The Power of Ideas: Keynes, Hayek and Polanyi

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European intellectuals of the generation of Keynes (b.1883), Hayek (b. 1899) and Polanyi (b.1886) were conditioned to assume responsibility for the welfare of society. They believed in the power of ideas to affect the course of world events. They understood that ideological beliefs can sustain an unsustainable social and economic order, or release forces of revolutionary change. They profoundly affect how we live in society, or react to perceived injustice. Keynes, Hayek and Polanyi shared a generational experience of the demise of the 19th century bourgeois order in the trenches of the First World War, the Russian Revolution, the Great Depression, Soviet five-year plans, fascism in Europe and the Second World War. In this brief note, we review their intellectual contributions and the impact of their economic and social philosophies on the entire postwar period from 1945 to the present. The first thirty years were dominated by Keynes. Hayek had to wait longer to claim ideological patrimony over the last quarter of the 20th century. Neoliberal policies of unleashing capital from national control since the 1970s have produced a crisis of capitalism more profound and intractable than that of the 1930s, because Western democracies are now captive to financial markets. In the first decade of the new millennium, Polanyi's warning of the dire consequences of permitting the (now global) self-regulating market to devastate social coherence and the natural environment has assumed new urgency and relevance.

The Keynesian Revolution in Economics

Keynes was a brilliant economist and committed public servant, a product of the best traditions of English liberalism. He believed that well-managed capitalism is the best system yet known, but he profoundly objected to the encouragement of the money making motives of individuals (Keynes, 1971, 293-294). His utopia was a society of abundance, leisure, and culture, where 'love of money' is regarded as a mental disorder (Keynes, 1971, 329). His greatest concern was that industry should be freed from the fetters of financial capitalism (Dillard 1948).

Keynes attended the Paris Peace Conference, which imposed punitive reparations on Germany. He considered it short-sighted, unjust and dangerous. His book *The Economic Consequences of the Peace*, published in 1919, was possibly the most widely-read of his works, translated into several languages at the time. The Austro-Hungarian Empire was dismantled and fragile new states were created and frontiers shifted in Central and Eastern Europe. Vienna, the glittering capital of the former empire of 50 million was reduced to the cosmopolitan capital of the Republic of Austria, with a population of only 6 million. The currencies of European states were linked to gold, sustained by credits from Britain and France, and accompanied by severe austerity requirements. Americans extended large credits to Germany to service reparation debts to Britain and France, enabling them to repay the war debts owed to the United States. This complex system of credits, negotiated by the governors of the central banks of the four major powers, cracked with the Wall Street crash of 1929 and collapsed in 1931, forcing the pound sterling off gold. By 1933 capitalism was in total crisis. International trade and investment had collapsed. Thirty million workers in Western countries were unemployed. The World Economic Conference had failed. Laissez-faire was universally discredited. The achievements of the First Soviet Five Year Plan, and the rise of fascism, attracted the best and brightest students to Marxism and communism. Keynes was not drawn to socialism; Washington of the New Deal rather than Moscow appealed to him as the exciting laboratory of a new model of economic organization.

In Britain unemployment was never less than 2 million persons from 1918 to 1939. The Gold Standard was restored in 1925 at pre-war parity. The now overvalued pound sterling favored the City and the overseas investments of the rentier classes. Britain's exports were uncompetitive. Miners were asked to pay the costs by increasing production of coal, England's principle export, and taking a cut in pay, resulting in the 9-day 1926 General Strike. Keynes observed that what appeared to be a technical issue of the exchange rate was really a distributive class issue favoring those who sat in the top tier.

In 1932, Keynes advised the British government to combat unemployment by a program of public works financed by central bank credit. This was definitively dismissed. Austerity policies were defended with a familiar list of objections: public works would raise interest rates and "crowd out" other investment, adversely affect business confidence, increase imports and reduce foreign exchange reserves, and, if the government spent more on public housing, local authorities would spend less. Chancellor of the Exchequer Neville Chamberlin stood firm in his resolve to balance the budget, come what may: "No Finance Minister ever deliberately unbalanced his budget." (Skidelsky 1992, 474) Incredible as it may seem, the academic establishment of the 1930s did not consider unemployment to be a subject meriting their interest or attention. Professor Edwin Cannan's presidential address to the Royal Economic Society on the "The Demand for Labour" concluded that "general unemployment appears when (workers) are asking too much …. [the world] should learn to submit to declines of money-income without squealing." (Cannan 1932, 267-69)

It was clear to Keynes that his policy advice, no matter how well argued, would continue to be ignored as long as the bastion of economic orthodoxy went unchallenged. He was possessed by the perception of the power of ideas in maintaining a policy regime which had long outlived its relevance to the realities of the times. His target was the entire corpus of English economic thought from Ricardo to Mill to Marshall and Pigou, which he dismissed as "classical". They were formulated entirely in terms of real costs. Business cycles and monetary problems were treated separately without relation to the real economy. Keynes had to crack "classical" economics wide open, and had to be perceived as having done so.

The path-breaking *General Theory of Employment, Interest and Money* was published in 1936, but it was not until Keynes was called to London to assist in the management of the war economy that he found acceptance by the establishment. By contrast, a young generation of American economists, many employed in the administration of the New Deal, including John Kenneth Galbraith, greeted the Keynesian revolution with excitement. Keynes was invited to the United States and his work was popularized and taught in some economics departments. The New Deal, however, was not influenced by the work of Keynes. It was an effective and pragmatic response to the calamity of the Great Depression.

With few exceptions, the theories of Keynes did not find acceptance in the English academic establishment until after the war. Indeed, the teaching of economics was dominated by Lionel Robbins' *An Essay on the Nature and Significance of Economic Science* (1932) and its definition of economics as "the theory of allocation of scarce means among alternative uses" (Robbins 1932, 16). When I graduated from the LSE in 1947, Keynes was not on the curriculum.

In 1940 the continent was overrun by Hitler's armies, and Britain faced the danger of German occupation. Churchill replaced Chamberlain. The extraordinary success of British society in rising to the challenge of the war transformed the political scene. Millions of women joined the labor force. A 12-hour working day was the norm and a 72-hour working week was not unusual. Wages were not increased, but deferred. Remarkably, the nutritional well-being of the industrial labor force improved significantly. I know because I participated in the surveys carried out by the Ministry of Food. There was a role for everyone in the war economy, in contrast with the unemployment, poverty, and social injustice in pre-war Britain. It was not the brilliance of Keynes, but the implicit social contract created by the war that led to the consensus that the first objective of the postwar government must be full employment, accompanied by price stability and reduction of income inequality.

The Churchill government commissioned William Beveridge to produce a plan for social security from cradle to grave. The Report of the Inter-Departmental Committee on the Social Insurances and the Allied Services laid the foundations of the British welfare state, starting with the National Health Service introduced by the Labor government in 1945. An influential publication by Beveridge, *Full Employment in a Free Society* (1944), which owed an acknowledged debt to Keynes, stipulated that unemployment should never rise above 3 percent. The labor market should at all times be a sellers' market because involuntary unemployment is an economic hardship; even when covered by insurance it is an affront to human dignity to be considered useless to society. To the employer this may represent an inconvenience or even a loss of profit, but the right of employers to own the means of production and employ labor was not an "essential citizen liberty" because "it is not and never has been enjoyed by more than a very small proportion of the British people" (Beveridge 1944). It is said that Nicolas Kaldor assisted or possibly wrote much of the text of this important work (Kresge and Wenar 1994, 86).

Keynes was asked by Churchill to lead Britain's negotiations with the Americans. In these negotiations, including Bretton Woods, Britain was at a disadvantage because the final settlement of the terms of its large war debts to the U.S. was awaiting the end of the war. A paper by Keynes on an International Clearing Union, which first appeared in 1942, became Britain's official bargaining position in the Bretton Woods negotiations of 1944. The objective was to replace the Gold Standard with its deflationary bias which puts the entire burden of adjustment to international disequilibrium on the debtor country. A special purpose currency for clearing balances between central banks would be backed by stocks of commodities including gold. Together with capital controls, the proposal would ensure policy independence to national governments to implement full employment and avoid deflationary adjustments to external deficits by the provision of medium-term financing from this authority. Countries in external surplus would be penalized to assure international equilibrium of trade and finance. Ultimately it was not the Bretton Woods financial order but the capacity of the United States to cover the external deficits of Europe in the 1950s, and the Cold War competition for political influence in Europe and Asia which sustained the historic compromise between capital and labor in the thirty golden years of full employment from 1945 to 1975.

Hayek and the Neoliberal Counterrevolution

In the setting of intellectual Vienna of the 1920s, the Austrian economist Friedrich von Hayek, his patron Ludwig von Mises and their associates were the misfits — the remnants of old Imperial Vienna's privileged urban elites, whose security had been shattered, whose savings had been decimated by wartime and postwar inflation and whose taxes were financing the pioneering housing programs of socialist Red Vienna. In their parlors and favorite coffee houses, they fed their fears of the dictatorship of the proletariat. They found more fertile soil for their ideas in the United States. It was not Hayek's theoretical work which was important in the construction of the neoliberal paradigm, but rather his radical commitment to combat economic planning of any kind, including the New Deal. The source of his market fundamentalism must be traced back to the Vienna of the 1920s.

Hayek came from a good patrician family. He served as an officer in the Great War, obtained a doctorate in law and political science from the University of Vienna in 1922 and spent a year in New York (1923–24) before returning to join Mises, who had converted him from early socialist inclinations to become his protégée. Neither Mises nor Hayek had appointments at the University of Vienna. Both were employed by the Austrian Chamber of Commerce where Hayek had a modest research institute on business cycles and Mises conducted his famous *Privatseminar*.

Mises was the third generation of the Austrian or Vienna school of economics, founded by Karl Menger and succeeded by Friedrich von Wieser and Eugen Böhm von Bawerk. Mises' *Privatseminar* was attended by students with a variety of political philosophies, including several who became well-respected American academics. Among the latter was Fritz Machlup who explained that none of his fellow students were as extreme in their libertarian views as Mises.

Hayek was brought from Vienna by Lionel Robbins in 1931 and installed in the prestigious Tooke Chair of Economic Science and Statistics to counteract the dangerous inflationary doctrines of John Maynard Keynes and his friends in Cambridge, who were regarded by the rentier interests of the City as threatening the financial stability and the edifice of the Empire. Hayek's theory of the trade cycle was not easy to understand, but he maintained that the slump was due to an excess of consumption in relation to investment. Joan Robinson has given us a graphic account of Hayek's visit to Cambridge in 1931, when Richard Kahn, known for the employment multiplier, asked Hayek the following question: "Is it your view that if I went out tomorrow and bought a new overcoat that would increase unemployment?" Hayek responded: "Yes, but (pointing to his triangles on the board) it would take a very long mathematical argument to explain why." (Robinson 1972, 2)

In England, Hayek found himself on the right wing of the political spectrum of the intellectual elites. Liberalism and laissez-faire were in retreat. In 1938, Mises and Hayek attended a colloquium in Paris in honor of the eminent American journalist and public intellectual Walter Lippmann. Here the term neoliberalism was coined to stake out a new liberal position on socialism and collectivism, which acknowledged that laissez-faire was an anachronism. Among the participants were Michael Polanyi, Raymond Aron, and Louis Rougier (Van Horn and Mirowski 2009). Hayek's *Road to Serfdom* published 1944 attracted little interest in England, but more in the United States, where it was serialized in *Reader's Digest*.

Initially wishing to be based in Europe postwar, Hayek chose to immigrate to the United States. However, neither the Law School nor the Business School nor the Economics Department at the University of Chicago was prepared to make Hayek an offer because *The Road to Serfdom* was not considered a scholarly work meriting an academic appointment. In 1950 the president of the university arranged a business-funded position on the Committee of Social Thought, and Hayek was on the way to becoming the unofficial doyen of the Chicago School. With participation of members of the law faculty and the economics department it was concluded that classical anti-trust legislation was no longer necessary because competition is a sufficient condition to contain corporate market power. Only labor unions were considered undesirable because they violated the right of a worker to negotiate individually with an employer.

If the launch of the Chicago School was one leg of the neoliberal enterprise, the establishment of the Mont Pèlerin Society (MPS) was the other on the long road to the implementation of neoliberal policies in the last quarter of the twentieth century. Membership was by private invitation and its proceedings were confidential. The purpose was to bring together like-minded individuals from the academy and the world of business to arrive at a neoliberal position regarding a variety of important issues, including antitrust policies, collective bargaining and foreign aid to underdeveloped countries. The project was innovative and ambitious, trans-disciplinary and cosmopolitan. It sought to construct what has been variously described as a neoliberal thought collective, an invisible international college and a comprehensive transnational discourse community. The time horizon of the project was long — possibly several decades, even several generations. Protracted negotiation failed to produce a manifesto of the project.

By the 1980s, the membership of the MPS had grown to over a thousand, but the real importance of the society was the nurturing of neoliberal ideas in the 1950s and 1960s, at a time when New Deal policies and issues of civil rights dominated American politics. It is a mistake to see neoliberalism exclusively in terms of the neoclassical economics associated with the Chicago School and the policies that served Reagan, Thatcher and the Washington Consensus. Ultimately, the appeal of the idea of individual liberty and distrust of government has sustained political consent for policies which concentrate income, wealth and power of a privileged elite, while median wages have not increased since 1980.

As the MPS evolved, its considerable diversity of opinion was reduced to the libertarian orientation of Hayek and Mises. They truly were the organizing force. From the beginning, corporate funders played a critical role in enabling Hayek and his close associates to gain influence in universities, but their economic theories and policies could not gain traction in the public arena without access to friendly journalistic and media resources to popularize them. The first neoliberal think-tank, which also employed Mises and the journalist Henry Hazlitt, who wrote for *Newsweek*, was established in 1946, followed by many others including the Heritage Foundation and the Adam Smith Institute. The measure of the success of the Mont Pèlerin project was the awarding of a Nobel Prize in economics to Hayek in 1974, shared with Gunnar Myrdal. Hayek's advice was sought by Margaret Thatcher, and a prominent MPS member, Peter Bauer, was awarded a lordship by her.

The neoliberal project requires a strong state to maintain law and order and expand the realm of private enterprise operating in a competitive market. In the neoliberal view, any involvement by the state in the economy is a threat to liberty. There is no such meaningful common good, other than the outcome of individuals and firms competing in the marketplace. As Mrs. Thatcher put it, "there is no such thing as society." (Thatcher 1987). As commercialization reduces private and public spaces, and deregulation diminishes the reach of public policy, power passes from the public and political to the private and economic sphere. This constitutes a progressive erosion of meaningful democracy.

The Rise of Polanyi's Ideas

Hayek and Polanyi lived in different worlds in the Vienna of the 1920s, where socialist majorities dominated politics from the foundation of the Republic of Austria in 1918 to 1934. While Hayek looked back on the liberalism of the *Belle Époque* of pre-war Imperial Vienna, Polanyi admired the Red Vienna of the 1920s as a remarkable cultural achievement in difficult economic circumstances. Working-class families were privileged in access to low-rental, bright, spacious, modern apartments with parks, kindergartens, and other communal facilities. These programs, together with a sweeping educational reform based on Alfred Adler's theories of psychology, plus the large-scale participation of the working people of Vienna in a remarkable variety of cultural, recreational, and educational activities organized by the socialist municipal administration made Red Vienna a world-class showpiece of avant-garde urban lifestyle.

Polanyi's socialism was rooted in early family influences, the 'free-thinking' anti-clericalism of the Hungarian student movement (the Galilei Circle), and the intellectual milieu of Red Vienna. Among his heroes were all the Russian revolutionaries of the late nineteenth and early twentieth century. Other important influences included Robert Owen and English guild socialism; the 'democratic functional socialism' of Otto Bauer; Max Adler's insistence on the socialist mission of the working class to raise the cultural level of society above the commercial ethic of the bourgeoisie; and last but not least, a re-reading of *Capital* and the early philosophic manuscripts of Marx. In terms of economic analysis, he favored the Vienna school over the labor theory of value because it introduced choices by consumers and producers. It is important to understand that in the 1920s, no socialist economy had yet existed anywhere. Mises had pronounced it to be impossible because of the necessity of price signals to allocate resources. To appreciate the 'socialization debates' of post-1918 Vienna, we must bear in mind the strength and sophistication of contemporary working-class organizations, and the great appeal of the Austrian Social Democratic Party.

The choices in Polanyi's functionalist model of a socialist economy were not those of atomistic individuals buffeted by 'impersonal' market forces, but negotiated choices of associational collectivities operating within the complexity of a democratic civil society. Polanyi's socialism has been located on the margins of Austro-Marxism. His socialism was neither that of traditional European social democracy, nor that of centralized communist planning. It was more akin to the third stream of the European socialist tradition—the populist, syndicalist, quasi-anarchist, and corporativist one.

In brief, Polanyi's attempt to construct a positive theory of a socialist economy, which would open the way for the exercise of social responsibility by all citizens, was rooted in his aversion both to the social-democratic market economy and to the administered centralized command economy. He considered both of these to be forms of 'unfreedom'. His model was essentially one of negotiation between associations representing workers, enterprises, consumers and civic municipalities, on a local, regional and national scale. The aim was the reconciliation of criteria of technical efficiency with distributive justice and democratic process. Unlike models which were idealistic blueprints, Polanyi's was built organically on existing organizations of trade unions representing workers, consumer cooperatives representing consumers, chambers of commerce representing employers, and democratically elected municipal authorities. This was not a market-less economy, nor an economy without money. Nor was it the 'capitalism without capitalists' of the Lange-Taylor-Dickenson variety developed in the English-language literature on socialist planning of the 1930s.

More than Keynes or Hayek, for Karl Polanyi the First World War was a traumatic experience. He served as a cavalry officer on the Russian front. For my father, an almost personal sense of the responsibility of his generation for the Great War and all its consequences motivated his search for *The Origins of Our Times* — the original title of *The Great Transformation*. From his position as a senior journalist on Austria's premier economic and financial weekly, he followed political and economic events of the 1920s and early 1930s until his employment was terminated due to deteriorating political circumstances and he left for London in 1933. In England, he was employed as a lecturer for the Workers' Educational Association and the notes of his courses on International Affairs and English social and economic history contributed to the making of *The Great Transformation*, published in the same year as Hayek's *Road to Serfdom* in 1944. Like the latter it attracted little attention in England, but American institutionalists invited Polanyi to join the economics department of Columbia University in 1947. His academic reputation was established in economic anthropology and the distinction between formal and substantive economics. Although they may have read the book, it was not *The Great Transformation* which attracted his Columbia students to his courses on general economic history. They did not comprehend that the motivation of his studies of primitive and archaic societies was to establish that market economy and market society was fundamentally different from all previous human civilization in subordinating social and cultural life to the requirements of the economy.

His friend Peter Drucker from Vienna and Bennington admired the originality of Polanyi's three patterns of economic integration: reciprocity, redistribution and exchange, but was wrong in dismissing it as "mere academic busyness". He was also wrong in his judgment of Polanyi as hopelessly idealistic with a sense of personal responsibility for the fate of Man and his survival. Polanyi's intention was not to provide academic economic anthropologists with an intellectual toy to explore 'distant' and esoteric cultures. It was rather to suggest that never in human history, or human experience, has fear of hunger and love of gain been established as the governing principles of economic livelihood, which opened the Pandora's Box of exponential economic growth accompanied by exponential social dispossession in 19th century England.

I have often been asked what my father's sphere of study was, what his specialty was. He has variously been referred to as an economic historian, economic anthropologist, economic sociologist, and in Continental Europe, an economist; but he had no formal certification in any of these subjects. His only degree was a doctor in law from the University of Budapest in 1912. In the last seven years of his life, he outlined a book on the "New West" in the hope of retrieving what was valuable in the best traditions of Europe. In an important letter written to a friend of his youth, Beatrice De Waard, he expressed the belief that he would be vindicated in his lifetime. His work, he wrote, was for the new nations of Asia and Africa. But, another fifty years had to pass before Karl Polanyi was recognized as the most profound critic of the liberal creed in all its manifestations.

Ultimately Polanyi was an educator and a social philosopher. The problem that he addressed throughout all his work was "the place of the economy in society." The economy is an instituted process or a social construct and there are a great variety of ways to organize economic livelihood in a modern technological society in accordance with the geographical, historical and cultural attributes of diverse regions, peoples and nations.

Homo Economicus or Economic Man, endowed with economic motives of maximizing utility, is a fiction that lives only in textbooks. There are invariant basic human needs including those for food and shelter and security, protection, affection, and respect, but institutional arrangements in which they are met have varied throughout human history.

The reality of society, as Karl Polanyi was so insistent upon, means more than the triviality that we live in society and cannot escape it. It means that within each of us is the need for the protection of a social support system that accords us self-respect and dignity, and thus personal freedom. We are by nature social and cooperative rather than individualistic and competitive.

The transformation of the capitalist order requires a new calculus of the value of work, the value of human needs and the value of nature. Economics has to return to some very basic questions of use value and exchange value, especially in the valuation of services. Some socially useless services are grossly overvalued while essential work of care is accorded little or no value. People do not like to be valued and respected only for the income which they can earn and to be totally disrespected if they are not able to earn income for whatever reason.

The international economic and political order must proceed with due respect to the sovereignty of nations, which are the political manifestations of modern cultural communities. In an effort to outline the basis of a viable and humane order of things, Polanyi identified what he called four vistas of a humanist socialism: 1) Pluralist democracy, or freedom within society; 2) national independence, or freedom from imperialist domination; 3) industrial culture, or acceptance of modern technology as a fact; 4) an international order which respects the coexistence of different cultures and national sovereignty.

To this brief summary, which scarcely does justice to Polanyi, we may add that we cannot afford to be afraid of restoring morality to the social sciences. Einstein, the greatest natural scientist of our era warned us to be careful that “the creations of our mind shall be a blessing and not a curse to (hu)mankind” (1931: 6). Concern for man himself and his fate must always form the chief interest for all technical endeavors.

Conclusion

In economics, ideas are more successful in maintaining the established order than in effecting change. Keynes was not successful in challenging prevailing doctrines until the Second World War transformed the economic and political scene in Europe. Hayek was more successful in achieving his stated objective of turning the doctrinal clock back to the era before Keynes. Keynes’ defunct economists, it seems, are alive and well in our universities. Polanyi invites us to step outside the box of formal models of market transactions to explore the real needs of real people and the variety of institutional arrangements which can satisfy them.

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