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The Economistic Fallacy*

Karl Polanyi

Endeavors to attain a more realistic view of the general problem posed to our generation by man's livelihood meet from the outset with a formidable obstacle – an ingrained habit of thought peculiar to conditions of life under that type of economy the nineteenth century created throughout all industrialized societies. This mentality is personified in the marketing mind.

We wish to point out, in a preliminary way, the fallacies to which the marketing mind has given currency and, incidentally, to expound some of the reasons why these fallacies have influenced public thinking so pervasively.

First we will define the nature of this conceptual anachronism, then describe the institutional development from which it sprang and enlarge on its influence on our whole moral and philosophic outlook. We will trace the reflections of this attitude of mind in the organized fields of knowledge, such as economic theory, economic history, anthropology, sociology, psychology, and epistemology, that make up the social sciences.

Such a survey should leave no doubt about the impact of economistic thinking on almost every aspect of the questions that confront us, notably the

*The "Economistic Fallacy" is Chapter I of Karl Polanyi's posthumous *The Livelihood of Man* (ed., Harry W. Pearson) soon to be published by Academic Press. It is part of a book which Polanyi had been working on for several years, but was unable to complete before his death in 1964. The forthcoming book consists of mostly unpublished manuscripts that Polanyi intended to include in *The Livelihood of Man*. The "Economistic Fallacy" was one of the early chapters and was completed by Polanyi sometime in the early or mid-1950's.

nature of economic institutions, policies, and principles, as they are revealed in the forms of organization of livelihood in the past.

To sum up the central illusion of an age in terms of a logical error is rarely to the point; yet, conceptually the economistic fallacy, in the nature of things, cannot be described otherwise. The logical error was of a common and harmless kind: a broad, generic phenomenon was somehow taken to be identical with a species with which we happen to be familiar. In such terms, the error was in equating the human economy in general with its market form (a mistake that may have been facilitated by the basic ambiguity of the term *economic*, to which we will return later). The fallacy itself is patent: the physical aspect of man's needs is part of the human condition; no society can exist that does not possess some kind of substantive economy. The supply-demand-price mechanism, on the other hand, (which we popularly call the market,) is a comparatively modern institution of specific structure, which is easy neither to establish nor to keep going. 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. On the other hand, to stretch the concept of the market until it embraces all economic phenomena is artificially to invest all things economic with the peculiar characteristics that accompany the phenomenon of the market. Inevitably, clarity of thought is impaired.

Realistic thinkers vainly spelled out the distinction between the economy in general and its market forms; time and again the distinction was obliterated by the economistic *Zeitgeist*. These thinkers emphasized the substantive meaning of *economic*. They identified the economy with industry rather than business; with technology rather than ceremonialism; with means of production rather than titles to property; with productive capital rather than finance; with capital goods rather than capital – in short, with the economic substance rather than its marketing form and terminology. But circumstances were stronger than logic, and overwhelming forces of history were at work to weld the disparate concepts into one.

The Economy and the Market

The concept of the economy was born with the French physiocrats simultaneously with the emergence of the institution of the market as a supply-demand-price mechanism. The new phenomenon, never witnessed before, was an interdependence of fluctuating prices which directly affected multitudes of men. This nascent world of process was the result of the comparatively recent spread of trade – an institution much older than, and independent of, markets – into the articulations of everyday life.

Prices, of course, existed before, but in no way did they constitute a system of their own. Their sphere was, in the nature of things, restricted to trade and finance, since only merchants and bankers used money regularly, a much greater part of the economy being rural and practically tradeless – a thin trickle of goods in the vast, inert mass of neighborhood life on the manor and in the household. True, urban markets knew money and prices, but the rationale of controlling these prices was to keep them stable. Not their occasional fluctuation but their predominant stability made them an increasingly important factor in the determination of profits from trade, since these profits were derived from relatively stable price differentials between distant points rather than from anomalous price fluctuations in local markets.

But the mere infiltration of trade into everyday life need not of itself have created an economy, in the new and distinctive sense of the term, but for a number of further institutional developments. First among these stood the penetration of foreign trade into markets, gradually transforming them from strictly controlled local markets into price-making markets with more or less freely fluctuating prices. This was, in the course of time, followed by the revolutionary innovation of markets with fluctuating prices for the factors of production, labor, and land. This change was the most radical of all in its nature and consequence. Yet not before it had proceeded for some time did the different prices, which now included wages, food prices, and rent, show any noticeable interdependence and thus produce the conditions that made men accept the presence of a hitherto unrecognized substantive reality. This emergent field of experience, however, was the economy, and its discovery – one of the emotional and intellectual experiences that formed our modern world – came to the Physiocrats as an illumination and constituted them a philosophical sect. Adam Smith learned from them of the "hidden hand," but he did not follow Quesnay on the path to mysticism. While his French master had noticed merely the interdependence of some revenues and their general dependence on corn prices, his greater pupil, living in the less feudal and more monetarized economy of England, was able to include wages and rent in the group of "prices" and thus, for the first time, glimpse a vision of the wealth of nations as an integration of the varied manifestations of an underlying system of markets. Adam Smith became the founder of political economy because he recognized, however dimly, the tendency towards interdependence of these different kinds of prices in so far as they resulted from competitive markets.

Although thus spelling out the economy in terms of the market was originally nothing else than a common-sense way of relating new concepts to new facts, it may be difficult for us to understand why it took generations for the realization to occur that what Quesnay and Smith had really discovered was a field of phenomena essentially independent of the market institution in which it manifested itself at the time. But neither Quesnay nor Smith aimed at the establishment of the economy as a sphere of social existence that transcends market, money, or price – and in so far as they did, they failed in their aim. They reached not so much toward the universality of the economy as toward the specificity of the market. Indeed, the traditional unity of all human affairs that still informed their thinking made them averse to the notion of a separate economic sphere in society, although it did not prevent them from investing the economy with the characteristics of the market. Adam Smith introduced business methods into the haunts of primeval man, projecting his famous propensity to truck, barter, and exchange even to the backyard of Paradise. Quesnay's approach to the economy was no less catallactic. His was an economics of the *produit net*, a realistic quantity in terms of the landlord's accountancy but a mere phantom in the process between man and nature of which the economy is an aspect. The alleged "surplus," whose creation he attributed to the soil and the forces of nature, was no more than a transference to the "Order of Nature" of the disparity selling price is expected to show against cost. Agriculture happened to occupy the center of the scene because the revenues of the feudal ruling class were at issue, but forever after the notion of surplus haunted the writings of classical economists. The *produit net* was the parent of Marx's surplus value and its derivatives. Thus was the economy impregnated with a notion foreign to the total process of which it forms part, a process that knows neither cost nor profit and is not a series of surplus-producing actions. Nor are physiological and psychological forces directed by the urge to secure a surplus over themselves. Neither the lilies of the field, nor the birds in the air, nor men in pastures, fields, or factories – tending cattle, raising crops, or releasing planes from a conveyer belt – produce a surplus over their own existence. Labor, like leisure and repose, is a phase in the self-sufficient course of man through life. The construct of a surplus was merely the projection of the market pattern on a broad aspect of that existence – the economy.[1]

If from the outset the logically fallacious identification of "economic phenomena" and "market phenomena" was understandable, it later became almost a practical requirement with the new society and its way of life which emerged from the throes of the Industrial Revolution. The supply-demand-price mechanism, whose first appearance produced the prophetic concept of "economic law," grew swiftly into one of the most powerful forces ever to enter the human scene. Within a generation – say, 1815 to 1845, Harriet Martineau's "Thirty Years' Peace" – the price-making market, which previously existed only in samples in various ports of trade and stock exchanges, showed its staggering capacity for organizing human beings as if they were mere chunks of raw material and combining them, together with the surface of mother earth, which could not be freely marketed, into industrial units under the command of private persons mainly engaged in buying and selling for profit. Within an extremely brief period, the commodity fiction, as applied to labor and land, transformed the very substance of human society. Here was the identification of economy and market *in practice*. Man's ultimate dependence on nature and his fellows for the means of his survival was put under the control of that new-fangled institutional creation of superlative power, the markets, which developed overnight from lowly beginnings. This institutional gadget, which became the dominant force in the economy – now justly described as a *market economy* – then gave rise to yet another, even more extreme development, namely a whole society embedded in the mechanism of its own economy – *a market society*.

From this vantage point, it is not difficult to discern that what we have here called the economistic fallacy was an error mainly from the theoretical angle. For all practical purposes, the economy *did* now consist of markets, and the market *did* envelop society.

From this line of argument, it should also be clear that the significance of the economistic outlook lay precisely in its capacity for giving birth to a unity of

[1] See Harry W. Pearson, "The Economy has No Surplus: Critique of a Theory of Development," Ch. XVI in K. Polanyi, C. Arensberg, H. Pearson, eds., *Trade and Market in the Early Empires* (Glencoe, Ill.: Free Press and Falcon's Wing Press, 1957).

motivations and valuations that would bring about in practice what it preconized as an ideal, namely the identity of market and society. For only if a way of life is organized in all relevant aspects, including pictures of the inner man and the nature of society – a philosophy of everyday life comprising criteria of common sense behavior, of reasonable risks, and of a workable morality – are we offered that compendium of theoretical and practical doctrines which alone can produce a society or, what amounts to the same thing, transform a given society within the lifetime of a generation or two. And such a transformation was achieved, for better or for worse, by the pioneers of economism. This is to say no less than that the marketing mind contained the seeds of a whole culture – with all its possibilities and limitations – and the picture of inner man and society induced by life in a market economy necessarily followed from the essential structure of a human community organized through the market.

The Economistic Transformation

This structure presented a violent break with the conditions that preceded it. What before was merely a thin spread of isolated markets was now transmuted into a self-regulating *system* of markets.

The crucial step was that labor and land were made into commodities; that is, they were treated *as if* they had been produced for sale. Of course, they were not actually commodities, since they were either not produced at all (like land) or, if so, not for sale (like labor).

Yet no more thoroughly effective fiction was ever devised. Because labor and land were freely bought and sold, the mechanism of the market was made to apply to them. There was now a supply of labor and demand for it; there was a supply of land and demand for it. Accordingly, there was a market price for the use of labor power, called wages, and a market price for the use of land, called rent. Labor and land were provided with markets of their own, similar to those of the proper commodities produced with their help.

The true scope of such a step can be gauged if we remember that labor is only another name for man, and land for nature. The commodity fiction handed over the fate of man and nature to the play of an automaton that ran in its own grooves and was governed by its own laws. This instrument of material welfare was controlled solely by the incentives of hunger and gain – or, more precisely, either fear of going without the necessities of life or the expectation of profit. So long as no propertyless person could satisfy his need for food without first selling his labor in the market and so long as no propertied person could be prevented from buying in the cheapest market and selling in the dearest, the blind mill would turn out ever increasing amounts of commodities for the benefit of the human race. Fear of starvation with the worker, lure of profit with the employer would keep the vast mechanism running.

Such an enforced utilitarian practice fatefully warped Western man's understanding of himself and his society.

As regards *man*, we were made to accept the view that his motives can be described as either "material" or "ideal" and that the incentives on which everyday life is organized necessarily spring from the material motives. It is easy to see that under such conditions the human world must indeed appear to be determined by material motives. If, for example, you single out whatever motive you please and organize production in such a manner as to make that motive the individual's incentive *to produce*, you will have induced a picture of man as altogether absorbed by that motive. Let the motive be religious, political, or esthetic; let it be pride, prejudice, love, or envy; and man will appear essentially religious, political, esthetic, proud, prejudiced, engrossed in love or envy. Other motives, in contrast, will appear distant and shadowy – ideal – since they cannot be relied upon to operate in the vital business of production. The motive selected will represent "real" man.

In fact, human beings will labor for a large variety of reasons so long as they form part of a definite social group. Monks traded for religious reasons, and monasteries became the largest trading establishments in Europe. The *kula* trade of the Trobriand Islanders, one of the most intricate barter arrangements known to man, was mainly an esthetic pursuit. Feudal economy depended largely on custom or tradition. With the Kwakiutl, the chief aim of industry seemed to be to satisfy a point of honor. Under mercantile despotism, industry was often planned so as to serve power and glory. Accordingly, we tend to think of monks, Western Melanesians, villeins, the Kwakiutl, or seventeenth-century statesmen as ruled by religion, esthetics, custom, honor, or power politics, respectively. Nineteenth-century society was organized in such a fashion as to make hunger or gain alone into effective motives for the individual to participate in economic life. The resulting picture of man ruled only by materialistic incentives was entirely arbitrary.

As regards *society*, the kindred doctrine was propounded that its institutions were "determined" by the economic system. The market mechanism thereby created the delusion of economic determinism as a general law for all human society. Under a market economy, of course, this law holds good. Indeed, the working of the economic system here not only "influences" the rest of society but actually determines it – as in a triangle the sides not merely influence but determine the angles.

In the stratification of classes, supply and demand in the labor market were *identical* with the classes of workers and employers, respectively. The social class of capitalists, landowners, tenants, brokers, merchants, professionals, and so on was delimited by the respective markets for land, money, and capital and their uses, or for various services. The income of these social classes was fixed by the market, their rank and position by their income.

While social classes were directly determined, other institutions were indirectly affected by the market mechanism. State and government, marriage and the rearing of children, the organization of science and education or religion and the arts, the choice of profession, the forms of habitation, the shape of settlements, the very esthetics of private life – everything had either to comply with the utilitarian pattern or at least not interfere with the working of the market mechanism. But, since very few human activities can be carried on in the void (even a saint needing his pillar), the indirect effects of the market system came very near to determining the whole of society. It was almost impossible to avoid the erroneous conclusion that, as "economic" man was "real" man, the economic system was "really" society.

Economic Rationalism

On the face of it, the economistic *Weltanschauung* may have seemed to contain in its twin postulates of rationalism and atomism all that was needed to lay the foundations of a market society. The operative term was rationalism. For what else could such a society be other than an agglomeration of human atoms behaving according to the rules of a definite kind of rationality? Rational action, as such, is the relating of ends to means; economic rationality, specifically, assumes means to be scarce. But human society involves more than that. What should be the end of man, and how should he choose his means? Economic rationalism, in the strict sense, has no answer to these questions, for they imply motivations and valuations of a moral and practical order that go beyond the logically irresistible, but otherwise empty, exhortation to be "economical." Thus hollowness was camouflaged by ambiguous philosophical colloquialism.

To maintain the unity of the facade, two further meanings of *rational* were brought in. With regard to the ends, a utilitarian value scale was postulated as rational; and with regard to the means, the testing scale for efficacy was applied by science. The first scale made rationality the antithesis of the esthetic, the ethical, or the philosophical; the second made it the antithesis of magic, superstition, or plain ignorance. In the first case, it is rational to prefer bread and butter to heroic ideals; in the second, it appears rational for a sick man to consult his doctor in preference to a crystal-ball gazer. Neither meaning of *rational* is relevant to the principle of rationalism, though per se one may be more valid than the other. While stark utilitarianism, with its pseudophilosophic balance of pain and pleasure, has lost its sway over the minds of the educated, the scientific value scale remains supreme within its limits. Thus utilitarianism, still the opiate of the commercialized masses, has been dethroned as an ethic, while scientific method justly holds its own.

Nevertheless, so long as *rational* is used, not as a fashionable term of praise but in the strict sense of pertaining to reason, the validation of the scientific test of means as rational is no less arbitrary than the attempted justification of utilitarian ends. To sum up: the economic variant of rationalism introduces the scarcity element into all means-ends relations; moreover it posits as rational, in regard to the ends and the means themselves, two different value scales that happen to be peculiarly adapted to market situations but otherwise have no universal claim to be called rational. In this way, the choice of ends and the choice of means are claimed to lie under the supreme authority of rationality. Economic rationalism appears to achieve both the systematic limitation of reason to scarcity situations and its systematic extension to all human ends and means, thus validating an economistic culture with all the appearances of irresistible logic.

The social philosophy erected on such foundations was as radical as it was fantastic. To atomize society and make every individual atom behave according to the principles of economic rationalism would, in a sense, place the whole of human existence, with all its depth and wealth, in the frame of reference of the market. This, of course, would not really do – individuals have personalities and society has a history. Personality thrives on experience and education; action implies passion and risk; life demands faith and belief; history is struggle and defeat, victory and redemption. To bridge the gap, economic rationalism introduced harmony and conflict as the *modi* of the individual's relations. The conflicts and alliances of such self-interested atoms, which formed nations and classes, now accounted for social and universal history.

No single author ever propounded the complete doctrine. Bentham still believed in government and was unsure of economics; Spencer anathemized state and government but knew only little of economics; and von Mises, an economist, lacked the encyclopedic knowledge of the other two. Among them they nevertheless created a myth that was the daydream of the educated multitude during the Hundred Years' Peace, from 1815 to World War I, and even after, up to Hitler's war. Intellectually, this myth represented the triumph of economic rationalism and, inevitably, an eclipse of political thought.

The economic rationalism of the nineteenth century was the direct descendant of the political rationalism of the eighteenth. It was as unrealistic as its predecessor, if not more so. As to the facts of history and the nature of political institutions, they were equally foreign to both brands of rationalism. The political utopians ignored the economy, while the utopians of the market took no note of politics. On balance, if the thinkers of the Enlightenment were notoriously unheedful of some of the economic facts, their nineteenth-century successors were totally blind to the sphere of state, nation, and power, to the point of doubting their existence.

Economic Solipsism

Such economic solipsism, as it might well be called, was indeed an outstanding feature of the market mentality. Economic action, it was deemed, was "natural" to men and was, therefore, self-explanatory. Men would barter unless they were prohibited to do so, and markets would thus come into being unless something was done to prevent it. Trade would begin to flow, as if induced by the force of gravity, and would create pools of goods, organized in markets, unless governments conspired to stop the flow and drain the pool. As barter quickened, money would make its appearance and all things would be drawn into the whirl of exchanges, unless some archaic moralists raised an outcry against lucre or unenlightened tyrants depreciated the currency.

This eclipse of political thinking was the intellectual deficiency of the age. It originated in the economic sphere, yet eventually it destroyed any objective approach to the economy itself, insofar as the economy possessed an institutional background other than a supply-demand-price mechanism. Economists felt so safe within the confines of such a purely theoretical market system that they only grudgingly conceded to nations more than a nuisance value. An English political writer of the 1910's was deemed to have clinched the case against the necessity for wars by proving that as a business proposition war did not pay; and in Geneva, the League of Nations to its last hour remained blind to the political facts that made the gold standard an anachronism. The discounting of politics spread from Cobden's and Bright's free-trading illusions to Spencer's fashionable sociology of "industrial vs military systems." By the 1930's, almost nothing was left among the educated of the political culture of David Hume or Adam Smith.

The eclipse of politics had a most confusing effect on the moral aspects of the philosophy of history. Economics stepped into the vacuum, and a hypercritical attitude toward the moral vindication of political actions set in. This resulted in a radical discounting of all forces but the economic in the field of historiography. The marketing psychology, which regards only "material" motives as real, while relegating "ideal" motives to the limbo of ineffectuality, was extended not only to nonmarket societies but to all past history as well. Most of early history now appeared as a jumble of slogans about justice and law bandied about by pharaohs and god-kings for the sole purpose of misleading their helpless subjects who groveled under the knout. The whole attitude was self-contradictory Why cajole a population of bond slaves? And if cajoling there must be, could it be done through promises that meant nothing to the cajoled? But if the promises meant something, justice and law must have been more than mere words. That a population of actual bond slaves need not be cajoled, and that justice and freedom must have been recognized as valid ideals by all before they could be employed as a bait by the few, escaped the critical apparatus of a hypercritical public. Under the sway of modern mass-democracy, slogans became a kind of political organizing force that they could never have been in ancient Egypt or Babylon. On the other hand, justice and law, which were embodied in the institutional structure of earlier societies, had worn thin under the market organization of society. A man's property, his revenue and income, the price of his wares were now "just" only if they were formed in the market; and as to law, no law really mattered except that which referred to property and contract. The varied property institutions of the past and the substantive laws that made up the constitution of the ideal *polis* had now no substance to work upon.

Economic solipsism generated that unsubstantial concept of justice, law, and freedom in the name of which modern historiography refused all credence to the numberless ancient texts in which the establishment of righteousness, insistence on the law, the maintenance of a central economy without bureaucratic oppression was declared to be the aim of the ancient state.

The true condition of affairs is so different from what is congenial to the market mentality that it is not easy to convey in simple words. Actually, justice, law, and freedom, as institutionalized values, first make their appearance in the economic sphere as a result of state action. Under tribal conditions, solidarity is safeguarded by custom and tradition; economic life is embedded in the social and political organization of society; no economic transactions take place; and random acts of barter are discouraged as a peril to tribal solidarity. When territorial rule emerges, the god-king supplies that center of communal life of which the loosening of the clan threatens to deprive the group. At the same time, an enormous economic advance becomes possible, and is actually made, with the help of the state: economic transactions, formerly banned as gainful and antisocial are made gainless, and hence just as lawful, through the action of the god-king, who is the fount of justice. This justice is institutionalized in equivalencies, proclaimed in statutes, and practiced in tens of thousands of cases by those organs of palace and temple who handle the taxational and redistributive apparatus of the territorial state. The rule of law is institutionalized in economic life through the administrative provisions that regulate the behavior of guild members in their trade dealings. Freedom comes to them through law; there is no master whom they must obey; and, so long as they keep their oath to the godhead and their loyalty to the guild, they are free to act according to their business interests, responsible to no superior. Each of these steps towards man's introduction into a realm of justice, law, and freedom originally resulted from the organizing action of the state in the economic field. But such recognitions of the early role of the state were barred by economic solipsism. Thus did the mentality of the market hold sway. The absorption of the economy by marketing concepts was so complete that none of the social disciplines could escape its effects. Unwittingly, they were turned into strongholds of economistic modes of thought.