

## **Freedom and Regulatory Intervention in the Functioning of the Economic System**

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### **Abstract**

*Many specialists consider that at the base of the existing depression there is an improperly regulated financial system that points out severe weaknesses of the new liberalism. The existing world financial depression, especially its control points out the recurrent idea of the government intervention in order to provide the economic policies with more reason and pragmatism. That is why, among the contemporary economic mechanisms, there is a periodical change of the government intervention amplitude under the circumstances of maintaining the essential role of the market forces in resource allocation and stimulation of the entrepreneurial spirit. The essay points out some conclusions: non-existence of some economic “pure” systems; free market; pure and perfect market which is a fiction; the mixed economy in the modern meaning, the economy based on reality, which represents the real economic system where the mechanisms of the free market intermingle with the regulatory measures which refer to the state intervention in the economy.*

**Keywords:** free market, mixed and command economy, economic performances, theoretical pattern of market economy, new liberalism

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### **1. The market economy vs. the ordered economy; theoretical research**

The operating mechanism of the contemporary market economy, more specifically the mechanism for regulating the economic system can be characterized as a hybrid mechanism which combines the principles specific to the traders’ freedom of action with the rules/regulations developed within a democratic system of government.

The market economy is an economic system where the **market mechanisms are the only ones that tend to ensure the balance between supply and demand**, and the resource allocation is performed ruling out completely the intervention of the state and/or monopolies. It is a system of organization and functioning of the economy in which the relationship between supply and demand establishes the priorities as to the production of goods, methods of organization and combination of production factors, whereas the persons and categories of people have access to the manufactured goods by means of the

price level and dynamics. It is, of course, a theoretical model of the market economy having the following structural elements: the economy operates under a system of market inter-connections, the private property and personal interests are decisive in the economic operation and decision-making, each economic agent ensures its self-reproducibility or comes out on the market as a result of their decisions, all traders and all the market categories are in a competitive relationship that is the most important factor of progress, cooperation and selection among the economic agents; the prices form freely, as a result of the relationship between supply and demand which, in their turn, they influence; it rules out the administrative interventions of the state and of the other powerful bodies (monopolies, syndicates, etc) in the activity and functioning of the economy (Dobrotă, 1999). It is impossible “to clone” this model as the real market economy, more specifically the system that actually works in different countries, never reproduces the features of the ideal model that existing only in the treaties of political economy, as in reality „No economy can function exclusively on the base of the invisible hand principle”.....no state in the world takes its hands off the national economy completely” (Samuelson and Nordhaus, 2000). In this respect, John Cassidy argues that the free market has been worshiped for twenty years and demonstrates that this is in fact a fiction, an invention. He calls the doctrine he denounces (neo-liberalism) "utopian economy", as opposed to the reality-based economy he disseminates. He criticizes the supporters of neo-liberalism - Friedrich Hayek, Milton Friedman and the Chicago School, as well as the unfounded attempt of the crisis' authors to resort to mathematical models such as those of Arrow and Debreu, rewarded with the Nobel Prize. The author sees in the invasive presence of utopians in textbooks and courses a fever that will be relieved only by returning to the economy based on reality (Malița and Georgescu, 2010).

There is a great variety of models/forms in which the real market economy manifests itself, in fact each country has its own model of real market economy. The supporters of considering economics as a social science have understood that it can meet neither the requirements of mathematical precision nor the implacable casualization of physics. The analysis of the economic phenomenon has thus passed from exclusively quantitative elements to the qualitative ones, including subjective, psychological elements, the economy being influenced by a multitude of non-economic factors - legal, cultural, educational, behavioural, territorial ones etc. The multitude of factors which influence the evolution of the economic activity, as well as the diversity and complexity of the forms in which the real market economy manifests itself, probably accounts for the existence of some "white stains" in defining and using some terms such as: market economy, mixed economy, real market economy, capitalism, contemporary capitalism, real mixed market economy system, capitalist economic system, etc.; in spite of all their differences, the modern real market economies have a number of common features:

- **The diversity of ownership forms**, where the private property prevails, is one of the most important characteristics, the owner of each type of property being firmly oriented toward earning and assuming the right to decision under circumstances of risk and uncertainty.
- **The ownership right** of each person and the private property – the individual or associated one, represents the fundamental support for free initiative which manifests itself through the totality of economic freedoms. The ownership rights

represent a large part of the rules that govern most social interactions in which traders get engaged deciding "who, what moves to make and under what circumstances". In this way, the property rights and other rules of the game determine, essentially, what the individuals want to do in the pursuit of their interest (Heyne, 1991).

- **Multi-polarity** represented by the plurality of autonomous centres of economic activity, management, and decision-making is a feature of the market economies. These centres represent economic agents that are in free trade relations based on market prices formed through the mechanism of supply and demand. The private company (firm) is focused as an economic unit that establishes the link between goods and services markets, the factors of production markets and the money markets. It is the framework of combining and using efficiently the factors of production. The entrepreneur is the promoter of the initiative and business rationality. Despite the multitude of traders, there is the tendency in the contemporary economy of forming force or pressure groups - monopolies, national and multi-national oligopolies, professional unions, etc. that change the economic system from the inside, firstly, the balance of power between economic agents, between different poles within the economy.
- **Profit** is the traders' main objective. Mainly, the efficiency of one's own capacities and competence sets their own limit on the profit level. Under the circumstances of free competition and of a large number of producers and buyers, equivalent exchanges are taking place, and the factors of production (represented by the workforce, land, financial capital and physical capital engaged in production units) are remunerated by wages, rent, interest, income/profit.
- **Market**, as the venue for supply and demand, has an active role in carrying out the economic activity. Based on the functioning of a competitive market system structured by clear rules - which stimulates the entrepreneurs and eliminates those who cannot adapt to the constantly changing conditions of the market - the decentralization of the economic life becomes possible as the tendency towards balance is achieved mainly through the market relations. Largely free prices are the main carriers of information and material incentives that determine the actions and behaviours of economic agents. For most freight goods, prices are established through free negotiation between sellers and buyers, without the administrative interference of the state and other centres of economic power.

In the market economy, **the democratic state** (Iancu, 1992; Bucur, 1999; Stiglitz, 2003) ensures that the rules are obeyed, while adopting a series of measures to complement and/or correct the functioning of the market by using the legal, financial and economic levers and other tools. The state is in fact the guarantor of the proper functioning of the specific rules of the market economy. **The state intervenes in the economy not to replace the market functions, but to remove some frictions and inefficiencies in the functioning of the economic mechanisms and to avoid some of its negative consequences.** In order to respect the economic agents' freedom of decision and to keep as unaltered as possible the competition and laws of the market economy, the state intervention is not performed directly through planning and administration, but indirectly through fiscal and monetary policy, as well as through the social protection

policy.

## 2. The real contemporary economy – the mixed economy

The analysis of the real structures in the contemporary world highlights the great diversity of situations as to the more or less importance attached to some characteristics such as: private property against public one, the economy's degree of polarity, the role of profit and economic levers against administrative levers, the level of monetization and banking institutions development, the degree and way of involvement of the state in the economy, the degree of decentralization of decision-taking, etc.

The two types of economic systems should be interpreted in a generalized manner, as **theoretical models**. In real life it appears that none of these theoretical models of organizing the trade economy operates in a pure form. The economic reality is always richer and more complex than the theoretical generalization. It appears that in today's trade economy, to certain extents, elements and mechanisms specific to the free market system interconnect with the central-planned ones belonging to the state intervention in the economy. From this perspective, some analysts consider that modern trade economy, as it operates in every country, manifests itself more as a mixed economy system that combines in different proportions both elements of the command economy and of the competitive economy. “We totally agree to the opinion that it is wrong to identify the socialist economy with the central-planned economy, and it is also wrong to consider the planning method inefficient and incompatible with the market economy” (Coșea, 2003). Consequently, it is necessary to adopt a methodological outlook that should enable to include the economic reality from a given country into the market economy system or into the command economy, according to the preponderance of these structures and mechanisms that are defining for one theoretical model or another. We shall list below the criteria for defining and grouping the various market economies mentioned. (See Table 1)

The existence in a given country of a particular type of market economy has several reasons. Firstly, we should take into consideration the changes in the socio-political choices of the dominant political forces in that country to give a particular direction to the market economy structures, which are supplemented by a number of factors, not less important, such as the existing social and economic conditions, the economic development, the existing political and economic institutions, social psychology, etc. For example, in a poor economy, where the entire operating mechanism needs to be reorganized, it is not possible to adopt a type of social market economy similar to that existing in the Nordic countries simply because it is deprived of the resources necessary to adjust production and / or technology; on the other hand, there isn't a proper institutionalized system, and psychological behaviour of the population is not fully adapted to the necessity of a hard and austere commitment with a view to enhancing rapidly the performance of the economic system.

**Table 1 – Comparative analysis of the command economy system and the market economy system**

<b>Features</b>	<b>The Command Economy System</b>	<b>The Market Economy System</b>
1. Propriety	Predominance of state and cooperatist public ownership of the means of production	Predominance of private ownership of the means of production
2. Resource allocation	Based on centralized administrative decisions	Based on market trends, supply and demand and price
3. Offer parameters	Established administratively by the unique national plan	Determined according to the evolution of the market demand
4. Prices	Fixed administratively	Established mainly according to the evolution of supply-demand ratio
5. Material incentives	Absent, being replaced with the theory and practice of egalitarian collectivism	Motivation by linking the income with the labour results
6. Consumer needs system	Established and covered administratively at central level	Corresponding to the signals /information sent by the market
7. Planning	Imperative, with a biased/strong political character	Indicative, strategic and market-oriented
8. Economic mechanism	Coercive-administrative	Freely competitive
9. Economic Performances	Chronic incapacity of ensuring efficiency and competitiveness; low living standard	High efficiency in using the resources; competitive advantages and a high living standard;

Source: Iancu (1992); Negucioiu (1999); Coșea (2003).

As a matter of fact, from a modern perspective, **the mixed economy** is the real economic system that works primarily in economically developed countries (Iancu, 1992; Popescu, Ciucur and Popescu 1996; Constantinescu, 1997; Negucioiu, 1999; Popescu and Trandafir, 2001). In such a system, most decisions are based on market mechanisms, but this is only one of the means of regulating the economic activity, the state plays an important role in correcting the market imperfections, in counterbalancing or correcting some excesses and inconveniences of the market functioning, as well as in ensuring the balance between economic efficiency and social equity. “None of the developed economies is left to the free play of market supply and demand, the respective governments keeping more or less these forces under control. No social system leaves to the market essential functions such as social security or the protection of individual, national security or the protection of the community” (Heyne, 1991).

Therefore we speak about **a hybrid mechanism of regulating the economic system**, a mechanism that combines private property, competition, free price formation with the use of economic and financial levers and the legal norms developed through a democratic system of government. "Our economy (the U.S. note) is a mixed system of free trade and economic control carried out by the company (through its specialized, democratic bodies) and by private institutions with monopolistic tendencies." – argues Paul A. Samuelson. The same author, pointing out that markets are the engines of

economic growth, believes that the state is not a useless relic, dating back to a previous era, as “it plays a critical role by ensuring a climate in which markets can flourish and that removes excesses that occur when markets enjoy an absolute freedom. The prosperity of a modern economy depends on finding a balance and dividing the responsibilities between markets and state” (Samuelson and Nordhaus, 2000).

The fact that the mixed economy, the real system of the market economy works only in the economically developed countries, also results from the fact that the diversified, modern equipped banking system and the modern technical-economic structures –key features of the real market economy – are present only in such countries.

**Within the current real economic system**, a mixed system, there is a combination of private initiative, of the competitive private company with a certain central control. While the allocation of resources for different uses is largely determined by the price mechanism, the authorities play an important role in determining the aggregate production level through fiscal and monetary policy, along with income distribution. In some cases, the government can exercise control over certain sectors of the economy by nationalizing industries. “For third world developing countries, the economic systems, very hard to define, are characterized by the incomplete and inefficient use of all human, material, financial and environmental resources, with serious consequences for human life, deepening the gaps between them and the developed countries on issues such as efficiency and competitiveness, living standard and social justice” (Popescu, 1996).

If we relate all the effects of the economic activities to the life transitions need of ensuring intergenerational equality of opportunity, more specifically to the human nature of the economy, we wonder, along with other professionals, to what extent the economic systems that have been so far operational in different countries of the world meet the requirements of human economy.

Taking into account the fact that the market economy system is dominant in the developed countries of the world, we can assert that because of the freedom of action and competition, it managed to produce an abundance of economic assets in a diversified structure and quality. This is an important argument for the superiority of the market economy system in the countries listed, compared to the system specific to the central-planned economies. But we should not overlook the fact that the same economic system, that of the competitive market economy, has generated serious environmental damage, has dispersed the most important factor of development (workforce - by the existence of chronic unemployment) and diverted a number of resources from their normal use (material, financial and environmental) through the production of military goods, etc.

### 3. Conclusions

The contemporary realities points out that the pure market economy and ordered economy, completely centralized are models of economic systems to be present only in the economic books. In fact, the market economy type which distinguishes the contemporary world is the mixed economy, in which the mechanisms of the free market and private property are interpenetrated with the mechanisms of the state intervention and public property. In these conditions the practical problem is not choosing one of the two

methods but we had to choose the mix of market and the govern intervention necessary to accomplish the objectives of the public policy without affecting economic efficiency. That means by rules and regulations, by public property, by tax, etc., the governs have to prevent or to correct the fail of the complete free markets. Many specialists consider that at the bottom of actual financial international crises is the co-operation of the markets and financial engineering insufficient and inadequate established.

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