THE GREAT TRANSFORMATION PART 8: MONEY AS A FICTITIOUS COMMODITY

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Karl Polanyi calls labor, land, and money fictitious commodities. He defines "commodity" as something produced for consumption. Obviously land and labor are not produced, and money is not consumed, and therefore they cannot be commodities. Polanyi says that for the self-regulating market to work its magic and make us all healthy, wealthy and wise, these three, like everything else that forms part of the production system, must be treated as if they were commodities and subjected to the the "market" without restrictions; hence his description of them as fictitious. In Parts 6 and 7 of this series, I discussed Polanyi's explanation of the dangers to society and to human life as we know it from this kind of treatment. Chapter 16 of ***The Great Transformation*** looks at the dangers to society

from treating money as a commodity, and specifically at the dangers of the gold standard.

He explains that markets are based on prices and profits, both of which are measured in money. If money is a commodity with a price set in a market for money, then changes in the prices of money will change the prices and profits for other commodities. Polanyi cites David Hume for his theory that if the amount of money in circulation is halved, then prices will fall by half. As Polanyi notes, there is a big lag time in that adjustment, and businesses will fail before the adjustment is complete.

It appears to me Polanyi is relying on an informal version of the quantity theory of money. A somewhat more formal version is set out in this short post from the St. Louis Fed. In monetarist theory, inflation is solely the result of too much money in the economy chasing too few goods. Deflation is the result of not enough money chasing goods. The later problem was rampant in the 19th Century, with booms and busts caused by trade changes and financial frauds, and it is deflation that Polanyi addresses:

> But the expansion of production and trade unaccompanied by an increase in the amount of money must cause a fall in the price level—precisely the type of ruinous deflation which we have in mind. Scarcity of money was a permanent, grave complaint with seventeenth-century merchant communities. Token money was developed at an early date to shelter trade from the enforced deflations that accompanied the use of specie when the volume of business swelled. No market economy was possible without the medium of artificial money. P. 202.

The English economy was heavily dependent on trade in the early 1800s, and maintaining stable prices became crucial to the success of English

merchants and the nation. Token money, either specie, bank or fiat money, only circulates within the boundaries of a nation. To deal with international trade, the gold standard became prevalent at about this time. With two types of money in circulation, one based on the gold standard and used in international trade, and one using bank or fiat money in internal transactions, it became necessary to harmonize the workings of the two kinds of money.

> Under nineteenth-century conditions foreign trade and the gold standard had undisputed priority over the needs of domestic business. The working of the gold standard required the lowering of domestic prices whenever the exchange was threatened by depreciation. Since deflation happens through credit restrictions, it follows that the working of commodity money interfered with the working of the credit system. P. 203.

That led to the creation of central banks, which could affect the level of credit in a nation's economy. Central banks could adjust the amount of credit in a country's economy to offset the worst of the consequences of sticking to the gold standard, and spreading the burden of sudden changes in the relation between the national currency and the price of gold. Elites supported central banks despite their insistence on maintaining self-regulating markets, because central banks were not thought to interfere with the free market in money, but rather to support it.

Polanyi says that this system worked as long as the gyrations in prices were slow enough and not too great. But when the changes were large, the activities of the central bank moved from technocratic to political, and people began to demand that government protect them from the dangers created by the gold standard. In the US, this can be recognized in the Free Silver Movement; from Wikipedia:

> The debate pitted the pro-gold financial establishment of the Northeast, along with railroads, factories and businessmen, who were creditors who would benefit from disinflation (resulting from demand pressures on the relatively fixed gold money supply against a backdrop of unprecedented economic expansion), against poor farmers who would benefit from higher prices for their crops (resulting from the prospective expansion of the money supplyby allowing silver to also circulate as money).

The gold faction won, but the pressure continued as crash after deflationary crash hit the US economy. The Fed was established in partial response to the Panic of 1907. For an interesting history see Nomi Prins, ***All the Presidentts' Bankers***. The goal was to stabilize the economy, a goal both of bankers and politicians though for different reasons. Bankers wanted to make sure they could harness the power of government to save them in times of financial disaster.

> In Washington, Republicans and Democrats both concluded that excessive reliance on bankers to stabilize the financial system in times of turbulence was too high a risk to their own influence over the country, and possibly damaging to American status in the world. The axiom that the group that controlled the money controlled the country remained true. But with the nation struggling economically, such a condition had political implications and had to be navigated accordingly. Id. at 19.

The result of central banking is that government becomes a participant in the market for money. The self-regulating market was thus defeated, even though its supporters claimed otherwise. They continued to see the central bank as a

neutral player, one committed to the maintenance of the gold standard.

Several Republican Presidential candidates, including Mike Huckabee, Ted Cruz and Rand Paul, have called for return to the gold standard. Probably a lot of that is their disdain for government, particularly government interference in something as sacred as money. It’s an extreme version of the proposal of Milton Friedman that the Fed adopt a firm rule for managing the money supply. After all, according to neoliberals, including Friedman, the market does a brilliant job of managing things if it’s just left alone. We saw how that worked out once, in the wake of the 1929 crash. Surely we don’t need to repeat the experiment.