



Do Markets Generate Stability and Prosperity, or Conflict and Crisis?

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Abstract. This paper explores how Adam Smith and Karl Polanyi have radically different opinions about the place of markets in society. Firstly, Smith (1776) argues that markets are natures of self-regulation that not only increase production and efficiency but also maintain stability. He believes that the human instinct to trade has led to the creation of a market system that results in wealth. However, Polanyi (1944) challenges this idea and states that the emergence of modern self-regulating markets causes social instability and crisis as it refers to the main social factors like labor, land, and money as commodities. For Polanyi, this commodification of social goods causes social breakdown and results in conflict and crisis instead of prosperity. This paper expands on these two conflicting perspectives, proposing that markets can produce both prosperity and crisis. However, the outcomes depend on the institutional context in which these markets operate. It develops a framework for understanding the institutional cycles of embedding, dis-embedding, crisis, and re-embedding to explain when markets lead to stability and when they lead to crisis.

Keywords: Adam Smith, Karl Polanyi, Market embeddedness

1 Introduction

Market-driven growth and collapse have shaped economic life ever since industrialization. Waves of inequality and financial shock matched the gains as societies embraced open trade and private ownership. Still, the balance between progress and turmoil remains uneven. That said, even after governments tried to stabilize things with safety nets in the mid-20th century, markets kept pushing boundaries. Now they influence every corner of daily living, often without clear rules or fair outcomes. It ends up stability feels fragile despite visible success stories. Markets keep evolving faster than any rulebook can catch up.^[1]

These two figures are amongst the most influential philosophers in the history of political economy: Adam Smith and Karl Polanyi. They both provide very different perspectives on the role and effects of markets on society. Adam Smith is a very famous classical economics pioneer, and he gives a very positive picture of markets, portraying them as self-regulated mechanisms that naturally bring about prosperity and peace. Whereas Karl Polanyi, in his well-known book *The Great Transformation* (1944), dis-

approves of the idea of self-regulating markets and points out that modern market economies, especially those of the industrial capitalist era, are sources of social disorder and instability, in particular when labor, land, and money are considered commodities.

The main focus of this paper is to determine if markets, by their very nature, tend to generate stability and prosperity or if they are destined to cause conflicts and crises. This paper will juxtapose the perspectives of Smith and Polanyi to assert that markets do not inherently produce either prosperity or instability. On the contrary, their consequences rest on the very institutional, hardly ever regulated frameworks they are subjected to. Initially, this paper will focus on the micro-causal explanations in Smith's theory and Polanyi's critique (Part 1), and subsequently, it will construct the cyclical model of prosperity and crisis in terms of the connecting phases of embedding, dis-embedding, crisis, and re-embedding (Part 2).

2 Markets as Sources of Prosperity and Stability: Adam Smith

Adam Smith's concept of markets, detailed in his major work *The Wealth of Nations* (1776), forms the backbone of classical economics and still strongly impacts the way we look at market movements today. According to Smith, markets come about naturally as a result of human actions and the inherent desire of people to trade and exchange goods. This willingness to exchange is the main point of Smith's thesis, and he even goes as far as to describe it as a general, natural inclination that is at the root of the formation of market economies.

Another significant aspect of Smith's work is his recognition that dividing labor into separate tasks results in higher output. By concentrating their efforts on a certain type of work, people can greatly improve the speed of their work. To make his point, Smith refers to the well-known instance of the pin factory. He observes that in a factory where workers are each responsible for only one part of the process, like drawing wire, straightening it, cutting it, or grinding the pinheads, output goes up enormously. In fact, ten workers in such a factory can make as many as 48,000 pins in a day, while one worker doing all the processes would make a substantially lower number of pins. Smith sees this jump in output as a factor that contributes to higher availability and lower prices, thereby delivering consumer benefits and leading to the country's overall wealth.^{[2][3]}

Smith's theory is based on the belief that free markets are the most efficient way to allocate resources, as competition guarantees optimal performance. He maintains that markets are able to coordinate people's actions automatically with the help of price signals. If there is not enough of a product available, the price increases, which motivates the suppliers to make more. On the other hand, if there is too much of a product, the price decreases, making production less attractive. This system of price changes leads the market to a balance point without any central control or interference being necessary.^{[4][5]}

Smith's concept, which is frequently identified with the metaphor of the "invisible hand," is based on the idea that the individual's pursuit of self-interest unintentionally

results in overall societal benefits. According to Smith's market ideal, people are free to follow their self-interests, but as a little side effect, the public good is also enhanced. Competition in the market will lead to the efficient use of resources, which means the benefits are shared among all. Smith believes that markets inherently generate wealth by motivating efficient supply, which results in lower costs and leads to the emergence of innovations. With the increase of market size and the escalation of competition, the end result will be higher productivity and economic growth, which are factors that, in turn, enhance the general welfare of the community.

Smith's theory points out the need for a supportive system of institutions that facilitate smooth market operations. He points out that markets, if successful, lead to certain outcomes, including the establishment of laws, order, and the creation of social capital. From this perspective, a stable institutional structure that provides legal and social protections is the environment in which Smith's perfect market could exist. Market-generated wealth is, in Smith's view, the consequence of a system of institutional supports that safeguard property rights, uphold the law, and foster competition.

Also, it is crucial to bear in mind that Smith's theoretical framework is based on the assumption of minimum regulation of markets by the state. He indicates that the government should mainly take responsibility for national defense, provision and upkeep of public infrastructure, and law enforcement. Apart from that, he was of the view that markets are at their best if free without external restrictions. He conceptualized the free market as a scenario in which the state minimally intervenes, and it is competition growing that acts as a source of prosperity.

3 Markets as Sources of Conflict and Crisis: Karl Polanyi

Adam Smith paints an enthusiastic picture of self-regulating markets uncontrolled by the government; however, Karl Polanyi presents a very different picture. In his book *The Great Transformation*, written in 1944, Polanyi writes that the emergence of self-regulated markets during the industrial revolution actually brought harmful changes to society. Polanyi maintains that markets, if functioning completely independently without any social or institutional constraints, end up breaking down social structures and causing social disorder.

The very core of Polanyi's theory revolves around the idea of "dis-embedding" markets from social relations. In pre-industrial societies, it was quite a common practice that markets were "embedded" in social and communal structures, and these were governed by customs, traditions, or a sense of collective responsibility. Industrial capitalism led to the separation or disembedding of markets from these social ties. According to Polanyi, self-regulating markets, in their perspective of labor, land, and money as mere commodities, end up breaking down the social fabric.

Polanyi explains that the reason why labor, land, and money are termed "fictitious commodities" is that they cannot be produced for the purpose of selling in the market. For instance, labor is not a product that is simply bought and sold like other goods. It is indispensable for human life and society. Moreover, if labor is commodified, then the

fluctuations of wages may lead to family and community instability, as families struggle to meet their basic needs and communities face increased poverty and social disintegration. Likewise, the commodification of land is the primary cause of resource exhaustion and the breaking down of local communities. The treatment of money as a commodity is the root cause of financial crises leading to the collapse of the economy.

In the opinion of Polanyi, the commodification of the core elements of society results in a weakening of the support structure of social life. Markets that are separated from social norms and institutions leave individuals and communities vulnerable to the merciless and often unpredictable forces of the market. According to Polanyi's interpretation, reference is made to the fact that when markets are deprived of social safety nets, norms, and values, their functioning becomes ineffective. Markets should be incorporated or embedded in social systems or frameworks that impose limitations on market forces so as not to undermine or destabilize social life.

4 The Institutional Cycle: From Embeddedness to Dis-Embedding

The simultaneous existence of wealth and downfall in market economies is quite explicable when we consider the notion of institutional cycles. A prosperous economy is one in which market activities are supported by social protection. The growth through competition, specialization, and productivity is what a market embedded in social protection will naturally generate. However, the reality is that the progressive expansion and success of these markets can lead to the gradual disappearance of the social protections that are essential for the market's effectiveness. The so-called "dis-embedding" of markets is what eventually brings about crisis and instability because, at this point, markets start to turn essential elements of society into mere commodities.

Smith's theory can also be helpful in market-embedded situations when institutions and social protections prevent market pressures from causing a dispute over people's means of living. If a market is so ingrained in social norms, communal obligations, and welfare protections that none of the Smith's mechanisms of specialization, competition, and price coordination generate economic growth at the expense of social dislocation. For instance, in early industrial Britain (1500–1750), markets remained so embedded in social and political structures that they did not pose a threat to social order. Real wages in England, particularly in London, were considerably greater than in other parts of Europe, largely due to social protections like communal relief and regulated urban labor markets. These safeguards stopped labor from being regarded as a completely commodified "fictitious commodity," and hence, the advantages of economic growth were more broadly shared (Allen, 2009).

However, the growth of markets and the decline of institutions undermine the prerequisites for stability. The slow removal of social safety nets, such as welfare benefits and community-based obligations, leaves people vulnerable to the merciless market forces. This is vividly shown in Britain during the late 18th and early 19th centuries when industrialization caused the enclosure of lands, the fading away of guilds, and the weakening of the systems of support from parishes. As these means of stabilization

withdrew, laborers increasingly relied on the variable monetary wages, thus making them subject to the unpredictability of the market. These developments led to an increase in instability as labor was completely turned into a commodity, with workers experiencing changes in wages and lack of housing security, and simultaneously, the society's cohesion started disintegrating.

Once markets get completely disembedded, they start to cause conflict and crises. The conversion of labor, land and money into marketable goods upsets the societal fabric by making individuals vulnerable to the unpredictable market forces. The rise of industry in 19th-century Britain vividly illustrates how disembedded markets can lead to social upheaval and instability. With industrialization, laborers were deprived of the protection of minimum wages, workplace health and safety and services like clean water and sanitation was neglected. This laid the groundwork for the overcrowding of dwellings, poor living environments and the outbreak of diseases. In the case of Glasgow, for example, life expectancy plummeted from 35 years in the 1820s to 27 years by 1837–41 due to factors such as poor housing, malnutrition and dirty living conditions (Szreter & Mooney, 1998).

The crisis eventually prompts political intervention, as societies seek to reembed markets within protective institutions. After the Second World War, one of the most evident illustrations of the market re-embedding through social protections to limit the damages by dis-embedded markets is the welfare state in the United Kingdom. Universal healthcare, social insurance, and public housing were some of the features of the Attlee government's social protection structure that re-embedded markets in such a way that all citizens had access to social protections. These policy changes not only led to a market system that could be maintained along with social welfare, but they also re-established the foundations of prosperity.

5 Counterarguments: Hayek and Marx

However, not all economists agree with the cyclical theory of market stability and instability. Friedrich Hayek, who was a leading Austrian economist, criticized the Polanyi's theoretical approach and the institutional cyclical model. According to Hayek, markets inherently provide stability not by implementing social protections but through the functioning of the price signals found in different geographical areas that are able to coordinate knowledge spread out among people (which no central authority can ever fully know) (Hayek, 1945). In fact, as he brilliantly points out, "the knowledge of the particular circumstances of time and place" lies with individuals who happen to locate themselves in the specific situations, and it is not for governments or central planners to have that knowledge (Hayek, 1945).

From that perspective, economic crises do not originate as a result of the disembedding of markets as Polanyi (1944) claims, but rather from the efforts of state intervention to override or replace the price mechanism. Centralizing decision-making, control imposition, or suppression of price adjustments by policymakers leads to disorientation of the price signals, which results in depriving market participants of the ability to respond to the real changes of scarcities and opportunities (Hayek, 1945). Similarly, Karl

Marx also, in a way, throws new light on crises of market economies. In his *Critique of Political Economy* (1859), he sees crises as corresponding to the internal development contradictions of capitalism. In fact, Marx views capitalism as an economic system whose essence revolves around the continuous process of accumulation and expansion. From here arise the inherent contradictions between the forces of production (capital, machinery, and labor) and the relations of production (class relations, ownership, and control of economic resources). Out of these contradictions, periodic crises result when the productive forces have grown beyond social relations that regulate production.

Hayek concentrates on the efficiency of decentralized decision-making, and Marx, on the inherent instability of capitalism. However, both of these critiques bring in other mechanisms that can cause crises. Hayek's thoughts are central to the idea that too much regulation or control can mislead market signals. On the other hand, Marx's ideas allow us to see the fundamental contradictions within the capitalist system such as the conflict between labor and capital which can lead to economic instability and crises. Nevertheless, both critiques complement rather than negate the institutional cycle framework proposed by Polanyi, which explains why markets may generate both stability and crisis depending on their degree of embedding in social and institutional structures.

6 Conclusion

The discussion between Adam Smith and Karl Polanyi enlightens the reader on the role that markets play in social life. Smith views the market as a self-directed system that inherently promotes general welfare and stability, while Polanyi warns that when markets are detached from social relationships, they can cause societal breakdown by transforming essential social goods into mere commodities. This paper argues that markets are not a magic wand that conjure up either prosperity or crisis out of nowhere; rather, they represent a reflection of the specific institutional arrangements in place at the time. Markets create prosperity if they are supported by social protection, whereas they cause a crisis and lead to instability if they are separated from social relations.

Both Smith's and Polanyi's ideas are right and, in fact, can be used together to better understand how markets work. Smith's concept helps one see the role of markets in creating prosperity and stability as long as they operate within the proper social and institutional setting. On the other hand, Polanyi's criticism unveils the risks of separating markets from societies leading to the cold commercialization of social goods and the resulting social disintegration. When put together, these two explanations shed light on the complicated interplay between markets, society, and the maintenance of social order.

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