“Modern Money Theory as a Foundational Component in Polanyi’s *The Great Transformation*”

Abstract: In Karl Polanyi’s *The Great Transformation* (*TGT*) there are two central narratives: first, he discusses how nineteenth-century society attempted to consciously construct a self-regulating market economy, and, second, how this contradictory epoch created the need for intellectual content that could justify the emerging order via ‘scientific’ legitimacy. Polanyi criticized both, yet what receives little attention is the extent to which his monetary analysis is rooted in what is now known as modern money theory (MMT). The purpose of this paper is to elucidate these connections, particularly in their shared rejection of metallism and embrace of economic anthropology to create an alternative framework depicting how ‘taxes-drive-money’, the mechanism that regulates the value of money and the process by which it is created, and the overlap between their political economies. Thus, we conclude that there is a significant and underappreciated connection between Polanyi and MMT’s respective monetary theories.

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In Karl Polanyi's *The Great Transformation* (*TGT*) there are two central narratives: first, he discusses how nineteenth-century society attempted to consciously construct a self-regulating market economy, and, second, how this contradictory epoch created the need for intellectual content that could justify the emerging order via 'scientific' legitimacy. Polanyi criticized both, yet what receives little attention is the extent to which his monetary analysis is rooted in what is now known as modern money theory (MMT)[1]. The purpose of this paper is to elucidate these connections. First, we highlight each's perspective on the origin and nature of money, which is used to reject metallism and the idea that capitalism is a barter economy. Second, we demonstrate that Polanyi and MMT have comparable views on the mechanism that regulates the value of money as well as how it is created. Third, we showcase that their political economies overlap, with the former laying the foundation for which traits are desirable in both a local and global world, and the latter serving as the policy vehicle to lead the way. Thus, we conclude that Polanyi's *TGT* had many elements of MMT as its foundational components.

Polanyi and MMT on the Origin and Nature of Money

The analytical core of *TGT* involves how the forced transition to a self-regulating market economy necessitated the disembedding of economic relations and its 'laws' from greater social relations, which meant that labor, land, and money had to become commodified. However, these entities are and always will remain 'fictitious' commodities in the sense that they are not innately produced for sale on a market, which made the entire transformational process inherently destructive to the very things that constituted the utopian experiment itself. Thus, to defend this trio from the self-regulating market economy's naturally damaging forces, society innately

[1] The authors are not asserting that Polanyi was inspired by MMT.

developed protective countermeasures in a sequence known as the double movement which functioned to stabilize the ontological properties of the fictitious commodities themselves and hence preserve the system. When exposing why money is a fictitious commodity, Polanyi's critique starts by rejecting the liberal metallist[2] myth in favor of a more accurate explanation on the origin and nature of money, which shares an economic anthropology with MMT.

Indeed, Polanyi begins:

> Ricardo indoctrinated nineteenth-century England with the conviction that the term "money" meant a medium of exchange, that banknotes were a mere matter of convenience, their utility consisting in their being easier to handle than gold, but that their value derived from the certainty that their possession provided us with the means of possessing ourselves at any time of the commodity itself, gold. It follows that the national character of currencies was of no consequence, since they were but different tokens representing the same commodity. (Polanyi 1944, 205)

Rather, he continues:

> Commodities are...objects produced for sale on the market. [Yet,] actual money...is merely a token or purchasing power which, as a rule, is not produced at all, but comes into being through the mechanism of banking or state finance[3]. (Polanyi 1944, 75-6)

For Polanyi, the fundamental error of conventional monetary theory came down to the fact that:

> {...} the institutional separation of the political and economic spheres had never been complete, and it was precisely in the matter of currency that it was necessarily incomplete; the state, whose mint seemed merely to certify the weight of coins, was in fact the guarantor of the value of token money, which is accepted in payment for taxes and otherwise. This money was *not* a means of exchange, it was a means of payment; it was not a commodity, it was purchasing power; far from having utility itself, it was merely a counter embodying a quantified claim to things that would be purchased. (Polanyi 1944, 205, italics in original)

And finally, Polanyi dismissed the notion that money implies the economy under consideration is necessarily capitalist by noting,"the presence or absence of...money does not necessarily affect the economic system" (Polanyi 1944, 61).

[2] Metallism asserts that the origin of money is found in barter economies and was invented to overcome the indivisibility problem and facilitate exchange through the reduction of transaction costs associated with the determination of relative prices after market players experienced a double coincidence of wants. The next logical question was then what would individuals be able to form a consensus on for the form that this medium should take, which metallism argues was the intrinsic value brought by gold or other precious metals embodied within a coin. To be sure it is ultimately this intrinsic value that led them to become the generally accepted medium of exchange (Menger, 1892, p. 242). However, as the story goes, mischievous governments eventually discovered coin debasement and began readily practicing it, which was followed by the introduction of paper money convertible into debased coins. Once this occurred, governments abandoned coinage altogether for fiat money, whose value is said to be derived only from trust, common consent, and seigniorage rather than any precious metallic content.

[3] As we shall see, Polanyi divides actual, or token, money into bank and fiat money.

There is a lot to unwrap from these quotations regarding MMT. First, both argue that money's origin comes from obligations to the state, typically through tax payments, which is MMT's 'taxes drives money' principle (TDM) (Wray, 1998). Second, Polanyi's use of the word 'counter' points to the importance that MMT places on the function of money as a unit of account and Keynes' assertion that, "money-of-account...is the primary concept of a Theory of Money" because the state, "claims the right to determine and declare *what thing* corresponds to the name...and has been so claimed for some four thousand years at least" (Keynes, 1930, p. 4). Third, this reveals that money is not an intrinsically valuable object; rather, it is merely a token, or *chartal*, which overlaps with MMT's emphasis on Knapp and Innes in which money is a social credit/debt relationship denominated in the aforementioned state-determined unit of account (Wray 1998, 2010). Fourth, Polanyi and MMT both maintain that money can exist independently from capitalism, which case study evidence has long demonstrated (Wray 1998, 2012; Graeber 2011; Davies 2002). Thus, far from being an efficient, commodified, barter-market invention to lower transaction costs, Polanyi and MMT both agree on the fact that the nature of money is to transfer real resources and the purchasing power commanded over them to the domain of the public sector[4], which, in capitalist societies, dictates distribution and the structure of effective demand. And, for the purposes of *TGT*, what is more is that Polanyi demonstrated beyond doubt that money is indeed a fictitious commodity and thus there was a need to construct a coherent alternative monetary theory, a project which MMT subsequently completed.

The Mechanism that Regulates the Value of Money and the Process of its Creation

[4] This is not to argue that the point of taxes is to fund government expenditure.

The next set of connections between Polanyi and MMT involves the mechanism that regulates the value of money as well as how it is created. For the former, Polanyi places central emphasis on the importance of sovereignty in bestowing money with value; indeed, he states that, “token money, whether bank or fiat, cannot circulate on foreign soil” (Polanyi 1944, 202). In addition, we have already seen that in *TGT* he attributes the origin of money’s value to the state’s fundamental power of taxation and purchasing power creation qua expenditure in its self-determined unit of account (Wray 1998). Since this is what Polanyi believed gives money value, it follows that he thought these same mechanisms can be used by the state to regulate its value, which is a fundamental tenet of MMT. Indeed, MMT argues that the state regulates the value of money through the tax levy (TDM) and the prices it pays for the private sector’s real resources (fiscal theory of the price level), with the former setting a base for how hard individuals must work to obtain the money-thing necessary to pay taxes, and the latter determining the price level and thus purchasing power. For example, if the state wanted to debase the currency it could raise taxes relative to wages or pay more than it previously did for the same good or service, with the key being how the state’s taxes and purchases alters the value of the money-thing.

MMT and Polanyi also agree on how money is created. Note that in the Polanyi quote in this section he separated token money into bank and fiat money, and we have seen that he believed token money derives its value from tax obligations--meaning bank money ultimately derives its value from the state. At the same time, however, Polanyi noted that token money,“comes into being through the mechanism of banking or state finance” and that banking involves,“the mechanism of supplying credit” (Polanyi 1944, 75-6; 204). Thus, bank money receives its value from the state, but is actually created by banks which gels perfectly with MMT’s endogenous money approach. To be sure, in this tradition actual money is never a commodity, but rather is a token that can be subdivided into bank or fiat money; it derives its value from the state yet can be created through the mechanism of banking; and it has a creation mechanism that involves supplying credit to borrowers given a lender's liquidity preference and margin of safety.

Polanyi's division of token money into bank or fiat money also resonates with MMT's concept of a pyramid of liabilities. Here different monies are ranked by their degree of liquidity, with currency occupying the top spot because the state's IOU will always be demanded by individuals to fulfill their tax obligations. Next, further down the hierarchy comes bank IOUs because of their access to lender of last resort operations, which validates the liabilities and grants them liquidity. Finally, at the bottom comes firm and household IOUs (Wray, 2014).

We believe that our findings indicate Polanyi would agree with this structure. First, he knew that token money could be created through either banking or state finance, and his distinction between bank and fiat money clearly indicates that he understood there is a qualitative difference between the two. Thus, the question boils down to what did he believe made bank and fiat money fundamentally separate, with our contention being that he would have seen fiat, or state, money as the most liquid of all monies due to the state's ability to tax and therefore perpetually remain in demand, which would then be followed by bank money because it derives its value from the state.

Freedom in a Complex Society and MMT

We would argue that the primary connection between Polanyi and MMT's respective political economies surrounds the former's analysis of the socio-economic traits that he thought a civil society should possess as found in *TGT's* final chapter entitled 'Freedom in a Complex Society', and the latter's policy-driven ability to 'deliver the goods'. It is helpful to start by highlighting that Polanyi declared unemployment to represent a, "brutal restriction of freedom" and that:

> Neither freedom nor peace could be institutionalized under that economy [a laissez-faire market system]...[Instead] We will have consciously to strive for them in the future if we are to possess them at all; they must become chosen aims of the societies...No mere declaration of rights can suffice: institutions are required to make the rights effective…[and] the list should be headed by the right of the individual to a job under approved conditions. (Polanyi 1944, 263)

However, just because he thought the fictitious commodification of labor should end did not also imply that the wage system itself had to go; rather:

> the basic wage itself, [should be] determined outside the market...though in the nature of things wage differentials must (and should) continue to play an essential part in the economic system. (Polanyi 1944, 259)

MMT's Employer of Last Resort (ELR) delivers these goals. Wray and Tcherneva (2005, 2005a) have shown how ELR enables all members of society to engage in meaningful employment while promoting socio-economic goals--whether this involves a particular group's empowerment, broad social issues, or even ecological concerns (Tcherneva and Wray, 2005). Second, ELR's macroeconomic benefits have been widely discussed, such as its preservation of full employment through time, its structuring of the composition of demand towards consumption, its ability to 'crowd in' private investment and lower inequality, and its stabilization of prices[5]. by virtue of the fact that the ELR wage becomes the de facto 'basic wage', enhances price stability by dampening cyclical price trends and explicitly defining the value relationship between a monetary unit and a standardized labor unit. Thus, society directly gains from individual, social, and ecological change, and these impacts are positively reinforced through improved macroeconomic conditions.

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[5] ELR creates price stability because as the value relationship between a monetary unit and a standardized labor unit becomes explicitly defined the ELR wage becomes the de facto 'basic wage' and thus dampens cyclical price trends.

A second connection between Polanyi and MMT's respective political economies involves functional finance.[6] Polanyi writes that, "since the introduction of functional finance in all-important states, the directing of investments [has] become [a] government task" which, if carried out in a way that properly allocates real resources among heterogeneous sectors of the economy at appropriate rates and levels, would mirror MMT's support for Keynes' socialization of investment and structural approach to analyzing functional finance (Wray, 2018). Indeed, this would create the type of political society that Polanyi wanted where it would be:

> {...} possible to tolerate willingly that other nations shape their domestic institutions according to their inclinations, thus transcending the pernicious nineteenth-century dogma of the necessary uniformity of domestic regimes within the orbit of world economy…[and therefore] the end of [the self-regulating] market economy may well mean effective cooperation with domestic freedom. (Polanyi 1944, 262)

Now, it is important to note that just because Polanyi felt that the self-regulating market economy project should end did *not* mean that he thought all markets were evil; rather he posited that:

> *The congenital weakness of nineteenth-century society was not that it was industrial but that it was a market society*. Industrial civilization will continue to exist when the utopian experiment of a self-regulating market will be no more than a memory. (Polanyi 1944, 258, italics in original)

It naturally follows then that Polanyi believed markets were absolutely necessary because, in the future, their role would be, "to ensure the freedom of the consumer, to indicate the shifting of demand, to influence producers' income, and to serve as an instrument of accountancy, while ceasing altogether to be an organ of economic self-regulation" (Polanyi 1944, 260). Indeed, it is *this* connection between Polanyi's desirable socio-economic traits and MMT's ELR and structural functional finance that constitutes our final connection between the two: neither want to do away with markets inasmuch as they desire to jettison and replace the ideas, policies, and

[6] Polanyi seems to believe that policymakers would follow this approach as he was writing *TGT*. Circumstantial evidence to this effect is found in Wray (2018), who points out that the main principles of functional finance were widely accepted in the immediate post-War era.

institutions associated with the (neo)liberal/neoclassical tradition that remains singularly focused on promoting a self-regulating, 'free' market capitalist system with something much more humane and economically effective. To be sure, MMT argues that because in a monetary production economy money is a real factor and financial instability is an inherent, unavoidable, and endogenous systemic feature that is it necessary for governments to use automatic countercyclical fiscal and monetary stabilizers to reach and maintain full employment, price stability, and relatively low levels of inequality. It is the contention of these authors that this is the path to Polanyi's 'Freedom in a Complex Society', and we believe that he would wholeheartedly support it.

Concluding Thoughts

The purpose of this paper was to highlight the extent to which Polanyi's monetary analysis is rooted in what is now known as MMT. In doing so, we demonstrated that both reject metallism in favor of economic anthropology that is centered on how the state's tax obligations 'drive' money and regulate its value, and that they share the view that most money is chartal money. In addition, Polanyi and MMT both agree on endogenous money and, at least broadly, the latter's concept of a pyramid of liabilities. Finally, we highlighted how Polanyi's political economy overlaps with the type of socio-economic civilization that MMT's ELR and structural approach to functional finance would create. In conclusion, there is a significant and underappreciated connection between Polanyi and MMT, and a potential avenue for future research might involve a more expansive analysis on how the former's political economy can be understood as setting the agenda for which ideational traits are desirable in both local and global societies, while the latter tradition as the policy vehicle for leading the way.

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