
GÁBOR SCHEIRING *

Sustaining Democracy in the Era of Dependent
Financialization: Karl Polanyi's Perspectives on the
Politics of Finance

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Abstract

With the contemporary crisis of liberal democracy and the rise of illiberalism in the aftermath of the global financial crisis we are witnessing a renewed interest in structuralist theories that conceptualize the inherent tensions of modernization, crises and democracy. In my paper I attempt to show that Polanyi's thinking represents such a framework that can be updated to fit contemporary realities both in core and peripheral countries. After the introduction I reconstruct Polanyi's political stance regarding democracy, socialism and the market based on a reading of his political speeches as well as other non-academic texts. Next I will bring to the fore his often neglected views regarding the commodification of money and the tensions between international finance and democracy. In the fourth section of the paper I introduce the notion of dependent financialization to make Polanyi's theory of money compatible with non-core capitalist economies. The Polanyian theory of money allows us to formulate hypotheses about political dynamics in different varieties of core and peripheral capitalisms as well. In the final section of my paper I conclude that Polanyi's theory of the double movement and fictitious commodification can only be understood and applied to empirical analysis once we bring it into dialogue with his political views. Polanyi urges us to preserve the market by protecting the economy and society from the damages of excessive commodification: markets need to be protected from themselves.

Keywords: Polanyi, double movement, fictitious commodity, finance, democracy.

1. Introduction

Financial crises impose immense economic, social and political losses. Financial crises might also lead to the rise of illiberal political forces. Economic crises are found to have a detrimental effect on democratic stability. Przeworski (2000) has pointed out that the likelihood of a democratic breakdown is tenfold in an economic recession as compared with a state of economic growth. In a democratic polity economic woes have political repercussions. With the contemporary crisis of liberal democracy and the rise of illiberalism (Levitsky & Way, 2002; Zakaria, 1997) in the aftermath of the global financial crisis we are witnessing a renewed interest in structuralist theories (Iversen, 2009: 617) that conceptualize the inherent tensions of modernization, crises and democracy. In my paper I attempt to show that Polanyi's thinking represents such a framework that can be updated to fit contemporary realities both in core and peripheral countries.

The first thorough analysis of the politics of finance goes back to Keynes. Liberal economists assert that banks allocate, divide or distribute risk, but do not create it, that is, money is neutral. In contrast to this view, Keynes famously asserted that uncertainty is inherent to a market economy. By creating money through loaning banks infuse the whole economy with uncertainty. Until the 1930s this system was maintained internationally through the gold standard which had profound economic, social and political consequences:

‘The gold standard, with its dependence on pure chance, its faith in ‘automatic adjustments’, and its general regardlessness of social detail, is an essential emblem and idol of those who sit in the top tier of the machine’ (Keynes, 1963(1931): 262).

Karl Polanyi started where Keynes left off (Polanyi-Levitt, 2005), explicitly addressing the political consequences of international money markets in general and fixed exchange rates in particular. Polanyi also draws our attention to the fact that monetary policy is not a technical but a deeply political question with major social implications, demonstrating the domestic political importance of the international monetary order.

Polanyi is mostly cited for his theory of ‘embeddedness’ (Barber, 1995; Gemic, 2008), however, his views on democracy and financial liberalization are rarely invoked. Yet, Polanyi has offered several prescient thoughts on the fictitious commodification of money that could serve as a valuable theoretical frame to analyse contemporary tensions between financial markets and democracy. Economic anthropologists have long recognized the value of Polanyi's work in understanding the nature of money (Graeber, 2009; C. Hann & Hart, 2011; C. H. Hann, 1992; Hart, 2009). However, most of these works have concentrated on his later writings and mainly took Polanyi's article *The semantics of money uses* as point of reference (Polanyi, 1971). As Saiag (2014) shows, *The Great Transformation* differs from his later writings on money in several dimensions, but most importantly, in its analysis of money as part of the historical process of the rise and fall of the fiction of free markets and fictitious commodification. More recently, several leading post-Marxist scholars

have tried to revive Polanyi's theories to reconstruct critical theory. Fred Block and Margaret R. Somers (2014) argue that Polanyi could be the central figure of renewing contemporary Left-wing thinking, echoing Burawoy's (2003) call to reconstruct Marxism on a sociological ground based on Gramsci and Polanyi. Social movement theorists have also rediscovered Polanyi's notion of the double movement to conceptualize movements fighting for a counter-hegemonic globalization (Evans, 2008; Munck, 2004).

Polanyi's work has been subjected to historical-empirical (Duncan & Tandy, 1996) and theoretical criticism as well. It has been pointed out that in *The Great Transformation* Polanyi was sensitive to the moral and the practical limitations of commodification, yet he was less sensitive to the relations of domination present in non-market societies, such as slavery, feudal subordination or gender inequalities (Fraser, 2014). Polemically targeting economic liberalism Polanyi was also less sensitive to the ways in which marketization actually improved the lives of people (Kindleberger, 1974) and thus was too quick to condemn liberal capitalism to death (Polanyi-Levitt, 2005: 175). The recent article by Hodgson (2016) offers a thorough critique of the ambiguousness of the terms society, economy and embeddedness in Polanyi's works as well as pointing out the future direction for possible conceptual clarifications. However, Hodgson also maintains the relevance of the concept of fictitious commodities and the theory institutionalization of the market. Notwithstanding the need for further clarification I will rely on the political economic theory of money as laid out in *The Great Transformation* to offer a structural theory of the tension between financial markets and democracy.

In my article I join the recent scholarship on Polanyi that aims to bring his theory of money to understanding the politics of contemporary financial crises (Block, 2015; Harmes, 2001; Helleiner, 2006; Holmes, 2014; Kara, 2014; Polanyi-Levitt, 2005, 2013; Woodruff, 2016). This literature focuses on the core capitalist countries, mostly the eurozone. By introducing the notion of *dependent financialization* I show that Polanyi's theory can be updated to analyse structural tensions between financial markets and democracy in semi-peripheral countries even without the presence of a fixed exchange rate or an outright currency union like the eurozone. Polanyi was the first political economist to link international financial liberalization to the erosion of democracy. He was also one of the first to forcefully argue that proponents of freedom have to regulate the free market to protect not only society but the productive process itself otherwise wholesale attacks on the institutions of freedom seem to be inevitable. In my paper I intend to show that Polanyi was deeply committed to the principles of freedom and democracy, and his critique of marketization was not meant to completely overhaul the institution of the market but to embed it into social regulation to reconcile it with democratic sustainability. The thrust of Polanyi's argument about the perils of fictitious commodification is that democracy can only be sustained if the operation of the market in general and money in particular is embedded into regulation. Failing to recognize this interrelation leads to the rise of antidemocratic forces according to Polanyi.

The paper proceeds as follows: *The Great Transformation* does not offer a detailed theory of democracy thus we need to look at Polanyi's earlier writings to have a clear understanding of his democratic ideal. In the next section I will reconstruct

Polanyi's political stance regarding democracy, socialism and the market based on a reading of his political speeches as well as other non-academic texts. In the third section I will bring to the fore his views regarding the commodification of money and the tensions between international finance and democracy as laid out in *The Great Transformation*. In the fourth section of the paper I introduce the notion of dependent financialization to show how the structural tensions inherent to liberal finance analysed by Polanyi can be applied to semi-peripheral countries even without a fixed exchange rate regime. The Polanyian theory of money allows us to formulate hypotheses about political dynamics in different varieties of capitalism. In the final section of my paper I conclude that Polanyi's theory of the double movement and fictitious commodification can only be understood and applied to empirical analysis once we bring it into dialogue with his theory of democracy. Democracy can only be sustained in the era of dependent financialization if society reasserts control of money and democratizes the economy.

2. Polanyi's theory of democracy

Before leaving Hungary and devoting his life to social science Polanyi was active in politics. He started his public involvement as an intellectual fellow of György Lukács, Oszkár Jászi and Endre Ady and became one of the most active organizers of the Galilei Circle, a Hungarian movement of progressive university students (see Csunderlik, 2016). As a young intellectual in Budapest he even had a brief flirtation with politics as a key figure of the short lived Civic Radical Party and became its spokesman and secretary general. Polanyi was said to be an excellent orator. In fact, in the turn-of-century Budapest the Polanyi family was at the centre of the progressive movement (Congdon, 1976; Dale, 2009; Litván, 2005).

The civic radicals of the era were fighting for a parallel democratization of the economic and the political sphere. Much in common with social democrats they were not only demanding land redistribution among the rural poor and for limiting class cleavages in life chances but also for the establishment of a modern liberal republic in place of the defunct and profoundly illiberal monarchy of the pre-First World War Hungary. Thus the radicalism of Polanyi and the Radical Party was based on the notion of equality also recognizing that political equality requires certain level of economic equality as well. Although he sympathized with the socialist movements of the era, in his most prominent political speech delivered at the convention of the Radical Party in 1918 in Szeged Polanyi gave a succinct overview of the programme and strategy of the party and also juxtaposed it to the 'scientific socialism' of contemporary Marxism (Polanyi, 1986b). As a central figure of social democratic thinking Polanyi was too much to the Left for the liberals, and too liberal for the radical Left. His progressivism was that of the welfare state, mixed economy (Szelényi, 1991), Robert Owen, social rights and the social regulation of the market (Holmwood, 2000), most closely resembling the Swedish or Nordic model of social democracy (Berman, 2006).

Central to Polanyi's critique of economic liberalism is his ideal of positive or substantial freedom (on the idea of positive freedom see Sen, 1999). His attack on economic liberalism connects the collapse of the gold standard and the rise of fascism

to the rise of the ideal of self-regulating markets. Polanyi considers it to be a grave error to mistake freedom for free markets, for the lack of state involvement. To prevent fascism democratic forces need to abandon the illusion of the self-regulating market and endorse regulation and planning to re-embed the market into society (Polanyi, 1935). According to Polanyi, human freedom and the functioning of the market both require state involvement into economic affairs. The notion of freedom as a lack of state interference as propagated by orthodox economic liberalism conceals '*such brutal restrictions of freedom as were involved in the occurrence of unemployment and destitution*' (Polanyi, 2001[1944]: 266).

Polanyi's strong criticism directed at economic liberalism does not mean a rejection of political liberalism (Kuttner, 2014). Although he eschewed the liberal utopia of self-regulating free markets (calling that 'our obsolete market mentality' (Polanyi, 1947)) and was an ardent supporter of regulation and planning both nationally and internationally, Polanyi was not a proponent of ideologies fetishizing state power. He feared individual freedom would be threatened not only by the dis-embedded economy but by a dis-embedded, non-democratic state as well (Ebner, 2011). Foreshadowing the critical theory of the Frankfurt School, Polanyi thought that '*The Machine Age*', as he called industrial society, is not only threatening freedom through the exploitation of men and nature but through bureaucratic control of human creativity as well (Polanyi, 1947). The last chapter of *The Great Transformation* is titled *Freedom in a complex society*, a text that Polanyi planned to develop into another monograph but did not have the time to do so. Individual freedom (especially 'the right to non-conformity') must be guaranteed in democratic socialism but this can only be achieved if we depart from the notion of freedom as free enterprise into which the liberal idea degenerated according to Polanyi. Freedom can only be fulfilled in and through society: democratic society has to be organized in a transparent way so as to provide ground for the informed and responsible intervention of individuals, who thereby achieve a new and 'positive' form of social freedom (Cangiani, 2012: 45). Therefore, institutions of planning and redistribution at the root of the welfare state, have to be embedded into social and communal coordination according to Polanyi to preserve freedom. As a democratic socialist, he believed that freedom can only be guaranteed through social or communal regulation. For Polanyi

'socialism is, essentially, the tendency inherent in an industrial civilization to transcend the self-regulating market by consciously subordinating it to a democratic society (2001[1944]: 242).

'the class of the employed can defend themselves against the fateful effects of industrial vicissitudes upon their personal lives only by deliberate political interference with the automatic laws governing capitalist markets and currency-systems, interest and wage-rates.' (Polanyi, 1934: 128).

Polanyi devoted several articles to the theory of democratic socialism during his stay in Austria. Following his disappointment with Hungarian politics he left for Vienna, where he spent more than ten years as a journalist also studying economics and sociology. In the 1920s he engaged in a debate with Mises (the mentor and patron of Hayek) and other economic liberals about the possibility of socialist accounting (Rosner, 1990). In his response to Mises Polanyi laid out his theory of functional socialism and did not argue for the elimination of wage labour but wanted to use regulation and planning to curtail unequal income, insecurity or unemployment (Polanyi, 1924). As Sommers and Block (2014: 32) point out, Polanyi believed that politics and other social norms and regulations effectively define the actual meaning of ownership, therefore the question is what those regulations and norms allow and prohibit and not who actually owns capital. In a letter to Oszkár Jászi he suggested that:

'Land, money and labour should not be left to the market. Apart from this the free operation of the market should be left intact.' (Quoted in Litván, 1991: 260)

'The end of market society means in no way the absence of markets. These continue, in various fashions, 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, 2001[1944]: 260)

This type of socialism resembles a corporatist system of industrial democracy with public property of the means of production that is governed by industrial associations and consumer organisations, and wages and prices regulated in terms of social values through democratic bargaining (Ebner, 2011). Polanyi's theory of democracy rests on his view of the inseparable nature of the economy and polity. Most of his articles on democracy in fact dealt with the extension of democracy to the economy through controlling and curtailing commodification (Cangiani, 2006).

Although Polanyi saw the final guarantee of democracy in democratizing the economy, he was not economic in the sense of equating productive forces, the economic structure, with the base that determines political outcomes. For Polanyi (1947), economic determinism of Marxism is as equally misleading as the liberal fiction of the free market. Influenced by the theory of commodity fetishism in early Marx (see Block, 2003; Brown, 1987), along the lines of humanist, liberal socialism he questioned the whole idea of separating material and non-material interests as driving human behaviour, for him the two are bound together (Özel, 1997). Echoing Weber's non-economic theory of class (Wright, 2009) Polanyi understood that social protection is not only about wages and living standards but also about respect and dignity. For Polanyi, the need for recognition is at least as important as material interests:

'Purely economic matters such as affect want-satisfaction are incomparably less relevant to class behaviour than questions of social recognition. Want-satisfaction may be, of course, the result of such recognition, especially as its

outward sign or prize. But the interests of a class most directly refer to standing and rank, to status and security, that is, they are primarily not economic but social.' (Polanyi, 2001[1944]: 160)

Economic power yields political power, but politics can be used to act against the interests of economic power holders and to ensure democratic equality. This approach to democracy also means that Polanyi's theory of democracy is of a political sociological nature, treating democracy as a socially and historically contingent phenomenon instead of an abstract ideal (see Polanyi, 1986a). Democracy should be understood in relation to mass politics or working class action. His emphasis on popular action went hand in hand with his life-long commitment to workers education. The ultimate source of democratic political change is not a Marxist or liberal vanguard but the social creativity that lies in the culture of common people (Polanyi-Levitt & Mendell, 1987). His commitment to progressive populism and his belief in the revolutionary potential of common people was also signified by his last book co-edited with his wife, the *Plough and the Pen* (Duczynska & Polanyi, 1963), a volume consisting of works by Hungarian populists.

Understanding Polanyi's political views is vital to comprehending and applying his theory of the fictitious commodification of money and its backlash on democracy. Polanyi was committed to the view that separating the economy and society is an analytical and political error and therefore the theory of democracy has to be built on a theory of the economy. His critique against economic liberalism is based on a positive theory of freedom that can be maintained only if the economy is subjected to political control. Yet, his insistence on a non-economistic conception of democratic socialism is crucial to avoid the pitfalls functionalism that Polanyian analyses of globalization and resistance often fall into. There is no preordained movement against commodification: the outcome of political struggles depends on political organization. This democratic autonomy of the political sphere against democracy can only be fulfilled if it is used to re-embed the economy into social control. The most important element of the economy that drives the deep tensions between democracy and markets is money. Therefore I turn in the next section to Polanyi's analysis of the commodification of money.

3. The great transformation of money

In *The Great Transformation* Polanyi showed that liberal economists have mistaken labour, land and money as commodities leading to a complete misunderstanding of the working of the economy. Therefore, following what Polanyi (1957) later called the substantive view of the economy, economic analysis has to transcend the focus on efficient use of scarce resources and become sensitive to history and social embeddedness of the market. *Fictitious commodification*' is one of the central elements of Polanyi's theory about capitalist crisis. It is not only morally wrong to treat land, labour and money as commodities, but leaving these spheres completely to the market also leads to a breakdown of the functioning of the market and society. Market societies therefore need the state and thus need some form of political decision making to guide state involvement in the economy. Society will in some way react to

the imposition of a fictive free market leading to what Polanyi calls '*the double movement*'. For Polanyi, the most important element of this historical development was in the sphere of *money*. Money is at the centre stage of his historical account of the rise and fall of liberal capitalism. Speaking about the collapse of the order of peace, the collapse of global capitalism and the rise of fascism he writes 'the gold standard proved crucial; its fall was the proximate cause of the catastrophe' (Polanyi, 2001[1944]: 3).

Polanyi's approach to international monetary affairs is clearly at odds with the classical view that separates the 'monetary' and 'real' spheres of the economy. Much of the mainstream analytical efforts to understand money treated it purely as a neutral expression of exchange value. According to this orthodox view of money there are no particular political preconditions and no major political implications of money, that is, money is neutral. *The Great Transformation* questions this view of money and places it in the history of the development of market society as a fictitious commodity. For Polanyi, both the rise and fall of the market system and the political challenges induced by the fixed exchange rate regime of the gold standard cannot be analysed separately from monetary policies and the collective representation of money. In his theory of money Polanyi thus departs both from the subjectivist theory underpinning neoclassical economics and the labour value theory underpinning classical and Marxist economics (Maucourant, 2001). Polanyi's approach to money is non-essentialist and institutionalist: he treats the economy and money as an institution that expresses empirical regularities of social life and as such is linked to the existing social order. From this it follows that money might take different forms and have different functions in society.

In his later writings Polanyi made an analytical distinction between 'special purpose money' and 'all purpose money' (Polanyi, 1957, 1971), maintaining that money had various functions in non-modern societies but in modern market society money has become 'all purpose money' (Melitz, 1970). This view of money in market society differs from that of *The Great Transformation* that treats money as an historically specific institution in modern societies that has social and political functions and cannot be conceptualized as a universal means of exchange (Saiaq, 2014). I agree with Holmes (2014) that we need to follow the logic of *The Great Transformation* and adhere to the special purpose view of money. This way we can conceptualize the power relations within which money as a social relation functions: money is more than a universal means of exchange, it can be a unit of accounting (for debt), purchasing power and also a disciplinary tool of neoliberal governmentality. In fact, as Polanyi points out, economic liberals also recognized the limitations of the view of money as a universal means of exchange and thus a commodity.

As Polanyi describes in the first chapter of *The Great Transformation*, the only exception where liberals tended to openly accept state intervention was the sphere of money. Stable exchange rates between national currencies were central to maintaining the liberal order of the 19th century, thus the protection of the exchange rate became one of the most important tasks of governments. Monetary stability was considered a prerequisite for the international expansion of the market, without which the free international movement of goods and capital could easily be jeopardized by sudden movements of the exchange rate. During the first era of globalization in the 19th

century, international financial investments (in the forms of railways, colonial companies, or international lending) grew to an unprecedented scale. Polanyi argues that international investors of the era - haute finance as he calls this faction of the economic elite - became strongly interested in the maintenance of peace and monetary stability. They were able to put pressure on governments - who would by themselves not be too much concerned with international peace - through the lever of lending. Thus the system of fixed exchange rates was born representing the highest form of the *fictitious commodification of money*. Yet, money has not been produced solely to function as a universal means of exchange. The whole working of the economy rests on it, therefore the quantity and price of money cannot be decided through the market as that would undermine the working of democracy:

Yet if profits depend upon prices, then the monetary arrangements upon which prices depend must be vital to the functioning of any system motivated by profits. [...] Hence, if the price level was falling for monetary reasons over a considerable time, business would be in danger of liquidation accompanied by the dissolution of productive organization and massive destruction of capital (Polanyi, 2001[1944]: 201)

The creation of the fictitious commodity of money - just as the creation of labour and land as commodities - required a new bureaucratic state and a series of new regulations to protect the functioning of the economy itself. Not only was the creation of the gold standard a result of deliberate political action, but so was the emergence of central banking to ensure the smooth running of the money market. Hence the remark by Polanyi: "*laissez faire was planned - planning was not*" (Polanyi, 2001[1944]: 147). The establishment of the gold standard and the free movement of money not only created problems for the producers but it often involved painful internal adjustment to preserve the value of money and protect fixed exchange rates. Fluctuations in economic processes induced by unchecked market forces went beyond the endurance of society calling forth protective measures of various kinds, from social insurance through social policies to tariffs and protectionism. Polanyi also notes how an internationally interconnected system of national economies might exaggerate these problems:

Under the gold standard—which we all the time assume to be in force—any governmental measure that caused a budgetary deficit might start a depreciation of the currency; if, on the other hand, unemployment was being fought by the expansion of bank credit, rising domestic prices would hit exports and affect the balance of payment in that way. In either case exchanges would slump and the country feel the pressure on its currency.' (Polanyi, 2001[1944]: 209)

The collapse of 19th century liberalism and the rise of fascism cannot therefore be understood without looking at the liberalized international economic system of the 19th - early 20th centuries also encompassing an analysis of the interaction between fixed exchange rates and the inability of the government to react to international economic disturbances and unemployment. Polanyi clearly understood this dynamic

interrelatedness of democratic politics and social protection against the effects of international free markets and the exchange rate. As Holmes (2014: 585) points out, the contradictory goals of sustaining the gold standard and defending the domestic economy led to the final collapse of the gold standard system. Nationalism and the ideology of autarchy took the place of liberal internationalism. There was no international mechanism to protect the economy (the Bretton Woods Institutions were established decades later), therefore national solutions became the only possible form of social protection against the fictitious commodification of money.

The collapse of the gold standard thus was not a result of errant politicians choosing bad policies or self-interested workers looking for protection but rather was an inevitable result of the imposition of the fictitious commodity of money upon society. The countries that were able to survive the thirties with the least inclination to succumb to illiberal forces were the countries first to abandon the gold standard. In the US, the New Deal would have been impossible without the country leaving the gold standard system. Polanyi also points out that in the case of macroeconomic adjustment through internal deflation liberals in effect chose the principle of price stability and the maintenance of the value of the currency and the gold standard over non-intervention and advised governments to push for the reduction of wages:

The stubbornness with which economic liberals, for a critical decade, had, in the service of deflationary policies, supported authoritarian interventionism, merely resulted in a decisive weakening of the democratic forces which might otherwise have averted the fascist catastrophe. Great Britain and the United States—masters not servants of the currency—went off gold in time to escape this peril.' (Polanyi, 2001[1944]: 242)

Polanyi described three major reactions to the Great Depression. In Central Europe, most notably Germany, the contradicting demands of different classes led to a high levels of debt and a democratic stalemate. Neither the rentier class nor the workers could prevail, inducing a prolonged political crisis and a loss of confidence in democratic politics and thus paved the way to fascism. Fascism according to Polanyi was the negation of democracy and the upholding of capitalism resulting in a disciplinary state. In England, according to Polanyi, democracy could be sustained only because the rentier class was able to defeat the working class politically. Investors thus did not have to fear a political backlash against their interests and could abandon the gold standard to which they had insistently adhered until the fall of the labour government and the failure of mass strikes. Finally, the third way according to Polanyi was that of the United States where Roosevelt building on the restructured Democratic Party was able to defeat the interests of Wall Street politically and abandon the gold standard.

Polanyi thus suggested that by opening up national economic decision making to parties representing working-class interests through the extension of the right to vote clearly played an important role in the fall of the gold standard system. However, the interplay of global finance and domestic politics did not necessarily lead to the collapse of democracy and the rise of fascism. The fate of democracy rested on the fate of the gold standard – the central expression of the fictitious commodification of

money. Governments that went off the gold standard were able to retain democracy. Polanyi points out that the common external factor of the gold standard led to divergent political outcomes in different countries based on local economic and political histories and different policy choices. By abandoning the gold standard and subjecting money to political control, democracy could be rescued. This solution depended on the balance of class forces and the different varieties of societal organization leading to divergent outcomes in response to the Great Depression.

4. The political trilemma of dependent financialization

Contemporary economists have produced several waves of theories of financial crises, most of them unaware of Polanyi's prescient analysis provided in *The Great Transformation*. Yet, Polanyi's theory is still relevant and can be updated to fit contemporary realities. In a similar fashion to the gold standard, currency pegs and currency unions (binding the exchange rate of one currency to the other) were widely recommended throughout the eighties and nineties to developing countries in the framework of the Washington Consensus. Reinhart and Vegh (1999) find that in most cases exchange based price stabilization was much slower than expected from the fixed exchange rate currency regime. The persistence of inflation differentials however leads to real overvaluation and seriously destabilizes the domestic economy through the loss of competitiveness. The slow convergence of inflation rates fuels a large real exchange rate appreciation which, together with the fall in private saving, leads to large current account imbalances and over-borrowing. This situation brings the Polanyian tensions of the commodification of money to the fore again.

Governments might react in two ways to such a loss of external competitiveness under a fixed exchange rate regime. The first type of reaction follows the suggestion of liberal economists – similarly to the economists analysed by Polanyi – to maintain the exchange rate which requires an internal devaluation to restore competitiveness: cutting wages, cutting social spending, decreasing pensions and cutting internal consumption. The fall in internal prices would restore competitiveness, boost exports and thus the crisis would be overcome. However, workers – as analysed by Polanyi – are reluctant to accept cuts to wages, and their resistance could lead to increasing unemployment and increasing public spending. Internal devaluation, a deflation of prices is always a painful measure to restore international monetary balance. Democratic governments, especially Left-wing governments relying on the votes of those hurt by deflation, are reluctant to allow such adjustment and are inclined to protect society from the pressure emanating from international financial markets. A second possible reaction to the problem of the loss of international competitiveness and currency overvaluation is not internal devaluation but external devaluation through a change in the value of the currency. However, this requires monetary policy autonomy to modify the exchange rate and this autonomy is not present in the system of fixed exchange rates as the gold standard of the 19th century or today's euro and other currency pegs.

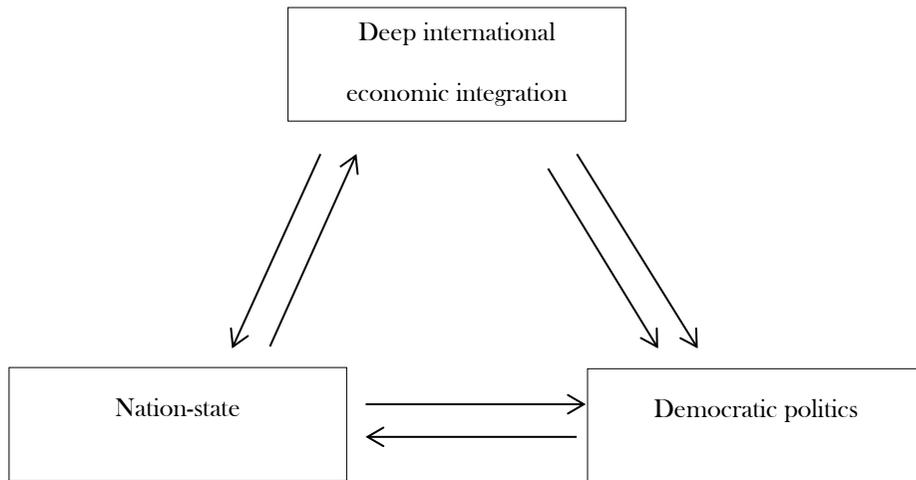
The so called second generation economic models of financial crises address this tension between democratic governance and international financial adjustment (Eichengreen, Rose, Wyplosz, Dumas, & Weber, 1995). The central question for

these theories is how governments will react to the double pressure, one emanating from the international financial market the other from the drive to protect society from the effect of adjustment. Although a government might be able financially to protect the currency against speculative pressures, but the political cost of doing so through internal devaluation (cuts to real wage) might induce the government to abandon the fixed exchange rate (Obstfeld, 1986). Although economic scholarship on financial crises clearly endogenizes political considerations they fall short of a deep political analysis of the tensions between international monetary order and democracy.

Among contemporary economists it was Barry Eichengreen to first note the usefulness of Polanyi's analysis of the collapse of the gold standard and the embeddedness of the monetary sphere into political processes. Inspired by Polanyi, Eichengreen (1996) points out that the stability of the nineteenth-century gold standard was possible because of the lack of mass democratic politics and the insulation of economic policy-making from democratic pressures. Before the mass extension of the franchise it was easier for governments to orchestrate internal deflation of prices as the social repercussions were not directly felt politically. The international macroeconomic model of the impossibility trilemma developed by Dani Rodrik goes even further in integrating political and economic analysis. Updating Rodrik's framework with the Polanyian notion of double movement as a reaction to fictitious commodification offers a powerful conceptual tool for international political economic analysis.

In his paper *The Governance of Globalization* Rodrik (2000) describes the political trilemma of the world economy as the impossibility to simultaneously pursue deep international economic integration, democratic mass politics and the sovereignty of the nation-state. According to the model, we have to choose either to curb integration to retain the nation-state and democratic politics; or maintain integration and the nation-state but abandon democratic politics; or to say farewell to the nation state and re-create democracy and the international level. As opposed to Polanyi, Rodrik thinks in terms of good policies and not in power relations that bring about various institutional orders. Rodrik's model is analytically more rigorous but static, whereas Polanyi's account of the great transformation was less rigorous but more dynamic. We need to be able to conceptualize the trilemma not as a theoretical impossibility of policy choices but as a dynamically evolving tension among the state, international capital flows and democracy that is driven by the structural dynamics of the changing balance class forces. This trilemma can be played out differently according to divergent local political structures. The double movement emanates from the political trilemma but takes different forms in different countries. Combining Rodrik and Polanyi offers a theoretically sophisticated understanding of the various ways in which external and internal political and economic forces shape each other. Figure 1 describes this modified trilemma as updated by the Polanyian notion of double movement.

Figure 1. The double movement dynamics of the political trilemma



Democracy, state autonomy and deep international economic integration are incompatible goals, and imposition of the fiction of free markets leads to social protective mechanisms. Similar political tensions have surfaced with the crisis of the eurozone (Holmes, 2014; Kara, 2014; Woodruff, 2016). Yet, it does not require a fully fledged currency union or a fixed exchange rate for the tensions of fictitious commodification to surface. After the collapse of the Bretton Woods system a new era of liberal finance has started as was described by the literature on financialization (Davis & Kim, 2015; Epstein, 2005). Further research could demonstrate the usefulness of Polanyi in understanding how the growth strategies of several externally indebted countries of peripheral Eastern Europe that could be characterized as *dependent financialization* lead to democratic tensions (Myant & Drahoukoupil, 2012; Roaf, Atoyan, Joshi, & Krogulsk, 2014; Smith & Swain, 2010).

There are significant differences in the way various countries of the European periphery developed their vulnerabilities and reacted to crises. Political structures diverge, different varieties of capitalism (Bohle & Greskovits, 2012) allow different resolutions of the political trilemma inherent to dependent financialization. The tradition of identity politics in the Baltic states allowed more space for political toleration of internal devaluation as opposed to Hungary for example. The trilemma not only developed in countries with fixed exchange rates but in countries where foreign currency debt tied the hands of monetary authorities. Bound to the rule of the free flow of capital in the EU and unable to significantly devalue their currencies due to high levels of private foreign currency debt the only option for the government in Hungary was to follow the logic of deflation: cut budgetary expenses and decrease real wages. The fictitious commodification of money, the uncontrolled flow of cross-border debt and emergence of institutional infrastructure of liberal finance pitted the logic of democratic politics against the maintenance of the confidence of investors. We can conclude with the posing the hypothesis that the collapse of the Hungarian Left and the rise of illiberalism can be understood using Polanyi's notion of the

double movement as a reaction to the commodification of money in the form of dependent financialization. New empirical research is needed to test this hypothesis.

5. Conclusion

Polanyi's analysis of the collapse of the gold standard has many important implications for today's financial crises and the resulting pressures on democracy. Without meaningful intervention and financial assistance to those countries that got into deep trouble during the crisis with their fixed exchange rates, a democratic collapse and a rise of political forces negating freedom can be the result. Fictitious commodification creates similar tensions under the regime of the gold standard, the eurozone or dependent financialization. The crucial question politically as well as analytically is what form the regulation of free markets will take and in what form the double movement emerges. Although monetary policy seems to be a technical problem better left to experts, applying the framework of Polanyi we are able to transcend the narrow focus of classical economics and realize that monetary policy is in fact deeply political with major social implications.

Bringing Polanyi's theory of the double movement into dialogue with his political views we can formulate a non-functionalist theory of the double movement. In the second section I showed that the motivation of Polanyi was to protect freedom including the working of the market albeit in a limited and embedded form. For Polanyi, democracy is only complete if the economy is democratized. If the economy is separated from politics then the power of capital prevails thus reducing the equality of citizens into a mere façade disguising the rule of economic interests. Polanyi's analysis of the tensions between democracy and finance is only complete by bringing in his political views. This way we can better understand his urge to preserve the market by protecting the economy and society from the damages of excessive commodification: for Polanyi, markets need to be protected from themselves.

Polanyi is right in pointing out that people will react *in some form* to dislocations, but this reaction could take many forms falling in three broad categories as famously pointed out by Albert Hirschman (1970): exit, voice or loyalty. That is, even if workers or citizens are hurt by the process of commodification, they still might chose to exit the political sphere, become disillusioned with the possibility of change and not engage in any form of social protection. It is thus far from clear what form the double movement might take. Understanding these reactions requires sophisticated analyses of movement building and political formation. Nevertheless, after stripping Polanyi's theory of its excessive functionalism, treating it as a macro-historical and institutional account of political and economic processes without taking any form of reaction to them as preordained, his main argument about the tension between free markets and democratic politics remains valid and powerful.

In the closing section of *The Great Transformation* Polanyi points out that both fascism and socialism were representatives of the double movement toward social protectionism, but whereas fascism rested on complete negation of freedom, the theory of socialism was built with freedom at centre stage. For Polanyi, socialism essentially means democratic socialism, a strong form of social democracy, with the preservation of markets within a system of public regulation, social protection and

planning. It is a question of local social characteristics, local path dependencies and local histories of class formation and ideological struggle what form the double movement will take. It might induce the rise of illiberal forces, it might result in pervasive withdrawal from politics or might give rise to new progressive forces aiming to deepen democracy through curtailing the fictitious commodification of money. Herein lies the potential of a Polanyian analysis of the commodification of money and the divergent reactions to it.

By securing social rights, supporting trade unions to fight for higher wages, providing public services and social insurance the social burden of international macroeconomic shocks might be eased. However, this will also necessitate the abandonment of completely liberal global financial markets and a return to capital controls and managed exchange rate regimes, and the introduction of international wealth and transaction taxes (e.g. Tobin-tax) as well as strong national and international regulation of lending to curtail the fictitious commodification of money. This way, society, democratic politics and the market based system of production might be protected from the negative effects of fictitious commodification. The real option against illiberalism for political liberals and democratic socialists is to uphold freedom against the illusion of the free market and fictitious commodification to protect society from the market:

‘The discovery of society is thus either the end or the rebirth of freedom. While the fascist resigns himself to relinquishing freedom and glorifies power which is the reality of society, the socialist resigns himself to that reality and upholds the claim to freedom, in spite of it.’ (Polanyi, 2001[1944]: 268)

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