it: “A boundedly rational individual intends to maximise, but finds it costly to do so.”[4]

Transaction costs

The main theoretical achievement of NIE is the transaction cost concept. It originated from Ronald Coase’s 1937 article on the firm, where he posed the question in this vein:

> But in view of the fact that it is usually argued that co-ordination will be done by the price mechanism, why is ... organisation necessary? Why are there these ”islands of conscious power”? ... Yet, having regard to the fact that if production is regulated by price movements, production could be carried on without any organisation at all, well might we ask, why is there any organisation? (Coase, 1993: 19)

His historic answer was the following:

> The main reason why it is profitable to establish a firm would seem to be that there is a cost of using the price mechanism. (Coase, 1993: 21)

This “cost of using the price mechanism” is a transaction cost. The concept remains rather contested, since definitions vary (see, Ankarloo, 1999: 62-68). But, in summary:

> These then, represent the first approximation to a workable concept of transaction costs: search and information costs, bargaining and decision costs, policing and enforcement costs. (Dahlman, 1979: 147-148) [5]

In the presence of transaction costs, markets and prices are not sufficient to create neoclassical equilibrium (“efficiency”). And new institutionalists argue transaction costs are pervasive in all economies, in every economic system. The development of transaction costs, is the key to

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[3] See e.g. Langlois (1990).

[4] Kreps, quoted from Furubotn and Richter (1991: 4). For critical expositions of the rationality assumptions of NIE, see Hodgson (1988: 53-116), Mäki, Gustavsson and Knudsen (1993).

[5] In the light of the widespread usage of transaction cost concepts today, it seems appropriate to stress that in Coase’s theory *prices are the cause of transaction costs*. His original idea was that the only plausible economy *without transaction costs* would be a fully planned economy, with no direction of the price mechanism. He says: “If I were asked to imagine an economic system in which transaction costs did not exist, it would be a completely communist society.” (Coase, 1992: 73)

the institutional structure of a society and economy. One cannot over-stress the importance of the concept in NIE. As two proponents explain:

> The concept of transaction costs is crucial to any acceptable interpretation of how a capitalist market economy actually functions. To see the truth of this judgement it is only necessary to consider a world where transaction costs are zero. In such a ”frictionless” world even basic institutions as e.g. money, the firm, public regulation become *irrelevant*. (Furubotn and Richter, 1991: 11)

In NIE institutions and organisations are described as “selected” (either consciously or through the mechanism of the “invisible hand”) in relation to how well they contribute to lowering transaction costs. Hence, NIE provides the analytical tool for explaining not only when the market is efficient, but also when other institutions and organisations (such as the firm, the manor system, etc.) are more efficient than the market.[6]

The operation of the market economy is in NIE based on a third condition, the distribution and protection of property rights.

Property rights

The focus on property rights with regard to capitalism is, of course, very welcome. In General Equilibrium, property rights’ distribution is immaterial to the equilibrium solution of the market, but in the light of bounded rationality and transaction costs, the original property rights’ distribution is decisive for economic efficiency. With property rights theory things have changed for orthodoxy.[7]

NIE’s definition of property rights is wide, to say the least. Yoram Barzel (1989: 2) for instance contends that human rights “are simply a part of people’s property rights”. In such a definition everything from buying a tomato to committing suicide or driving a car too fast is an exercise in private property rights. But sticking to the economics of it, we conclude:

> There are various categories of property rights; the right of ownership, however, is the best known. By general agreement, the right of ownership in an asset consists of three elements: (a.) the right to use the asset (usus), (b.) the right to appropriate the returns from an asset (usus fructus), and (c.) the right to change its form, substance and location (abusus). (Furubotn and Richter, 1991: 6)

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[6] Examples of such explanations of the rationale of non-market, non-capitalist institutions in NIE abound. See e.g. North and Thomas (1973), McCloskey (1972; 1975; 1976), Dahlman (1980), Fenoaltea (1976; 1991).

[7] The property rights theory has its origin in NIE in Coase (1960) and has subsequently been developed by among others Demsetz (1964; 1967), Furubotn and Pejovich (1972; 1974), Alchain and Demsetz (1972), De Alessi (1980), Barzel (1989).

The economic problem now becomes how and when property rights are exchanged in the economy. For this to happen, NIE argues, property rights should be exclusive; and in order to assure this exclusiveness of private property rights, they must be well delineated and enforced (by the state). If indeed property rights are easily delineated, well protected and enforced by the state, then the transaction costs will be low and the gains from trade inherent in the neoclassical market argument will be realised. If not, exchange will not occur and the market will not be put to work. North summarises:

> A theory of the state is essential because it is the state that specifies the property rights structure. Ultimately it is the state that is responsible for the efficiency of the property rights structure, which causes growth or stagnation and economic decline. (North, 1981: 17)

So, in NIE, the functioning of the market is made dependent upon the workings of the state, and the way in which property rights and institutions work to lower transaction costs.

Institutions

Institutions are "the humanly devised constraints that shape human action" (North, 1990: 3). With this concept NIE can arguably become more realistic in its approach. In the words of the founding father: "Modern institutional economics should study man as he is, acting within the constraints imposed by real institutions" (Coase, 1984: 231). Institutions are both "informal constraints" (custom, culture, incentives, taboos etc.) and "formal constraints" (law, property rights etc.). Institutions are the rules of the game in the economy, and "organisations" ("the players of the game") arise in response to the institutional structure. North (1993: 7) explains: "It is the interaction between institutions and organisations which shapes the institutional evolution of the economy". Conceded that neoclassical equilibrium does not come about in the real world, and that the property rights structure, the state and the institutional evolution of society determine economic performance, North comes to the following conclusion:

> History matters. It matters not just because we can learn from the past, but because the present and future are connected to the past by the continuity of a society's institutions. Today's and tomorrow's choices are shaped by the past. And the past can only be made intelligible as a story of institutional evolution. (North, 1990: vii)

So, with its conceptual and theoretical innovations NIE attempts to make neoclassical economics more *realistic*. The prime example of this is the adoption of the conception of "bounded rationality", which is perceived to be more in line with actual human behaviour.

With the introduction of "transaction costs", in combination with the focus on property rights, NIE also takes economics in a more *social* direction, allowing for and explaining both historical evolution and different economic systems than the market, as well as pointing to the necessity of institutional and state support for the market to work. "Institutions" has become the key concept in indicating the need for a more realistic, social, historical approach to economics. Above all, *history* has come to the centre of economics.

Considering all these traits in NIE one might argue that it seems well equipped to deal with the charges previously launched against orthodoxy. Contrasting NIE to Polanyi, I will argue that this is not the case.

II. An exposition of Polanyi's theory

The economistic fallacy

The stepping stone of Polanyi's thought is his critique of the orthodox view of the economy. To orthodoxy the economy is the *choice* between *scarce* means in relation to preferred ends. Economising means allocation of these scarce resources. This is "the economic problem". Polanyi calls this a formalist definition of the economy. Its validity is relative to the historical development – and fact – of a market society (a specific form of economic organisation) but, in essence, the substance of the economy is to provide a physical environment to sustain human life. According to Polanyi, it is impossible to understand economic history from the formalist perspective, because "to narrow the sphere of the genus *economic* specifically to market phenomena is to eliminate the greatest part of man's history from the scene" (Polanyi, 1977: 6).

Polanyi instead stresses that distribution mechanisms are socially instituted without necessarily an economic meaning (in the formalist sense). Where trade and markets have indeed existed in human history they have taken on very different meanings and social functions than those described by neoclassical economists. First and foremost because markets have not *regulated* the economy, but also for the fact that scarcity and choice do not entail a market. To believe so is to commit "the economistic fallacy" (Polanyi, 1977: 25-26).

Polanyi conceives of the economy as "substantive", reflecting two different levels: (i) Man's relation to nature and interaction with his surroundings, (ii) the social institution of the

economic process.[8] The need for an economy does not arise from a universal need to allocate scarce resource in the presence of choice and information problems, it arises simply because human beings cannot survive without production and interaction with nature. With his theory, Polanyi tries to understand the economy as the institution of this process.

Modes of circulation

Polanyi argues that the market is only one possible way of allocating resources in a society. *Redistribution*, designating "appropriational movements towards a centre and out of it again", and *reciprocity*, "movements between correlative points of symmetrical groupings", are other alternatives and historically more important than the market (Polanyi, 1968: 149). A *market system* only comes into being when there is a market for the "fictitious commodities" of land, labour and money. It is only when the bulk of income for survival becomes dependent upon the market that it evolves into a market economy. It is only then that the market takes over society – *becomes* society. And "only in the institutional setting of a market economy are market laws relevant" (Polanyi, 1957c: 38).

Polanyi stresses that it makes no sense to privilege one mode of circulation in relation to the others, because "the need for trade or markets is no greater than in the case of reciprocity and redistribution" (Polanyi, 1957c: 53). In fact, he argues, reciprocity and redistribution are more stable forms of economic integration than the market:

> Reciprocity and redistribution are able to ensure the working of an economic system without the help of written records and elaborate administration because the organisation of the societies in question meet the requirements of such a solution with the help of patterns such as *symmetry* and *centricity*. (Polanyi, 1957c: 48)

Thus we arrive at Polanyi's main criticism of economic orthodoxy in this area. The "economic man" and the economising society are the results of specific historical and social conditions, which are rather novel. But in pre-capitalist societies where reciprocity and redistribution are the main forms of integration and resource allocation, these traits of human society play a subordinate role, if at all they exist, since the logic of the economy is embedded in social relations. He concludes:

> As long as social organisation runs in its ruts, no individual economic motives need come into play; no shirking of personal effort need be feared … In such a community the idea of profit is barred; higgling and haggling is decried; giving freely is acclaimed as a virtue; the supposed propensity to

[8] Polanyi (1957b), Hopkins (1957).

> barter, truck and exchange does not appear. The economic system is, in effect, a mere function of social organisation. (Polanyi, 1957c: 49)

Polanyi thus maintains that historically the market has played no vital role in human social life until recently. The division of labour in society does not itself entail market exchange, only the circulation of goods either by reciprocity, redistribution or exchange. Furthermore, trade and exchange do not *per se* explain the birth of a market system. Polanyi says:

> It is not true, however, that individual acts and attitudes simply add up to create the institutional structures that support the forms of integration.
>
> The supporting structures, their basic organisation, and their validation spring from the societal sphere. In the case of redistribution ... the movement cannot proceed without an established centre from which redistribution takes place. Redistribution is not an individual pattern at all; and even when started on a small scale, it would depend upon the prior existence of a recognised centre. With reciprocity and exchange the position is essentially the same. They certainly also denote different kinds of attitudes and actions, those of mutuality and barter, but diffuse actions of mutuality and barter lack the essentials of effectiveness and continuity on the societal plane. Neither reciprocity nor exchange is possible at that plane without a structure pattern, which neither is or can be the result of individual acts of mutuality and barter ... As to exchange, random actions of barter between individuals, if they occur at all, are incapable of producing the integrating element of price. Here, as with reciprocity, the validating and organising factor springs not from the individual but from the collective actions of persons in structured situations. Exchange as a form of integration is dependent on the existence of a market system, an institutional pattern which, contrary to common assumptions, does not originate in random actions of exchange. (Polanyi, 1977: 37)

Contrary to the preconceptions of liberal political economy, and *a fortiori* NIE, Polanyi maintains, the decisive question is not how come the market did not come about (how it was "constrained") but rather how it did come about. Since Polanyi does not assume specific markets at the outset – he can also explain them. In short, his conception allows for a history of markets and a prehistory to market capitalism, which does not presuppose its logic.

Pre-capitalist markets

Before we go on let us get rid of a common misunderstanding. Polanyi does not deny *the existence* of markets in pre-capitalist society, nor does Marx for that matter.[9] Polanyi readily acknowledges that "the institution of a market was fairly common since the later Stone Age", but, he continues to pinpoint the real issue: "its role was no more than accidental to economic life" (Polanyi, 1957c: 43). It must be emphasised that markets throughout history have been

[9] Cf. Marx (1973: 156): "Prices are old, exchange also, but the increasing determination of the former by the costs of production, as well as the increasing dominance of the latter over all relations of production, only develop fully and continue to develop ever more completely in bourgeois society, the society of free competition. What Adam Smith in the true 18th Century manner, puts in the prehistoric period, the period preceding history, is rather a product of history."

very different, performing different functions. Polanyi says that in pre-industrial societies, the presence of market places and money "does not necessarily affect the economic system … since they do not provide for the necessities of life" (Polanyi, 1957c: 58 and 61).

Internal trade on local markets has had other and more important functions in society than that of allocating scarce resources or setting prices. Actually, pre-capitalist trading was a matter of culture, religion, status (gift giving) and ceremonial values, rather than economic allocation. Long-distance trade between nations and regions also entailed gift giving, and most of all, it was highly administered by the state (the *polis*). Local markets and long-distance trade were sharply separated from each other. Prices were not uniform but matters of custom and not spontaneous or fluctuating according to market rules. Analytically, it is therefore important to separate "the market" from the mere existence of a locus: the "market place". The market is an abstraction, which denotes a mechanism, which cannot simply be equated with a locus. Likewise the existence of a "market place" does not necessarily imply the market mechanism, only trade and exchange of goods; neither price nor economising need enter into it, according to Polanyi.

Therefore the presence of fairs and market places in the Roman Empire, the medieval market etc., on which the liberal economist so ardently bases his case, does not prove the presence of a market in the economist's sense (Neale, 1957: 366-367). I would say rather the opposite; the limited extent and diverse functions of pre-capitalist markets suggest how different they were from today's market. They were often periodically limited to special days of the year and they were highly fragmented (so we have a fruit market, a fish market, a meat market, etc) and not conceived of as *a* market. In many cases markets also coincided with celebrations and feast of various kinds. But who puts on a feast to go to the supermarket under prevailing wage-labour based capitalism?

This implies that the first starting point of a relevant theory of the birth of the market system is to analytically separate the concepts of trade and market. The market is simply one of many modes of trade. Trade does not entail a market, whereas the market entails some specific kinds of exchange. This is exactly what Polanyi spots in his classification. For instance, considering trade in ancient Babylon, he maintains:

> Nonmarket trade – this is the crucial point – is in all essentials different from market trade. This applies to personnel, goods, prices, but perhaps most emphatically to the nature of trading itself.
>
> The traders of the *Karum* of Kanish were not merchants in the sense of persons making a living out of the profit derived from buying and selling, i.e., price differentials in regard to the

> transaction in hand. They were traders by status, as a rule by virtue of descent or early apprenticeship, in other cases maybe by appointment. (Polanyi, 1957a: 19)

The income earned from such trading was not profit but either land grants or a commission for traded goods. If prices were indeed used in trading they "took the form of equivalents established by authority of custom, statute or proclamation" (Polanyi, 1957a: 20). In short, trade served wider social functions, not just the individual microeconomic ones in the formalist sense described by economists. This conception is supported by Rosemary Arnold, who commenting on the slave trade of Whydah of the Guinea coast, says:

> ... We [have] no need to refer to markets in order to explain the conduct of trade. From start to finish, the trading operation is an affair of the state, administered from the palace, and conducted by the dignitaries of the land under terms of treaty. The presence or absence of markets makes no difference to the trading operations described there. That a market exists in the port of trade itself is, then, striking confirmation of the independence of trade from market. (Arnold, 1957: 177)

In a similar vein Vishwa R. Gosch has concluded in the case of the Sonepun Fair in India:

> Two elementary features of the non-capitalist market stand out vividly. *One*, periodic or otherwise, they did not emerge as institutions designed to perform strictly one function, namely the economic. The market served a gamut of proto-materialistic, spiritual and non-spiritual, social intercourse, political needs of society, etc. *Two*, the economic function was intertwined with the other functions and inlaid in social values ... The non-capitalist market mechanism is rooted in prevalent values of ritual and status. Hence the markets were socially embedded. (Gosch, 1995: 17)

Polanyi sums up the argument by maintaining that in pre-capitalist societies: "markets are not institutions that function within an economy, but without. They are meeting places of long-distance trade. Local markets proper are of little consequence" (Polanyi, 1957c: 58). Such markets are ”embedded markets”, in Polanyi's conception, markets which tend to be personal, social, closed, marking social inequalities and identities. In contrast to capitalist markets which tend to be impersonal and ”equal”. So, Polanyi does not deny the existence of markets in pre-capitalist societies, but maintains that the decisive issue is their function and limited influence on the economy. With such a conception there is an analytical need for a theory of the self-regulating markets of capitalism – as opposed to the pre-capitalist ones.[10]

[10] Marx (1847: 2-3) captures this analytical need well: "Exchange has its own history. It has passed through different stages. There was a time, as in the Middle Ages, when only the superfluous, the excess of production over consumption, was exchanged. There was again a time when not only the superfluous, but all products, all

The Great Transformation

> Our thesis is that the idea of a self-adjusting market implied a stark utopia. Such an institution could not exist for any length of time without annihilating the human and natural substance of society; it would have physically destroyed man and transformed his surroundings into a wilderness. Inevitably society took measures to protect itself, but whatever measures it took impaired the self-regulation of the market, disorganised industrial life, and thus endangered society in yet another way. (Polanyi, 1957c: 3-4)

Thus begins *The Great Transformation*, Polanyi's classic account of the capitalist market economy. The market economy: "an economic system controlled, regulated and directed by markets alone" (Polanyi, 1957c: 68) is conceived as a distinct social order, built upon the "fictitious commodification" of land, labour and money, "to subordinate the substance of society itself to the laws of the market" (Polanyi, 1957c: 71). This commodification makes human social life dependent upon the fluctuations of the market, to its "supply and demand", and hence threatens to annihilate humanity as such. This market mentality, the allocation of scarce resources, is not "natural" to human beings. It has to be taught and learned.[11] Market capitalism achieves this by the social institution of "scarcity" and the threat of *individual* starvation (Polanyi, 1957c: 216).

Polanyi describes the capitalist market society as a system of markets "disembedded" from society. Rather than markets being regulated by societal and human needs, society and humanity become regulated by the market, so "instead of an economy being embedded in social relations, social relations [are] embedded in the economic system" (Polanyi, 1957c: 57).

The decisive issue is that under capitalism, production itself, including human reproduction and survival becomes dependent on market exchange. Failure to exchange – both for goods, but more importantly for labour-power on the labour market – entails the threat to individual survival. Thus, society becomes market-*conditioned.* Under such conditions, Polanyi argues, society as a self-preserving measure had to protect itself. So, contrary to the laissez-faire creed of liberal political economy, "*laissez faire* economy was the product of deliberate state action, subsequent reactions on laissez faire started in a spontaneous way. *Laissez faire* was planned, planning was not" (Polanyi, 1957c: 141).

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industrial products had passed into commerce, when the whole of production depended on exchange. How are we to explain this second phase of exchange…?"

[11] Weber (1958: 60) argues in a similar vein as regards pre-capitalist man: "The opportunity of earning more was less attractive than that of working less. He did not ask: how much can I earn a day if I do as much work as possible? But: how much must I work to earn the wage … which I earned before and which takes care of my traditional needs? … A man does not 'by nature' wish to earn more and more money, but simply to live as he is accustomed to live and to earn as much as is necessary for that purpose".

The self-regulating market system of capitalism is not a spontaneous outcome of "rational" individual action. Polanyi rather maintains that individuals every step of the way tried to protect themselves, and society, from this self-regulating market. But since we are here only dealing with the birth of capitalist market society, we do not account further for Polanyi's conception of this "double movement" contained in the great transformation. Nor for his perceptive analyses of the ways in which society took measures to protect itself during the first half of the 20th century. Instead we sum up Polanyi's argument in relation to NIE.

Firstly, Polanyi's conception allows for different functions of markets dependent upon the institutional context. Only in a capitalist market society does the market become self-regulating and a necessity for human survival – i.e. a genuinely disembedded economising tool. In pre-capitalist trade, markets play but a subordinate role in economic life. Exchange is not a confirmation of human nature, as we know it.

Secondly, therefore, there is nothing inherent in acts of barter and exchange to turn into this market society of self-regulation. Rather, enormous technological, social and policy-induced changes (often administered by the state), e.g. the enclosures, had to be put in place for the market to become disembedded and self-regulating. As a mere protective measure society reacts to try to re-embed the market in society again.

III. Orthodox critics of Polanyi's theory of economic history

The (non-) history of markets

The main orthodox criticism that has been launched against Polanyi relates to the fact that he, in the eyes of the economist, reduces the role of markets in history.

Morris Silver (1983; 1995) delivers one of the more ambitious attacks on Polanyi's framework, from this viewpoint. He is a clear advocate of transaction cost theory. In this framework he argues that Polanyi is simply wrong on empirical grounds. Silver's account is based on a vast reading of literature and "evidence", and contrasts directly to the views of Polanyi. Above all, Silver argues that markets did not only exist in the ancient economy, but they operated in the ordinary sense of price fluctuations and supply and demand. They were hence much more prevalent and important than Polanyi maintains. In ancient economies, he finds that there was an extensive banking and debt system, quite developed markets in land, free wage workers "in considerable number" and a slave market. (Silver, 1995: 122-135). To

pursue this line of reasoning, however, Silver has to deal with the conceptual consequences, head on. Hence, when Silver finds evidence of trade, he sees a "market economy". When he finds evidence of contract, he sees "a labour market" – although what is contracted are slaves. When he spots a merchant, he sees a "capitalist". When he sees different prices in an ancient economy, he sees "the law of supply and demand". When he finds evidence of production in the family, he calls it a "family firm". When he sees status, he calls it an "investment in name trust". When he sees skill, he calls it "human capital". When he sees temples and worship, he calls it the lowering of transaction cost by the collective "investment in gods". When he sees gods he analyses their "contribution to economic growth" (Silver, 1995: 3-38). When he sees man he sees "economic man". In short, when he sees economy, he sees a capitalist economy.

So rather than disproving Polanyi by evidence Silver engages in a neoclassical deconstruction of textual evidence from letters, inscriptions and tales of ancient societies. But arguing the case of the economic system of the ancient economies of Ure-dynasties, Babylonia, Egypt, Greece etc. on the question of direct "evidence" strikes me as a very doubtful venture indeed. The "evidence" is scanty to say the least, so the question rather becomes conceptual.[12]

Another criticism in a similar vein is delivered by A.J.H. Latham (1996). He argues that Polanyi has misunderstood the relationship between money, exchange and reciprocity. For instance slave trade, so important in ancient and primitive economies, is not one of reciprocity: "How can a slave enjoy a reciprocal gain from the person who sells and sacrifices him?", Latham (1996: 13) says. Furthermore, Polanyi states that money in pre-capitalist economies were not universal equivalents but bearers of status, and hence did not fulfil the same function as in capitalist market exchange. To this Latham (1996: 13) objects:

> The rod currency was the principle Polanyist example of a status exchange unit operating within a system of reciprocity, and key to their interpretation of primitive and archaic societies. But if it turns out to have been a true general purpose currency operating within a market economy, as appears to be the case, then the whole Polanyist interpretation is thrown into question … It must be emphasised that if a currency contains both large units and small units which can be used as small change for petty transactions, then it is almost certainly a true general purpose currency. If it is a true general purpose currency, then it is operating in a market economy and not a reciprocity system. True general purpose currencies and market economies are synonymous.

[12] The bulk of Silver's evidence is textual and relates to letters, inscriptions, books and tales of the ancient societies, but the understanding of these entails translation, which is certainly problematic without knowing the context. Silver here is totally unconvincing; because he has already decided what the meaning of "house", "business", and "merchant" must be in the ancient societies (i.e. what it is in capitalism). The point is rather if

Latham concludes that although Polanyi's conception of modes of circulation is correct, the evidence rather shows that the market has played a much larger role than Polanyi has acknowledged – and that the substantive conception of the economy actually seems to support the conclusions of the formalists.

D. McCloskey, in the vision of history as one great achievement of the bourgeoisie, also criticises Polanyi. McCloskey (1994) simply claims that Rome and Greece in ancient times were "business empires" and that "the emerging truth is that we have lived in a world market for centuries, a market run by the bourgeoisie" (McCloskey, 1994: 191).[13] McCloskey also means that it is time to abandon the idea that there was a great divide between the economic logic of the manor system and capitalism. It is myth that there was no market of land in medieval economies:

> Owning is supposed to come with capitalism ... [but] on sober consideration, the subnotion that land was inalienable and common has never been very plausible: a society that marketed human beings and eternal salvation would be unlikely to have scruples about land. But speculation is unnecessary since the evidence of an active market in land among peasants is ample.[14]

But do these conceptions provide relevant criticism of Polanyi? I think not. First of all the would-be evidence provided by these critics is achieved by the usage of some very specific conceptions of the problem at hand, which must be questioned. Take Silver for instance. He follows this line of reasoning to its extreme conclusions. He reaches his result by a very specific conception, where every human action and exchange is simply translated into the language of formalist economics. But this does not settle the issue; rather it just shows the relevance of Polanyi's critique.

Let us for the sake of argument accept that Silver's description of the ancient economies were true. Then he runs the risk of remedying a problem for his own economics by killing off the patient. Some questions arise if we accept the argument that the market economy and all its prerequisites were present already from the start of civilisation, if the ancient economy abounded with wage-labourers, capital, "entrepreneurs", profit-motive, long-distance trade, diffusion of technology etc., like Silver says. One immediate question is for instance why it is

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these concepts really are the same then and now. Even today, language is context-dependent. I mean if I tell someone to mind his "own business", it does not mean that I am talking to a businessman or entrepreneur.

[13] Books and articles more or less in this tradition of economic history now abound. Examples are: Andersen and Latham (1986), Galenson (1989). See also Schultz (1964) which rather deals with development issues in agriculture. But Schultz's main point, that although these economies are poor they are both efficient and rational in the microeconomic sense of orthodox economics, although not immediately related to Polanyi, is quite influential among Polanyi's critics.

[14] McCloskey 1986 quoted from Eggertsson (1990 p. 286).

that the economy did not develop its productive forces, its technology and organisation, in short its economic growth, then, but only now. If basically a market economy was already present from day one, why did it not grow the way modern capitalism does?

It seems that in Silver's framework economic development becomes accidental and not at all integrated with the way the economy itself works. His conception ends up by giving market capitalism too much and too little credit at the same time. Too much in the sense that he makes it eternal, and too little in the sense that the economic system of market society, and its basics of wage-labour, commodity production and markets cannot be used as the main explanatory variables of economic growth later on in the explanation.[15] *Some* transformation in the logic of the economic system between then and today's capitalism must indeed have taken place. But Silver's transaction cost tools scarcely allow for such a conception.

Polanyi on the other hand does try to provide a framework for explaining some qualitative changes in the development of human societies exactly in the qualitative change that capitalism became for the people subjected to it. Following Silver's argument no such change even occurred. It could not occur, because the result was literally already there! Rather than analysing, and providing new tools to explain new phenomena, Silver translates what he ”sees” into the language of the preconceptions of his own theory. Here Silver approaches the absurd (I do not know what else to say about a book of economic history with an opening chapter called ”The Contribution of Gods to Economic Growth”). To Silver any economy is market. His conceptions do not even touch the basic questions of Polanyi's framework.

McCloskey too reaches similar results. However, it seems obvious that most of this criticism is put forward on the wrong grounds. As said, Polanyi has never argued that markets did not exist in pre-capitalist societies. He only says that they are socially embedded and do not influence – let alone determine – human social life in general in pre-capitalist societies. The fact that a market for land did exist in pre-capitalist England for instance is well documented. It seems also to be the case that there was a labour market from quite early on in history; even ancient Rome had a proletariat, as Marx was well aware. But these observations do not settle the point on market capitalism. The main issue in Polanyi's argument is the commodification of labour and money as the main prerequisites to the capitalist market

[15] Liberal political economy has since at least the days of Smith sought the rationale of its economic system in “the invisible hand” of the system; in this self integrating and “civilising” aspect of capitalism, in its growth and “efficiency” – as opposed to previous stages of the evolution of human society. With Silver's particular version of transaction cost theory this focus is lost; it is actually denied and thrown away. To paraphrase an American saying: ”If you're so market, why ain't you rich?”

system. The evidence and arguments from the proletarianisation research puts serious doubts on neglect of this.[16] Hence McCloskey's conceptions do not really touch the core of Polanyi's framework either, and do not provide the basis for a successful (i.e. persuasive!) criticism of Polanyi on the matter.

There is also an answer to Latham's attack on Polanyi on the general purpose currency and market exchange in pre-capitalist economies. Latham equates the market economy with exchange and sees a general purpose currency as ”a medium of exchange”. (I note in passing that his example of exchange of slaves is seriously ill-conceived because slave trade is neither reciprocity nor a market economy, it is trade, even market trade, but definitely not a market economy, or capitalism.) Money may very well be a general purpose currency in pre-capitalist societies – as a medium of exchange. But as I see it Polanyi's point is that in a capitalist market society money itself is a commodity; it is a structural need and an *end* in itself – *not a medium of exchange*, but the goal of societal production.[17] Evidence of general purpose currencies is not the evidence of such a society. (If the rod-currency economy is a market economy, as Latham contends, are we to assume that its inhabitants produced and exchanged in order to gain rods?)[18] The great transformation to market capitalism remains to be examined and explained!

The Critique from Douglass C. North

The empirical criticism accounted for above is difficult to evaluate directly. It must rather be considered in relation to theoretical and conceptual questions. North (1977; 1981) criticises Polanyi on conceptual issues. North values Polanyi's "challenge", in that Polanyi has convincingly shown that the market is only one of the modes of resource allocation in history and that it (even in a market system) is a very limited mode of allocation. However, North maintains, Polanyi makes a theoretical mistake at the outset:

> Polanyi made a market synonymous with a price-making market. It should be readily apparent, however, that any form of voluntary contractual exchange involves a market and that its form will be dictated by the considerations [of transaction costs] advanced… (North, 1981: 42)

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[16] See e.g. Tilly (1984).

[17] See Marx (1973: 221-238) for these different roles of money in capitalism and in other systems.

[18] Latham (1996: 13) exposes himself fully, in exclaiming that slave economies ”are more of a market economy than our own”, since slavery is forbidden now. But for slaves, surely, the market is not the means for getting grub, the necessities of life? So *qua slaves* they are not part in any market economy at all. As Marx (1973:

North agrees with Polanyi that any economic system is a mix of market, redistribution and reciprocity, but he argues that the explanation of the different modes of allocation that Polanyi has described actually lies in transaction cost theory (North, 1997: 714). He says:

> But the point goes much deeper than even Polanyi realised, and poses a fundamental problem to the economist and the economic historian. How do we account for substitutes for price-making markets of which families, firms, guilds, manors, trade unions, co-operatives, etc., are organising institutions which allocate resources in place of markets (North, 1977: 709).

This problem is exactly what NIE addresses, according to North, for instance in Coase's explanation of the firm (a non-market). About the firm North says:

> ...[I]t is clearly a wealth maximising institution which substitutes for price-making markets. It is reasonable to assume that the forces that lead to the substitution of firms for markets today may help us to explain the variety of forms of organisation in past societies. (North, 1977: 711)

North argues that the same goes for the alternative ways of resource allocation to the market. Reciprocity for instance is "the least-cost trading solution where no system of enforcing the terms of exchange between trading units exists" (North, 1977: 713). The great merit of the transaction cost approach is that can provide us with refutable explanations, whereas Polanyi's explanation cannot, argues North:

> Polanyi provides us with an account of reciprocity and redistributive systems which is inherently changeless. There is nothing in his framework that explains changes in the mix of the system over time. To the degree we can develop an ordinal ranking of transaction costs, then changes at the margin should produce predictable pressure for institutional rearrangement. (North, 1977: 715)

North is the most historically sensitive exponent of NIE. His theory, including his criticism of Polanyi, is therefore worth taking seriously.[19] I will therefore conclude this essay with a critique of NIE, using him as its prime exponent.

Let me just, before this, point out that I think that North has slightly misconceived Polanyi's theory. As I see it, Polanyi's point is that an analysis of an economic system cannot start from the viewpoint of the market and then explain alternative modes of resource allocation, from this viewpoint. The market is an alternative (and historically limited) way of allocating resources to reciprocity and redistribution. Non-price distribution within a family, a

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224) points out: "In antiquity, one could buy labour, a slave, directly; but the slave could not buy money with his labour."

19 As I have argued in (Ankarloo, 1999: 167-173), as regards the last point, North may very well have found a weakness in Polanyi's conception of institutional change. See also Lie (1991). Answering Polanyi's orthodox

clan, a firm, etc. *precede* the market and can therefore not be explained as alternatives to a market (cf. Fourie, 1989; 1993). A historical approach to economic history must take allocation systems as alternatives (as well as complements) to *each other* not just to the one – the market. The market system is an effect of the capitalist ownership structure – i.e. of the commodification of land, labour and money. Other social systems and modes of production have *preceded* this system and cannot therefore be seen as mere alternatives to this market system. It is ultimately on this very issue that Polanyi's conception is valuable and where NIE, including North, goes astray. Let me therefore conclude with a discussion on North's institutional theory.[20]

IV. A critique of New Institutional Economics – the case of North

In his seminal works (North and Thomas, 1973; North, 1981; 1990) North has argued that a historical conception of institutions, based on transaction cost theory, is the key to understanding the development of economies over time. Having, at least in principle, further and further distanced himself from standard orthodox conceptions North has come the closest within NIE to acknowledging the merits in Polanyi and the demerits in orthodoxy. This has rendered him rather popular within unorthodox anti-neoclassical circles as well. However, one can argue that his basic conception of economic history remains seriously flawed.

Admittedly, North is sensitive to those historical facts that, among others, Polanyi has stressed. North for instance acknowledges that feudalism is not capitalism, that it was characterised by "an almost total absence of markets for goods", only a "rudimentary market for labour…" and by "a general absence of a market economy" (North and Thomas, 1973: 32). Therefore "wage labour developed" (North, 1981: 168) and is not the starting point of history. In short, North is not Silver.

To make a long story short, the disturbing problem of North's economic history is all the same that the decisive institutions and human characteristics that are specific to capitalism have to be assumed to exist even when he admits that market capitalism is not at hand. Otherwise his explanations of institutions and organisations do not work. The market in North's explanations remains the universal yardstick – the eternal reference point. But if we

critics does of course not imply that Polanyi is beyond reproach. He is however not guilty of the charges made by the liberal orthodoxy, accounted for above.

[20] The critique of North presented below is a summary of points more elaborately presented in Ankarloo (1999: 113-153).

acknowledge that markets and the institutions of capitalism originate from somewhere, and evolve, we cannot assume them from the start. The market is *not* a universal yardstick for the comparison of institutions.

North knows all this, but in order for the explanation to work *the economic logic* of the market has to be described as present, even in the "absence of the market".[21] This is due to the fact that institutions evolve as rational responses to relative price changes, by, albeit "constrained", micro-rational economic men, in his model. But such calculation cannot explain the origins of the market. Calculating what to buy only makes sense when there already are commodities on the market to buy. These calculations cannot at the same time be the cause of the market for these commodities.[22] This is especially true of the labour market. If wage labour "develops", and there is "an absence of a market economy", as North concedes, then the price of labour cannot be assumed from the start of the explanation. So, North fails to acknowledge the fact that the "free" individual – the micro-calculating consumer – is the result of capitalist markets, rather than the other way around. In North's theory this individual has no history, and that is a critical limitation on his program of "history matters". This problem of neoclassical theory is not solved at all. It is inherited.

Also, North and Thomas (1973) put a lot of weight in the explanation of the manor system and its demise on population changes and how they alter the relative prices (the land-to-labour ratio) and transaction costs in market versus non-market arrangements. We do not need to doubt that population change and a changing land-to-labour ratio will have effects on the economic system, and its underlying logic. The decisive counter-argument is that these changes cannot be *mediated* as price changes and microeconomic choice, the way North and Thomas describe it, unless land and labour (labour power) already are commodities. But they were not. This remains valid both as a historical remark, in relation to the historical development of proletarianisation and marketisation, but more importantly as an *analytical* remark, since feudal work relations are not wage labour relations. North and Thomas do acknowledge that in the *definition* of feudalism labour and land are not commodities. Though

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[21] Phrases like "the absence of the market" and the consistent view of institutions as "constraints" to the market, despite their sensitivity to history betray ideological residues in North's thought. Why not just describe "the presence of serfdom" rather than "the absence of a market"?

[22] In short, we can at best choose to buy more or less commodities on the market, but not more or less market organisation itself in "the absence of a market". There are numerous critics of these conceptions in North's work. See Field (1981) and Brenner (1977), which even today remains one of the most revealing critiques of the "Smithian legacy" to economics – and which, although not specifically addressed to North, applies to him as well.

commodification did exist, it did so only to a limited degree.[23] We cannot have it both ways: either capitalism came from some different economic system, or else it is ubiquitous. In the first case, we have to describe the economic logic of the preceding system in its own right – i.e. as non-capitalist, as Polanyi does. In the second case economic history does not explain market capitalism. Rather it assumes it from the start, and then economic history must be totally revised from being the history that leads *to* capitalism, into a history *of* capitalism.

North and Thomas (1973) try to solve this dilemma by using words like "implicit contracts" with, I gather, "implicit prices". But how could the people of the feudal era, who supposedly chose the most efficient property rights, make these calculations on implicit information? If there was no market, how could they visualise it and economise on it? And considering the persistence of serfdom, even if individuals could calculate on a non-existent market, how could they act upon it? Labour mobility was heavily restricted by the serf's dependence of the lord, so even if market opportunities indeed were present, individuals could not take advantage of them.

In short, despite his sensitivity to history, North, like NIE at large, can only use the market as a universal yardstick. Even the absence of a market is described in the logic of the market. We therefore approach a framework, which argues: "if the market is there it is because it is efficient. And if it is not there it is because that is efficient too" (Cf. Williamson, 1975; 1985).[24] Such ahistorical assumptions and explanations constitute a red thread in North's work.[25] North ends up, willy-nilly, in maintaining that all institutional frameworks

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[23] On the rate of proletarianisation, see Tilly (1984) which estimates that the proletariat between 1550 to 1843 grew eightfold, by 131 million people, almost equivalent to the total population growth of Europe at the time.

[24] This remark remains valid even though North (1990) and North and Wallis (1994) have left the efficiency paradigm of NIE. The basic framework of explanation either remains the neoclassical, ahistorical one or else it is contradicted. North has yet to acknowledge this fact fully. In Ankarloo (1999: 146-152) I argue that either North keeps the neoclassical conception of the economy, which is ahistorical, or he remains historical and institutional in his approach, which however renders this conception of the economy superfluous.

[25] There are examples of this analytical procedure in North's writings, even to the prehistory of man: "Prehistoric man employed his labour in conjunction with natural resources to produce his living. The natural resources whether animals to be hunted or vegetation to be gathered, were initially held as common property. This type of property right implies free access by all to the resource. Economists are familiar with the proposition that unconstrained access to a resource base will lead to its inefficient utilisation. This inefficiency as the demand for the resource increases eventually leads to the depletion of the resource … This instance is an example of incentive failure caused by cultural or institutional (property rights) inadequacies." (North, 1981: 80) See also: "Let us examine the situation where several bands compete for the same commonly held migratory animals … The band then has the incentive to exploit the resource to the point where the value of the last animal killed is equal to the private costs of killing it. The collection will continue until all of the income the scarce resource would have earned under private property is dissipated. That is, in a competitive situation no band has any incentive to conserve the resource, since the animals left to reproduce probably would be taken by the rivals. The stock of animals thus could be placed in danger of extinction. The crucial element causing this inefficiency is the lack of any barrier to the exploitation of the commonly owned resource base … The result is too many hunters." (North, 1981: 81)

work “as if” capitalist micro-rational principles are in place, even when he knows they are not (Mirowski, 1988: 70-72). He paints himself in a corner because theoretically, in order to make his explanations work, he has to accept, through the backdoor, assumptions which he on historical grounds knows are falsehoods.[26] What he knows as a historian, he cannot allow himself as an economist.

Despite all niceties and elaboration, NIE retains a view of economic history that is ultimately revealed in the counter-historical credo “in the beginning there were markets”. To this misconception Polanyi remains a most valuable and necessary corrective.

[26] It is for instance difficult to see why North clings on to transaction cost theory in light of his own concession: “All the modern neoclassical literature discusses the firm as a substitute for market. [This] ignores a crucial fact of history: hierarchical organisation forms … predate the price-making market.” (North, 1981: 40)

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