

ENDOGENOUS PREFERENCES AND EMBEDDEDNESS:
IMPLICATIONS FOR ECONOMIC THEORY
A REAPPRAISAL OF KARL POLANYI

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INTRODUCTION

Economic Activity is motivated by social obligation and regulated by the moral context that governs social life in general.

J. R. Stanfield in "Karl Polanyi and Contemporary Economic Thought" (1989)

Karl Polanyi's contributions to social theory are widely recognised among the generality of social sciences. In the fields of economic anthropology, historical and economic sociology and economic history, Polanyi's work, in particular *The Great Transformation*, is considered a classic².

In this article we want to explore its relevance to economic science in general and to the issue of endogeneity of human preferences in particular. By endogenous preferences, following Bowles (1998), we understand the still highly neglected idea in economic theory that individual preferences, that is, reasons for behaviour or attributes of individuals that (along with their beliefs and capacities) account for the actions they take in a given situation (Bowles, 1998: 78), are at least partially formed and moulded by institutions and that this should be taken into account by economists.

By analysing Polanyi's methodological insights, emphasising its opposition between a formalistic and a substantive science of economics we will be in a good position to appreciate the link between these methodological considerations, a more realistic version on preferences and the indispensable need to construct an economic theory which takes into account the moral and political dimensions.

TOWARDS A SUBSTANTIVE PERSPECTIVE IN ECONOMICS³

In Polanyi (1992), one clearly finds a crucial distinction between the two senses that the term economy can assume: the formal and the substantial. The formalistic perspective, associated with mainstream economic theory, presupposes that economics is the science of autonomous rational

² For an analysis of Polanyi's general contribution to social theory see Block and Summers (1991), to sociology see Smelser and Swedberg (1994) and to economics see Stanfield (1980, 1989, 1993).

³ This section largely draws on Stanfield (1989).

choice among different alternatives in a context of scarcity. This choice is informed by a careful analysis of relative prices and is always oriented towards the maximisation of individual gain. This concept, which is rooted in an abstract and ahistorical view of human behaviour, is clearly present in Robbins (quoted in Stanfield, 1989: 267) when he declares that “scarcity of means to satisfy given ends is an almost ubiquitous condition of human behaviour”.

For Polanyi (1992), this formalistic perspective, which he regards as the scientific expression of a growing autonomy of the economic sphere in relation to social totality, presents several shortcomings for the analysis of the economy. In the first place it is incapable of recognising that the prosecution of individual gain is a pattern of behaviour which, far from being a universal feature of human nature, is institutionally imposed and therefore should be analysed as the result of a particular historical process instead of being assumed as an antecedent of that same process. In the second place, formalism inevitably falls into what Polanyi labelled “the economistic fallacy” which consists of the idea that the economic motivations and propensities that are hegemonic in a given social context are common to all societies, present, past or future⁴. For him, human motivations, its reasons for behaviour, in short, its preferences, are complex, historically mutable and not reducible to individual material interests: “The outstanding discovery of recent historical and anthropological

⁴ This “economistic fallacy” can also be understood as the idea that a given institution or socioeconomic system is the result of certain propensities or motivations that are already present in individuals. Polanyi (1957), criticises Adam Smith for assuming that the division of labour is dependent upon an innate propensity of man to barter and exchange. As Wood (1999) showed most accounts of the origin of capitalism tried to make this liaison between certain human traits and the emergence of this socioeconomic system. Nevertheless, one can find in Polanyi’s work a profound ambivalence towards Smith. In fact, while he certainly criticises certain aspects of his work, he also recognises the profound rupture between the moral economy of Smith, whom he associates with the tradition of the “inventors of the State” in line with Maquiavel, More or Lutero, and the tradition of Ricardo and Malthus classical political economy. According to Polanyi (1957: 111): “Adam Smith, it was true, treated material wealth as a separate field of study; to have done so with a great sense of realism made him the founder of a new science, economics. For all that, wealth was to him merely an aspect of the life of the community, to the purposes of which it remained subordinated (...) Smith wished to regard the wealth of nations as a function of their national life, physical and moral (...) In his view nothing indicates the presence of an economic sphere in society that may become the source of moral law”. For Polanyi, Smith distinguishes himself from the formalistic conception of economics because for him the economic sphere is not autonomous, and cannot be made autonomous, from the moral and political spheres. The interpretation of Smith as a moral economist, which redeems him from certain misrepresentations of his thought, is also made by Caldas (2002).

research is that a man's economy, as a rule, is submerged in his social relationships. He does not act so as to safeguard his individual interests in the possession of material goods; he acts so as to safeguard his social standing, his social claims, his social assets" (Polanyi, 1957: 46). In third place, by elevating individual economic motivations to the sole guide of human action, the formalistic concept is blind to what Polanyi (1957) viewed as the unsustainable character of a society solely based on those principles. In fact, Polanyi's work can be read as an effort to show simultaneously what the institutional conditions are that make individual economic motives prevalent and by what mechanisms a society solely based on self-interest is a utopian endeavour that is destined to fail.

The shortcomings of the formalistic conception can only be surpassed, according to Polanyi (1992), if one assumes a substantive view of the economy. As we shall see, this concept implies an economic theory which adopts institutionalism, holism and a moral stand as its methodological starting points.

For Polanyi (1992), the economy can only be understood as an "instituted process" of social interaction, as a collection of culturally determined institutional arrangements by which the different social groups satisfy their material needs and secure their social reproduction. Reproduction is not the maintenance of the *status quo*, because change is considered not only to be inevitable but ceaseless. The substantive economy has two levels: the first is the relation between each individual and others and each individual and nature, the second is the institutionalisation of that process. Institutionalisation is associated with a system of communication and sanctioning which allows the individual to know what is expected from him and what he can expect from others. The variety of human motivations is therefore disciplined and made more or less predictable by the existence of certain general principles of behaviour, certain "patterns which may be called forms of integration" (Polanyi, 1992: 35), which are instituted because there is a social organisation which makes them operative. Polanyi (1992) distinguishes three possible patterns of integration: reciprocity, distribution and exchange that are supported by a social organisation which is respectively based on social symmetry (egalitarian societies), centrality (societies with a despotic or bureaucratic State) and markets systems. The role of a substantive economy should be to inquire into the historically specific ways by which these patterns of integration are combined, the institutions that support them and the type of human beliefs and preferences that result from them.

The individual motivations and preferences cannot be understood without reference to the institutional context which partly shapes and defines them. Economic behaviour is thus acquired. If men are generous in one place and egoistic in another it is not the supposed human nature that differs but the social organisation. Polanyi (quoted by Block and Somers, 1991: 64) is very clear about that

when he says that “human beings will labour for a large variety of reasons as long as things are arranged accordingly”.

The base of the substantive view of the economy developed by Polanyi implies a holistic perspective according to which the economy cannot be separated from the analysis of the social totality. As society is the starting point for Polanyi, the economy can only be understood as a sphere which is structurally related to all other spheres determining and being determined by them. For example Polanyi (1992: 34) wrote:

The human economy then is embedded and enmeshed in institutions, economic and non-economic. The inclusion of the non-economic is vital. For religion and government may be as important for the structure and functioning of the economy as monetary institutions or the availability of tools and machines themselves that lighten the toil of labour.

Society, the social whole, forms a kind of background by reference to which most of the themes developed by Polanyi can be understood. The example of social classes is a case in point: “neither their birth nor the death of classes, neither their aims nor the degree to which they attain them; neither their co-operations nor their antagonisms can be understood apart from the situation of society as whole” (Polanyi, 1957: 152). Polanyi uses the concept of social class, although in a more enlarged version than that of “popular marxism”, refusing to see classes as a mere aggregate of sectional economic interests: “Purely economic matters are incomparably less relevant to class behaviour than questions of social recognition (...) 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, 1957: 153). Classes are social constructions that represent collective responses to problems that are posed to society as whole, by virtue of certain structural transformations, and are only effective when they are able to propose solutions for society as a whole. The refusal of an economicistic view of social classes, as well as of communities and other social groups, leads Polanyi to emphasising their importance in providing the social bond that keeps the individuals together, that is, that gives them shared moral values and meanings that sustain the reproduction of a given socioeconomic system.

The substantive economy implies the reintroduction of morality into economics because, as we shall see, it not only recognises the functional importance of moral values to the maintenance of social order and to the good functioning of the economy, but also because it considers that the economy cannot be analysed separately from the other spheres of society in which it is “embedded”.

MARKET ECONOMY AND SOCIAL ORDER

Our Thesis is that the idea of a self-adjusting market implied a stark utopia. Such an institution could not exist for any length of time without annihilating the human and natural substance of society.

Karl Polanyi in *The Great Transformation* (1957)

All the points that we have been making about Polanyi will be clearer if we analyse the main thesis of his most important book – *The Great Transformation* – an effort to assess the causes for the emergence in the nineteenth century of a particular economic system - the market economy – and its social implications⁵.

The market economy is defined as a socioeconomic system based solely on a self-regulating system of markets, that is an economy where all spheres of life are “directed by market prices and nothing but market prices” (Polanyi, 1957: 43). The idea of a social order exclusively based on markets is considered to be a “utopian endeavour” that would result in the “demolition of society”.

Polanyi showed that although the market is an institution which precedes the nineteenth century, its role in pre-capitalist formations was highly secondary and incidental: “markets were merely an accessory feature of an institutional setting controlled and regulated more than ever by social authority” (Polanyi, 1957: 67). These were societies where reciprocity and redistribution were the dominant forms of integration which assured order in production and redistribution. These were

⁵ We will not analyse Polanyi’s original thesis about the origin of capitalism. For a critical overview see Wood (1999).

societies where the economy was embedded in the general fabric of social, political, religious and moral life and because of that human motivations in those societies are considered to be highly varied.

In the nineteenth century a broad set of technological transformations together with a deliberate action by the State initiated a process which expanded the market pattern. The tendency of markets to become the dominant form of integration had profound social consequences, implying a reorganisation of the entire social fabric: “Such institutional pattern could not function unless society was somehow subordinated to its requirements. A market economy can only exist in a market society”. This subordination of society to market requirements is the logical consequence of the extension of the market mechanism to labour, land⁶ and money which by their own nature could not become commodities. This is very clear when Polanyi (1957: 72) states:

Labour is another name for a human activity which goes with life itself, which in its turn is not produce for sale for entirely different reasons, nor can that activity be detached from the rest of life, be stored or mobilised; land is another name for nature, which is not produced by man; actual money, finally, is merely a token of purchasing power, which, as a rule is not produced at all, but comes into being through the mechanism of banking and State finance.

The social consequences of this system of “gross fictions” are profound and unsustainable for any society, ultimately resulting in its destruction. Social order is declared to be incompatible with an economy which is uniquely based on a system of self-regulating markets. This is clear in a passage where Polanyi (1957: 73) dramatically states that:

In disposing of a man’s labour power the system would, incidentally, dispose of the physical, psychological and moral entity “man” (...) Robbed of the protective covering of cultural institutions, human beings would perish from the effects of social exposure (...) Nature would be reduced to its elements, neighbourhoods and landscapes defiled, rivers polluted (...) Finally the market administration of purchasing power would periodically liquidate business enterprise, for shortages and surfeits of money would prove as disastrous to business as floods and droughts in primitive society.

⁶ “But labour and land are no other than the human beings themselves of which every society consists and the natural surroundings in which it exists. To include them in the market mechanism means to subordinate the substance of society itself to the laws of the market” (Polanyi, 1957: 71).

Besides the dramatic consequences of this system of “gross fictions”, there is an effect of a social system exclusively based on markets that Polanyi frequently emphasises and that has to do with the effects of markets upon human preferences. In fact, associated with the market pattern there is a distinct economic motive “rarely acknowledged as valid in the history of human societies, and certainly never before raised to the level of justification of action and behaviour in everyday life, namely gain” (Polanyi, 1957: 30). Self-interested individual preferences tend to become paramount for explaining individual behaviour in such a system, marking a profound rupture with societies based on reciprocity and redistribution, where individual preferences were mainly directed to “the maintenance of social ties” (Polanyi, 1957: 46) and where “individual passions, good or bad, are merely directed towards non-economic ends” (Polanyi, 1957: 47). It is precisely here that a contradiction emerges, because every society needs to maintain certain common values, meanings and understandings in order to reproduce itself, but a “market society” erodes those values and tends to institute a culture of greed and self-interest. Polanyi is particularly clear on this point when he discusses labour issues and the effects of subjecting labour to the market and to the sole principle of freedom of contract, which “would destroy noncontractual relations and prevent their spontaneous re-formation” (Polanyi, 1957: 163). This echoes Durkheim’s famous emphasis on the noncontractual basis of contract. Even the “disembedded” economy, that is an autonomous sphere of human activity, self-regulated through a system of price-making markets and exclusively based on self-interest, depended on non-pecuniary preferences, which it is intrinsically incapable of delivering. It is this fact, more than anything, that according to Polanyi, marks its utopian nature. Hodgson (1999: 69) has underlined this point very well:

The system depends on cash incentives and individual acquisitiveness. Yet if a social culture of greed and self-interest becomes overwhelming it threatens the bonds of duty and loyalty which are also necessary for the market system to function. If social cohesion and trust are undermined too far, then the system becomes incapable of sustaining the enduring social ties that are required for the market system to function. If social cohesion and trust are undermined too far, then the system becomes incapable of sustaining the enduring social ties that are required for organisational cohesion and longevity, in the sphere of production and elsewhere.

The survival of the social order demanded society’s response against this movement of the extension of market logic to all institutional fields. This is what Polanyi (1957) labelled a protectionist counter-movement which assumed very different forms: labour legislation, social assistance programmes,

trade-unions, etc. In the nineteenth century this movement had a spontaneous character and assumed State and non-State forms. Polanyi (1957: 141) reverses what he considered to be a liberal prejudice, when he extensively argues that “while *laissez-faire* economy was the product of deliberate state action, subsequent restrictions on *laissez-faire* started in a spontaneous way. *Laissez-faire* was planned; planning was not”.

In fact the *Great transformation* can be read as a critique of liberal thought, specifically of Ricardian political economy, that typical nineteenth century product of liberalism, which originated a mode of thought that has pervaded economic science ever since⁷. Conventional economic science is seen as the theoretical expression and ideological justification for a social order exclusively centred on market interactions, which were justified by a portrait of man as a being exclusively dedicated to the pursuit of self-interested economic motives. Social order was seen as the natural and ineluctable product of certain individual ahistorical traits. The foundations of this mode of thinking implied two separations, which severely impaired its comprehension of human affairs: the first was that its “foundations were utterly foreign to the moral world” (Polanyi, 1957: 116), the second “was the separation of the political and economic spheres” (Polanyi, 1957: 196). The first separation implied a naturalistic view of society which, instead of being the conscious and unconscious product of the actions of social groups with historically determined values, was seen as the aggregation of individuals with certain pre-existing preferences to social interaction, it also implied a blindness to the social consequences of market institutions and to the desirability of their reform.

The separation of the economic from the political leads to the idea that individuals are entirely autonomous – the underlying premise of the principle of freedom of contract – and therefore solely responsible for the consequences of their actions, underestimating the fact that compulsion and power are constitutive of life in society; it also leads to a misleading account about the origins and reproduction of the market economy, ignoring the fact that “no market economy separated from the political sphere is possible” (Polanyi, 1957: 196) and that “the road to the free market was opened and kept open by an enormous increase in continuous, centrally organised and controlled interventionism” (Polanyi, 1957: 140). The lack of realism, ontological and historical, is clearly imputed to classical economics; nevertheless, its impact in the conduction of human affairs was undeniable, the “edifice of classical economics” was considered to be “the most formidable conceptual instrument of destruction ever directed against an outworn order” (Polanyi, 1957: 223). In fact, the vision of man’s motivations in the dominant strand in economics, although quite misleading, was influential to the point that “nineteenth century civilisation was organised on the assumption

⁷ This is the formalistic perspective to which we have already made reference.

that such a motivation could be made universal” (Polanyi, 1957: 153), that is, by imputing to man certain preferences and by prescribing a set of institutional changes which were more or less implemented and which made those preferences operative, economic theory contributed to making the disembodied economy a dangerously realistic picture of society. Nevertheless, and despite all efforts made, the concept of economic man, was never a reality, as Polanyi (1947: 114) states:

In actual fact, man was never as selfish as the theory demanded. In vain was he exhorted by economists and moral theorists alike to discount in business all other motives than material ones. On closer investigation, he was still found to be acting on remarkably ‘mixed’ motives, not excluding those of duty towards himself and others – and maybe, secretly even enjoying work.

This picture of man as a being with mixed preferences is related with the idea that pervades Polanyi’s thought that the disembodied economy, that is, an economy where self-interest and the self-regulating market are respectively the sole motive for human action and the unique economic mechanism, is an intrinsically utopian endeavour in both senses of the word: it never existed and it could never exist. One thinks that for Polanyi the disembodied economy was never understood - contrary to Granovetter’s (1985) interpretation of Polanyi and correspondent critique - as a description of really existing market capitalist systems. It should be understood as an effort to extend to its full consequences certain trends that were operative with the rising of market capitalism and to criticise those who simultaneously constructed theoretical systems where those trends were deliberately extended, that is, where markets, in a highly idealised version, were the unique pattern of integration, and advanced policy prescriptions that dangerously tried to conform social reality with theory. We therefore argue that the concepts of embeddedness and disembodiedness should not be interpreted in Polanyi as being associated with two different epochs of the history of socioeconomic systems, with the embedded economy identified with pre-capitalist social formations and the disembodied economy identified with market capitalism. In fact all real existing economies can only be embedded. This interpretation is also made, in a very skilful introduction to a new English edition of the *Great Transformation*, by Block (2001: 8):

Polanyi does say that classical economists wanted to create a society in which the economy has been effectively disembodied and they encouraged politicians to pursue this objective. Yet Polanyi also insists that they did not and could not achieve this goal. In fact, he repeatedly says that the goal of a fully self-regulating economy that is disembodied is a utopian project; it is something that cannot exist.

In Polanyi (1957) one can, in fact, infer simultaneously the conditions that endangered market capitalism and those that assured its survival. Briefly one can say, following Polanyi, that its reproduction was guaranteed because it never relied exclusively on the market. In reality in every market system, there are always institutional elements that rely on reciprocity and redistribution as patterns of social interaction. Hodgson (1999: 126) has put forward the ‘impurity principle’ to reflect the idea that “every socioeconomic system must rely on at least one structurally dissimilar subsystem to function”. Furthermore, the social ties are maintained because this plurality of patterns of interaction is associated with and tends to enforce a set of very distinctive preferences, as Polanyi (1992) has remarked. Pecuniary motives tend to combine with codes of moral obligation that the economist cannot ignore to assure the maintenance of social order. The complexity and plurality of human preferences seem to reflect the socioeconomic system which moulds them.

CONCLUSIONS

The discarding of the market utopia brings us face to face with the reality of society.

Karl Polanyi in *The Great Transformation* (1957)

To conclude, one should underline Polanyi’s main themes. Although he never spoke either of endogenous preferences one can capture in his work a vision of the historical specificity and institutional dependence of human purposes and reasons for behaviour. It is undeniable that in Polanyi there is a certain tendency to overlook human volition and to fall into a kind of institutional determinism. Nevertheless Polanyi (1957: 254) recognises the scope for deliberate human action when he defines institutions as “embodiments of human meaning and purposes”. Furthermore in Polanyi’s work there is a very clear awareness of the complexity of the motives for human action and a defence, which is continuously reaffirmed, of the plurality of reasons to act in economic interactions and their relation to the patterns of interaction that are dominant. Nevertheless there is a

lack of a clear and well systematised account of the possible causal links by which institutions influence human preferences⁸.

If one recognises that it is important to consider preferences as endogenous and complex, then Polanyi's substantive economy can be a good starting point. His substantive economy takes morality into account, in the sense that its foundations lie on the recognition that man is a moral being with duties towards himself and others, with a sense of what is good and what is bad and that these moral codes, which are somehow dependent on the institutional milieu but which are still open to interpretation and choice by reflexive individuals, exert a powerful influence upon economic affairs. It is also a political economy in the sense that it considers that power and compulsion are constitutive facts of life in society and therefore cannot be ignored by assuming a picture of the individual as an entirely autonomous being, forgetting "the reality of society and its all-powerful influence upon character" (Polanyi, 1957: 127). If this is so and if, as Polanyi thought, individual development, "moral freedom and independence of mind" are the ultimate values then political economy is about inquiring into the ways institutions – be they the market or the State – enhance or hinder these values. For him a desirable society, a society with "distinctively human relations of persons" should consciously subordinate economic institutions to these values. How is that done? We do not know but we suppose that this is the fundamental question for economic theory.

⁸ For an attempt to make them explicit see Bowles (1998).

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