

ADAM SMITH'S PLACE IN CONTEMPORARY ECONOMY

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Abstract: *One of the most important ideas developed over time in a liberal economic doctrine is that competitive markets which, only partially, not in an absolute way, enjoy a low degree of regulation, do a better work in the allocation of resources than in the situations in which the governments or the governing or regulatory bodies also play a major role in this process. This idea first appeared to Adam Smith in his classic book "The Wealth of Nations". However, it should be mentioned that we will talk about a system that has dominated the history of major world economies, such as the US, France, Japan, the United Kingdom and so on.*

Key words: *economy, market, capitalism, environment*

INTRODUCTION

From its earliest signs of life until now, capitalism has been the answer behind all the economic ups and downs of each democratic state. The questions that should be asked are [8]:

1. Does the invisible hand still work in a contemporary economy?
2. When and why do competitive markets fail? What is to be done with them at that time? Should they be regulated more tightly by governments or should they be replaced?
3. Is capitalism the future or was it just a stage in our history? [4]

MATERIALS AND METHODS

The present paper is based on more and various research methods, such as: the analysis, the synthesis, the induction, the deduction, the case study, the brainstorming or the cost calculation [1].

RESEARCH RESULTS

THE HAND AND THE MARKET WHERE EVERYTHING STARTED

Capitalism has achieved the greatest things in economic development, if we look at our history, predominantly in the West. After stabilization and a deeper understanding of capitalism, economic growth and along with them the state budgets exploded, for exemplification we created a graph with the GDP/capita evolution of several countries that we considered important for the exemplification: USA, Germany, Belgium, Great Britain, France, Japan, Russia and China [9].

This chart best illustrates how capitalism has helped economies to develop, especially by analyzing developmental differences between periods [2]. In the case of China it is a more special situation, because China is not an assumed capitalist state, the Chinese Communist Party controlling the direction the state takes, they still have successful capitalist entrepreneurs and their economy, the business directions of the country and especially the pace of investments, of production and consumption, it is a capitalist one [5].

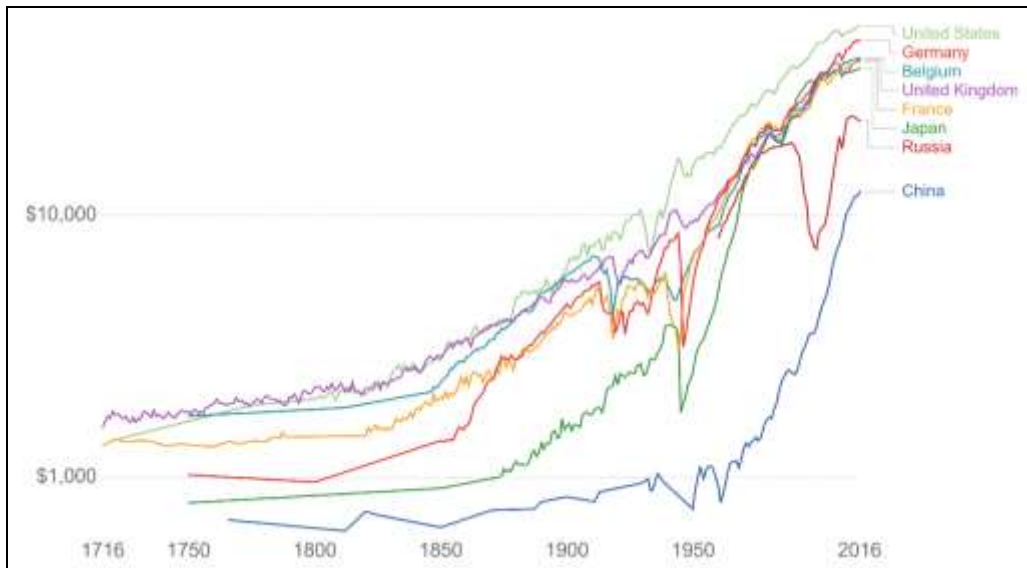


Figure 1. Evolution of the GDP/capita
 Source: Madison Project Database, 2018

THE FAILURES APPEARED IN TIME THE CASE OF THE CHILE STATE

The complete economic destabilization of the state of Chile by the "Chicago boys", a group of Chicago-trained economists who have applied almost unchanged the theoretical teachings they have studied, privatized all social programs, deregulated markets, did not impose laws on prices, letting them self-regulate based on the law of competition, and thus, the inflation rate at 2 years after the changes of the team of economists reached 341%, the prices for consumers increased by 375%, and the prices increased, in overall, with 440%. [12]

THE CASE OF RUSSIA

Another example of the failure of capitalism would be the case of Russia, a situation in which Jeffrey Sachs and a team of economists tried to make a rapid transition from Russia to a free market, not taking into account the positive example that China has given before, this approaching a gradual closeness and an organic transition towards the free markets. In just one month after the sudden and radical change that Russia has suffered, food prices have risen by 400%, and inflation has risen by 2400% in just one month [13].

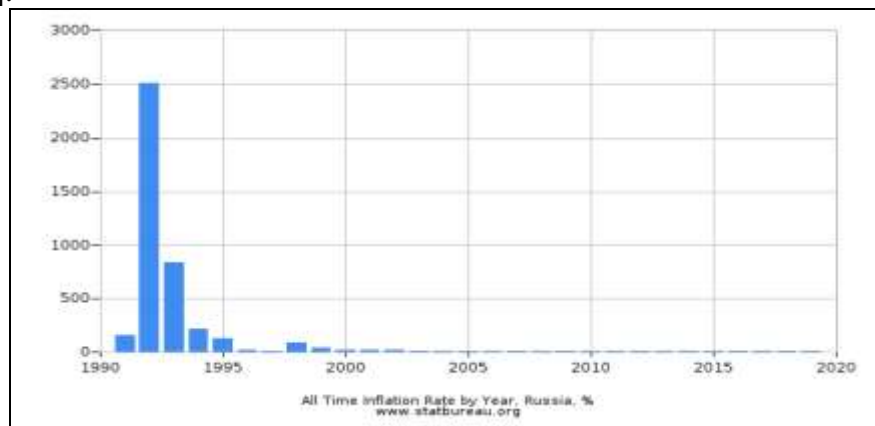


Figure 2. All Time Inflation Rate by Year in Russia
 Source: www.statbureau.org

THE ECONOMIC CRISIS FROM 2007-2008

However, I think the most relevant example for the possible disastrous results that free markets can have and the invisible hand is the global financial crisis of 2007-2008. Stock exchanges more precisely the stock market and stocks, is the market that comes closest to the utopian idea of the completely free market. This financial crisis is the best example for the “invisible hand” dysfunction [3]. Many signs announcing the possibility of this event were ignored because of theories that claimed that markets are self-regulating and that the emergence of a global crisis of such magnitude is completely impossible. As a brief summary, market destabilization began in the banking system, it was immediately felt on the real estate market, after that in the interest rates, after that materializing in the inability of the vast majority of people to pay their loans (which is evident from the moment when the banks' requests for loans have dropped drastically), which has led to the bankruptcy of several banks and companies, among which the most notable being Lehman Brothers, the crisis has already appeared and in 2008, the stock market crashed, resulting in a global crisis [15]. The conclusion is that markets find it incredibly difficult to self-regulate because of excessive, irrational consumption behavior and also because of the fundamental principles of capitalism that underline the focus on profit as an element that generates and dictates the social and economic order of the state, which combined with the other two aspects outlined above, only manages to destabilize economies by creating huge short-term profits that can only materialize through economic collapses due to the inflation generated by such events. (E.g. the idea of “Credit with the bulletin” which theoretically generated unimaginable long-term gains for banks and the investment area, but also made the market vulnerable so badly that it made it dependent on the commitments made by those who accessed the credits, which is almost impossible for most of those who have accessed them).

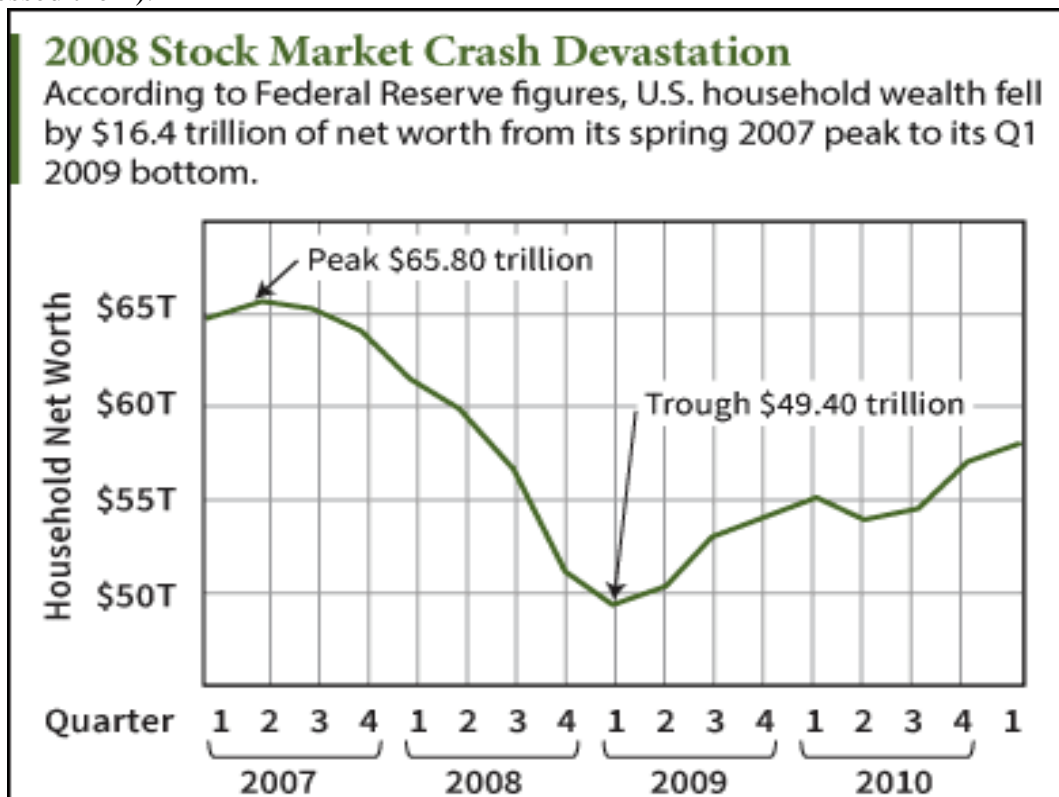


Figure 3. The 2008 Stock Market Crash Devastation
 Source: Federal Reserve, CNN Money, Money Morning Staff Research

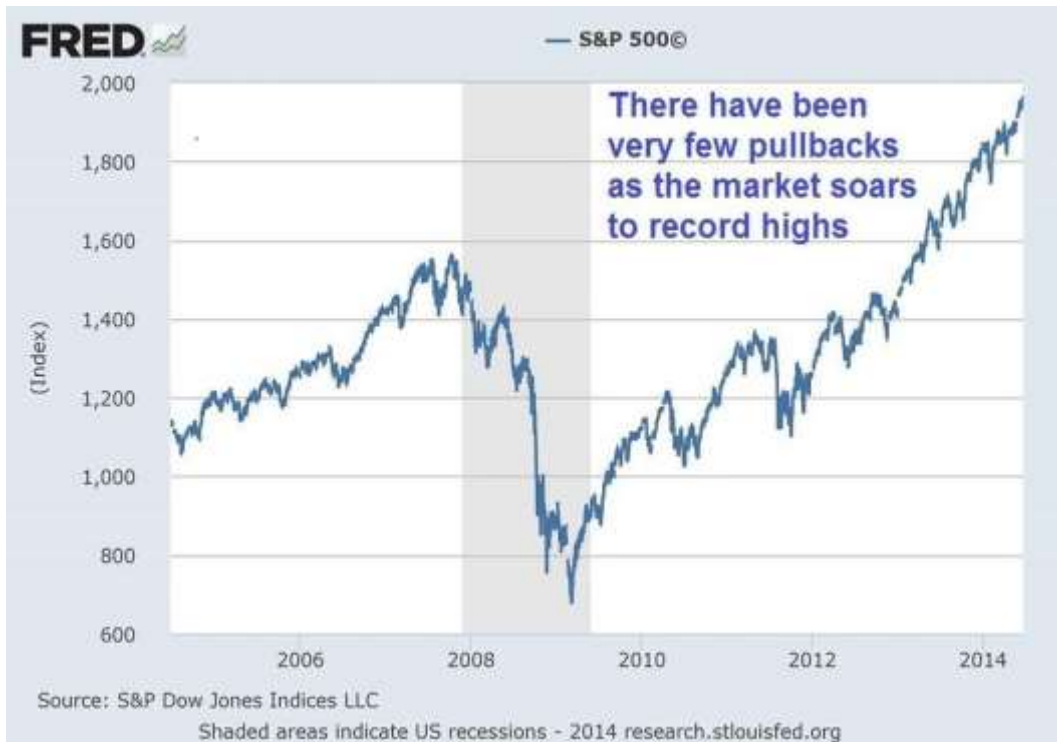


Figure 4. The Fall of the S&P 500 Index
 Source: S&P Dow Jones Indices LLC

In the graph no. 4, we can see the fall of the S&P 500 index in 2008, and in the graph no. 3, we can see the devaluation of real estate, also in the same year.

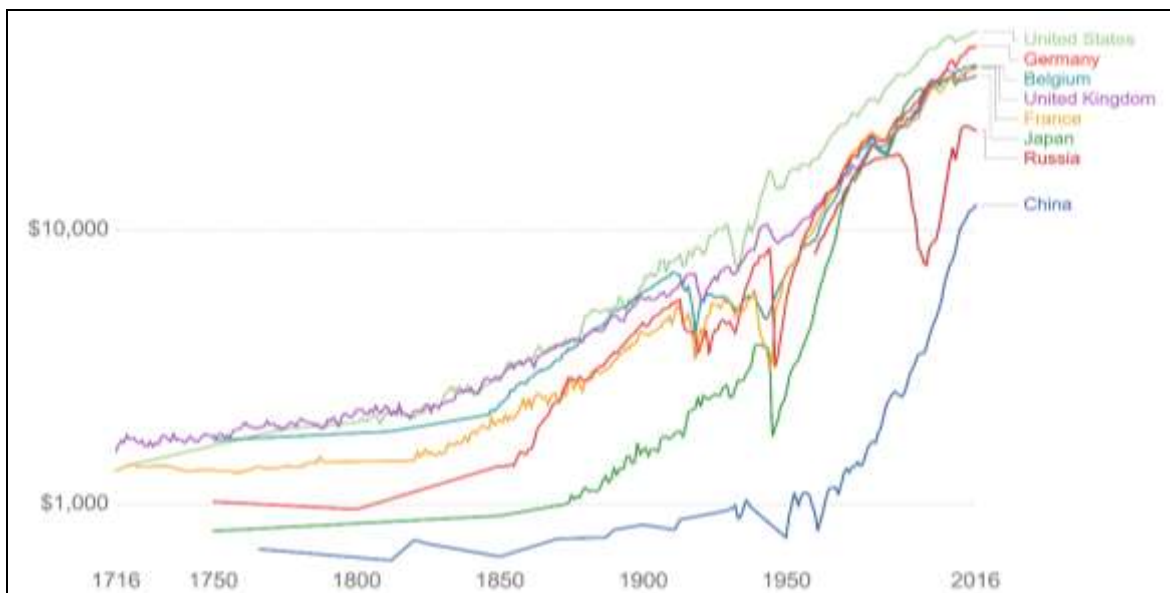


Figure 5. The correlation between the capitalism and the development of the countries
 Source: Madison Project Database, 2018

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CONCLUSION

Adam Smith's "hand" failed in any of the situations described above to balance, regulate or control the destructive events in the respective markets, moreover, its existence (i.e. the lack of regulations, to some extent), aggravated or even lead to a point of financial collapse. In a contemporary economy, Adam Smith's "Invisible Hand" does not have a high degree of functionality, as certain socialist measures and policies are indispensable for the smooth running of things. After the markets fall, they must at least be regulated, because the "Invisible Hand" becomes an even more devastating tool than it is in general if it is left functional in an already destabilized market [6].

Nowadays, financial markets are characterized by a very high degree of volatility and interdependence, one cannot speak of segments completely separated from one another, and at the same time, the power and dominance of the richest people and companies in the world is so high, that only through regulation and forced equalization of markets can some degree of competitiveness be maintained, although there are many branches of sales and services where one can only speak of monopoly [7].

While discussions are still on, whether some companies have a monopoly over their share of activity, such as Youtube, Microsoft, Apple/Samsung, Facebook/Instagram, there are still monopoly situations in other areas, such as the business of seeds and pesticides, where 61% of global sales are owned by only three companies: Monsanto (bought by Bayer in 2016, another company that can be considered as having a monopole), DowDuPont and ChemChina [8].

Also, capitalism is a system that has been proven to create inequality between the social classes, while at the same time making it accentuate, for a few simple reasons: inherited assets, this destroying the idea of equal opportunity, thus appearing generations and generations which develop the assets of a family, another reason would be the interest for goods: real estate, bonds and so on, which in turn generates income through rents and dividends, thus amplifying the enrichment process of the upper class, which at the same time increases the gap between the other classes and the upper class [10].

There is another aspect to be mentioned, namely that this capitalist system instigates greed, I know it may sound a little absolute, but the principles behind it are quite simple: in a world in which all directions lead to mass consumption and towards policies rather of "replacement" than "reuse", all because of the nature of capitalism to reward profit [11].

In a society of mass consumption and production, it is clear that problems also arise regarding the management of the natural resources available to the planet. In the last period one can best observe the mass movements of environmental activists, the rise of environmental political parties, and especially the increasing tendency of people to blame the greed and excessive use of certain resources. This is only the beginning, but the environment together with its defenders may become the greatest enemies of capitalism in the future [3].

Capitalism, as far as we could observe, is not a perfect system, but of all the others, it has been proved, to this date, the best of all. The problem now arises because apparently the problems, considered not necessarily very pressing in the past, have jumped a few places in the list of priorities and have reached the point where they threaten the potential continuity of capitalism. We cannot say for sure that it will disappear, but we can safely say that with the passage of time, it is increasingly departing from its original form, in many respects even with substantial changes, and economic ideologies are beginning to model, combine and improve each other, leaving aside the ideological barriers imposed by

their creators. Capitalism has come to be controlled worldwide to some extent, also to be combined with many socialist actions and measures, and even to bear fruit, as in the case of Germany [14].

We cannot currently have an economically sustainable world without capitalism, but we can hope for its improvement in the future, maintaining its already adopted path, namely that of improvement.

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