The Concept of Regulation as Institutional Counter Movement in Polanyi: Some Reflections on the Current Crisis

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Abstract

This paper deals with the concept of regulation as institutional counter movement in Polanyi. The paper claims that both regulation and market have been cooperating together in the history of capitalism and the capitalist system is not self-regulating one as the liberal ideology claims. In fact, it is inherently open to crisis. For this reason, the paper argues that our modern economies need some degree of regulation in order to balance the negative effects of uncontrolled market forces.

Key words: *Regulation, counter movement, self-regulation*

1- Introduction

As the world has been living an unprecedented kind of financial and economic crisis at the moment, both academic and policy entities have been trying to uncover the dynamics of the crisis. This papers aims to use Polanyi's concepts in identifying the determinants of the current crisis in general and the banking crisis in particular. The current crisis has started in USA subprime housing market and has outspreaded to the world especially to the European area. The crisis has been both economic and financial ones though it has social and political sides in most of the countries especially in USA and the European Community. Our paper, aims to focus on the banking sides of the crisis in terms of regulation and supervision. The meanings of the concepts of 'regulation and control' used by Polanyi have a promising starting points for understanding and theorizing the current banking crisis. In addition the concepts of regulation and control with respect to the discussions in Polanyi's Great Transformation, the roles and the place of regulation takes an important standing point in handling banking issues.

Before getting into the concepts of regulation and control in Polanyi's Great Transformation, it is useful to introduce main theories of regulation and supervision with respect to our modern market economy. Economic regulation is an important instrument in market economies. It does not mean the total governance of the economy as a whole, but to exercise of some influence on an activity that is different from total control. As direct state ownerships decline, the economics of regulation becomes very important both in academic and policy areas (Rickett, 2006:34).

There are various theories of regulation depending on ideological backgrounds of the different schools of thought. For the far right, it is said that regulation is an unpleasant word which represents the heavy hand of authoritarian governments and the creeping body of rules that constrain human or national liberties. For the old left, it is said that the concept of regulation is a part of superstructure that serves the interest of the dominant class and power relations in seemingly civilized forms. For democrats, it is argued that regulation is public good, a tool to control profit-hungry capitalists and to govern social and ecological risks (Levi-Faur, 2011:3).

Broadly speaking, there have been five different groups of regulation theories: The first one is public interest theory which justifies the regulation as a way of preserving the benefits of common public. The second one is named as capture theory. The third one is the theory of special interest which puts forward a special interest within the society for regulation. The fourth and the last ones are money for nothing and boutleggers and Baptists theories respectively (Levi-Faur, 2011:25).

The rest of the paper is organizes as the following: the next main section retells Polanyi's crisis theory in relation to economic system as well as money, banking and regulation and control. The following one introduces the current banking crisis. The third main section updates the views of Polanyi through secondary literature about the issue at hand. The paper ends with a brief conclusion.

2- Economic and Financial Crisis in Great Transformation

According to Polanyi, the main critical problem about the capitalist self-regulating market economy is that its economy is based on self-interest (Polanyi, 1994:249). Buğra explains that none of the basic human motivations is economic in nature. Because the liberal self regulation market ideology takes the self interest one and only motivation for the explanation of economic individual this is contradictory with the real nature of human which is determined by social and political as well as psychological backgrounds. The self regulating market is a system that directs all economic activities of human towards the self regulating markets by detaching them from the control of the society (Polanyi, 2000:19). Based on this false assumption of self-interest, the self-regulating economy creates three fictitious commodities as labor, land and money. These commodities destroy the natural relations of human with land and society. The main reason for the capitalist crisis is the existence of inconsistency between markets system and human societies (Polanyi, 2000:11).

In his Great Transformation, Polanyi gives the dynamic history of the market economy right from the earlier evolution of the capitalist system from mercantilism to the premature state of the market system in the late 18th century. It was said that '*[F]rom the 16th century onwards markets were both numerous and important. Under the mercantile system they became, in effect, a main concern of government, yet there was still no sign of the coming control of market over the human society. On the contrary, regulation and regimentation were stricter than ever; the very idea of a self regulating market was absent*' (Polanyi, 1944:55). As we know from Polanyi's writings, once the market is organized as a separate institution, it is allowed to function according to its own rules. This is, with the sayings of Polanyi, assertion that *a market economy can function only in a market society* (Polanyi, 1944:57).

There are three main phases in which regulations take place different forms. The first one is during the pre capitalist period in which customs and wage were regulated in order to give the markets way to flourish. The second phase is the mercantilist era in which prevention of natural monopolies took place mostly. The last phase was the late 18^{th} century in which the regulation became the central to the establishment of a market society. This last stage marks radically altered relations between economy and society. Labor, land and money became commodified. The market society is characterized by a belief in self regulating capacity of markets though regulation is central to its functioning (Lange, 2012:4).

According to Polanyi, *regulation and markets grew up together in this phase* (Polanyi, 1944:68). Intervening into the market is just to safeguard the functioning of it under the given conditions (Polanyi, 1944:66). However, *a market economy*, in its original sense, *is an economic system which is controlled, regulated and directed by market alone; and order in the production and distribution of goods is entrusted to the self-regulating mechanism* (Polanyi, 1944:68). In this case, intervention is allowed only to ensure the self-regulation of the market by creating conditions just to make the market organize itself by own its own (Polanyi, 1944:69).

However, in real life other than the ideology of self-regulating market supposed to be existed due to nature of the homo economicus there has been a double movement in the society in general. On one side we have the developments of the self regulating market, and on the other side we have the reactions of the society and some classes against self-regulating market in terms of opposition through some institutional responses or protections against the market such as the Speenhamland law and practice in England (Polanyi, 1944:130). This opposition against the market is because of that devastating market forces are believed to allow a permanent evil to emerge in the society (Polanyi, 1944:129). Polanyi clearly explains that *the countermove consisted in checking the action of the market in respect to the factors of production, labor and land. This is* said to *be the main function of the interventionism* (Polanyi, 1944:131).

It was argued that *since the working of markets of labor, land and money threatens to destroy the society, the self-preserving action of the community was meant to prevent their establishment or to interfere with their free functioning once established* (Polanyi, 1994:201). Within this context, Polanyi introduces various justification and examples for intervening and regulating the market mechanism: According to Polanyi, one for example is that regulations are justified just to safeguard the natural characteristics of labor as human against alleged commodity of labor (Polanyi, 1994:177). Another example is that justification for the intervention is the unrestricted working nature of the market mechanism which may destroy capitalist businesses. According to Polanyi, modern central bank is a device which was developed for the purpose of protecting economic agents' right from the negative behaviors of the self regulating markets (Polanyi, 1994:192). In fact, because the gold money system does not adjust to the needs of market economy, the market created the fiat money as an effective innovation in the market economy because no market economy was possible without the medium of such artificial money (Polanyi, 1994:193). However, if there is no control on that, the price instability would devastate the whole economy. This uncontrolled state of money calls the protection of that modern central bank into the system as a regulator as well as supervisor of the money market.

According the Polanyi general crisis in the capitalist system originate through the strains and stresses which the forces of markets and the protective movements forced by the social movements put create. Polanyi argues that: it disintegrated as a results of entirely different set of cause; the measures which society adopted in order to not to be, in its turn annihilated by the action of the self regulating market. The conflict between the market and the elements requirements of an organized social life provided the contrary with its dynamics and produced the typical strains and stress which ultimately destroyed the society (Polanyi, 1944:249). Although Polanyi does not explain the dynamics of the crisis in detail the main reason for it is the self interest based economic system which disembedded the human from his/her social context.

Apart from the general crisis Polanyi argues that breakdowns happens very quickly in monetary issues as every part of people regard stable money as the supreme need of the human society. He gives detailed examples of financial and banking problems which the 19th century economies had faced (Polany, 1944:23,24).

3- Current Banking Crisis

The current banking crisis started in the US housing market and outspreaded to the world quickly. The problem was that credits given to housing sectors have been securitized in the regional regulated and supervised banking sectors, and then, they have been sold to other financial institutions which were not efficiently regulated and supervised by the public authorities. Another problem was that these credits and loans are not backed by the whole assets of consumers but limited to the collateral taken for the credits as security.

The matter of loans which have created crisis in the US housing market have been very large and let to the bankrupts of various banks and firm in the financial sectors. This has created very sharp drop in confidence and liquidity in the overall markets. As a result, investment rates, and thus, rates of growth have been dramatically affected by the turmoil in the markets. These outspreaded quickly all around the world, especially European countries and markets devastating economic growth rates and employments as well as creating unprecedented liquidity needs at both firms and sovereign state levels.

As a response to all these the Fed, and later on, other central banks moved quickly in decreasing basic lending interest rates, and then opened up windows of borrowing channels to banking sectors as well as other financial institutions by increasing funds which are not conventional during the normal times. In other words, the central banks have been taking necessary measurements in order to provide necessary liquidity and confidence to financial market and investors and economies in general. It is argued that very low level of interest rates in the international market created excess demand for funds and let to huge bubbles in regulated and unsupervised markets as in subprime housing market in the USA (Moessnor and Allen, 2010:23).

Furthermore, it is argued that main reasons for this crisis are failures of legal and regulatory institutions as well as political ones (Ostrop et al, 2009). HC(2009) argues that failings of corporate governance, renumeration practices which encouraged excessive risk taking, the failure of institutional shareholders to scrutinize the decisions of boards, credit rating agencies, accountants and auditors are all together responsible for the current banking crisis. In fact, it is possible to uncover all these multidimensional causes behind various individual cases which make up all together the global crisis now. At macroeconomic level, Brundel-Wignall et al(2008:2-3) argues that the current financial crisis was caused by global macro liquidity policies and the poor regulatory framework with off balance sheet activities of banks and financial institutions. In addition to these, FS (2009:121) emphasizes the inadequacy of capital and liquidity and unregulated segments of the financial sectors. Lauven and Valanci (2012:26) adds to these excessive liquidity with housing prices bubbles, very large current account and fiscal account deficits in macroeconomic terms and weak regulations and supervision in microeconomic terms. In addition it is argued that financial goods which were produced as results of industrial innovations could not taken into account quickly for risk management (Lauven and Valanci, 2012:27). Lastly, Fraser (2012:11) claims that the reason for the current crisis is the lack of efficient national and global financial regulatory and supervisory agencies.

It is said that *the paradigm that financial markets are efficient has proved the intellectual back ground for the deregulation of the banking sector since the 1980, allowing universal banks to be fully involved in financial markets, and investment banks to become involved in traditional banking*. However, it is argued that financial markets are not efficient due to overwhelming evidence (Grauwe, 2008:1). Although there are some regulatory and supervisory activities in banking sector, it is not enough because it is argued that matter for universal banks are tail risks which associated with bubbles and crashes. These risks are not quantifiable. For this reason, banking sector must be return to its narrow banking type which is a model that emerged after the previous large scale banking crisis of the Great Depression in 1930s. However, it was discarded during the 1980s and 1990s under the influence of the efficient market paradigm (Grauwe, 2008:2).

The main reason for the current crisis is the degenerations of the central banks from 1970s to now days. The financial system lost its check and balance system with introduction of new classical policies especially deregulations and further liberalization of the financial systems (Özgür and Özel, 2010:1-2).

It was argued that the current economic crisis shook the foundations of free market ideology and dislocated the idea that market self regulation is inherently efficient. Furthermore, it is claimed that depression of 1929, the small scale crisis that mediated and the current crisis indicate that when functioning without appropriate regulations, markets tends toward excess behaviors. This calls for state interventions and regulations ((Athina, 2010:11). It has been known that nearly all states in the world started to intervene into banking and financial sectors through appropriate tools at hands including most liberal countries as USA and UK (Athina, 2010:12).

4- Updating Polanyi

It is strongly argued that *in the rise of the market economy in the West, the road to the free market was open and kept open by enormous increase in continuous, centrally organized, and controlled interventionism* according to Karl Polanyi. In fact, administrators had to watch continuously in order to ensure the free functioning of the market economy (Nee, 2002:2). In fact, it is further said that in Polanyi's view the unregulated market threatened to destroy the society and efforts to protect society from its ravages necessitated sustained regulatory interventions by the liberal state in the process of which the state incrementally constructed the institutional framework of the free market. According to him, ^free market could never have come into being merely by allowing things to take their course' (Polanyi, 1944:139)(Nee, 2002:3).

It was argued that a market economy requires administrators to ensure the free working of the market economy by constantly watching the economy. Now days it is argued that Chine has been trying to regulate its economy by creating a bureaucracy which has close links with market institutions (Ricketts, 2006:35). In fact, it is argued that a competition process is regulated competition to the extent that its ends and means are oriented to an order which is mostly designed by government or public authorities (Weber, 1947:132).

If the market is embedded in social institutions, then they cannot destroy social aspects of human life. This is the main reason why it is thought that free market forces should be socially and politically regulated and controlled so that social protections is ensured (Athina, 2010:1). It is said that *according to Polanyi, all parts of social whole are structurally related and hence there is no genetic determinancy of any aspect; for Polanyi, all human behavior is socially shaped and defined, whether a person is trying to make money or achieve inner peace, the sources of the action is in a set of socially related definitions that makes one or other goal appear rational or desirable* (Athina, 2010:2). It is further argued that liberal economic which focuses on deregulation and home economicus, is diametrically opposite to Polanyi's social and cultural approach to economics, which rests on the concept of embeddedness. Liberal ideology separates economy from the societal context of human. This attempt is based on the idea that there is only one type of human nature in the world both now and in the history (Athina, 2010:4).

With the popularization of new classical theory both in the academic and policy areas deregulation and light touch regulation of the financial system have been the key ideas since the 1980s and early 1990s. There are two main assumptions with regard to this school: The first one is that markets are always in equilibrium and they always clear; the second one is rationality assumption which is related directly with the self-interest of rational homo economicus. Later on as the markets show that there has not been equilibrium at all times it was accepted that hands off approach towards the banking industry and that the credit crunch were totally wrong. This was accepted by Greenspan in one of his speech in the Congressional committee (Athina, 2010:2).

According to Ebner (2010:4), Polanyi claims that all economic system, with the exception of the market system, submerge the economy in social relationships, framed by non economic institutions. For this reason, it was said that Stiglitz refers to not only Keynes but also to Polanyi by claiming that a new paradigm for development policy needed to account for social capital, education and a strict regulation of financial markets as a means of achieving social coherence in economic growth. Market making and market constraining initiatives are required in order to stabilize our modern financial system (Ebner, 2010:24).

It is argued that *the current recession and financial crises constitute a manifestation of market failure and that the role of government is to mitigate the undesirable consequences of market activity through regulation, an appropriate fiscal policy instruments without losing the benefits of competitive economy* (Aikis, 2009:3). In fact, market exchange and regulation co evolve (Ebner, 2010:6).

It was argued that the current banking crisis is thought to be rooted in the neo classical policies without appropriate adjustment of the regulatory framework, inefficient regulatory authorities and the failure to learn from the past. The history shows that both government and market are need for our economies to produce necessary outcome efficiently (Ebner, 2010:17).

It is argued that there is an internal inconsistency within the self-regulation markets in extent that although capital market relations depend on certain institutional arrangements, but natural development of market forces deteriorates these institutional arrangements such that even the capitalist business itself had to be protected from the unrestricted working of the markets (Özgür and Özel, 2010:1).

According to double movement theory, while the principle of liberal economic ideology or believe try to establish as self regulating market, the principle of social protection inherited in different sections of the society aims to preserve the nature of man and land as well as productive organizations. These protections can be carried out in the forms of protective legislations, restrictive associations, and other instruments of interventions. The protective side of the double movement has got institutional dimension, class and ideological dimensions (Özgür and Özel, 2010:2-3).

With the Great Depression in 1929 the banking firm was regulated heavily to give a narrow area of scope to the industry in order to ensure the stability of banking industry. This legacy of Great Depression on the commercial banking industry continued until 1970s. In addition, the legacy of the Great Depression let to the reconstruction of international financial system by setting up IMF as international supervisory agency of the world economy and the World Bank as assistance for countries in need. Furthermore, Keynesian economic theory added up a critical justification for intervening states of economies when they are under employment. However, with the difficulties lived in the beginning of the 1970s the idea of self regulating market mechanism became popular against the interventionist Keynesian economic policies. Since then the self regulating market mechanism and new classical economics ideas have been dominating world economic systems. This brought massive deregulations and liberalization all around the world and world financial markets (Özgür and Özel, 2010:21).

Now and the crisis which we have being living in is strongly argued to be created by the self destructive power of the self regulating market system as Polanyi implies in the

Great Transformation. These events which we have been facing reveal only the institutional dimension of double movement in terms of Polanyi.

For Polanyi the regulatory countermovement is society's response to the disembedding of economic out of social relationships. Broadly speaking Polanyi's concept of regulation is quite wide in terms of coverage. It contains firstly the regulatory force of social norms, and secondly, political and legal institutions for regulating economic activities such as trade unions, central banks and monetary policy authorities as well as commercial and competition laws (Lange, 2012:2). Regulation and regulatory agencies are definitely a part of double movement in according to Polanyi and they arise at the time in history when economic activities become increasingly coordinated through markets. In addition, regulations both enable and restrain economic activity depending on the direction of regulations.

According to Polanyi, human being should use the instruments of democratic governance in order to control and direct the economy to meet our individual and collective needs (Block, 2001).

5- Conclusion

This paper aimed to utilize the Polanyi's concept of regulation in order to look at the current crisis with a different perspective. It is clear that, according to Polanyi, capitalist system is inherently exposed to crisis because of self interest based economic system which cuts the social and political context of human by concentrating only on economic self interest motivation.

On the other hand, we have seen that both regulation and market have been cooperating together in the history of capitalism. Something is clear that that capitalist system is not self regulating one as the liberal ideology claims. In fact, it is inherently open to crisis. For this reason our modern economies need some degree of regulation in order to balance the negative effects of uncontrolled market forces.

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