

A faded, light-colored portrait of Adam Smith, an older man with white hair, wearing a dark coat and a white cravat. The portrait is centered in the background.

Adam Smith

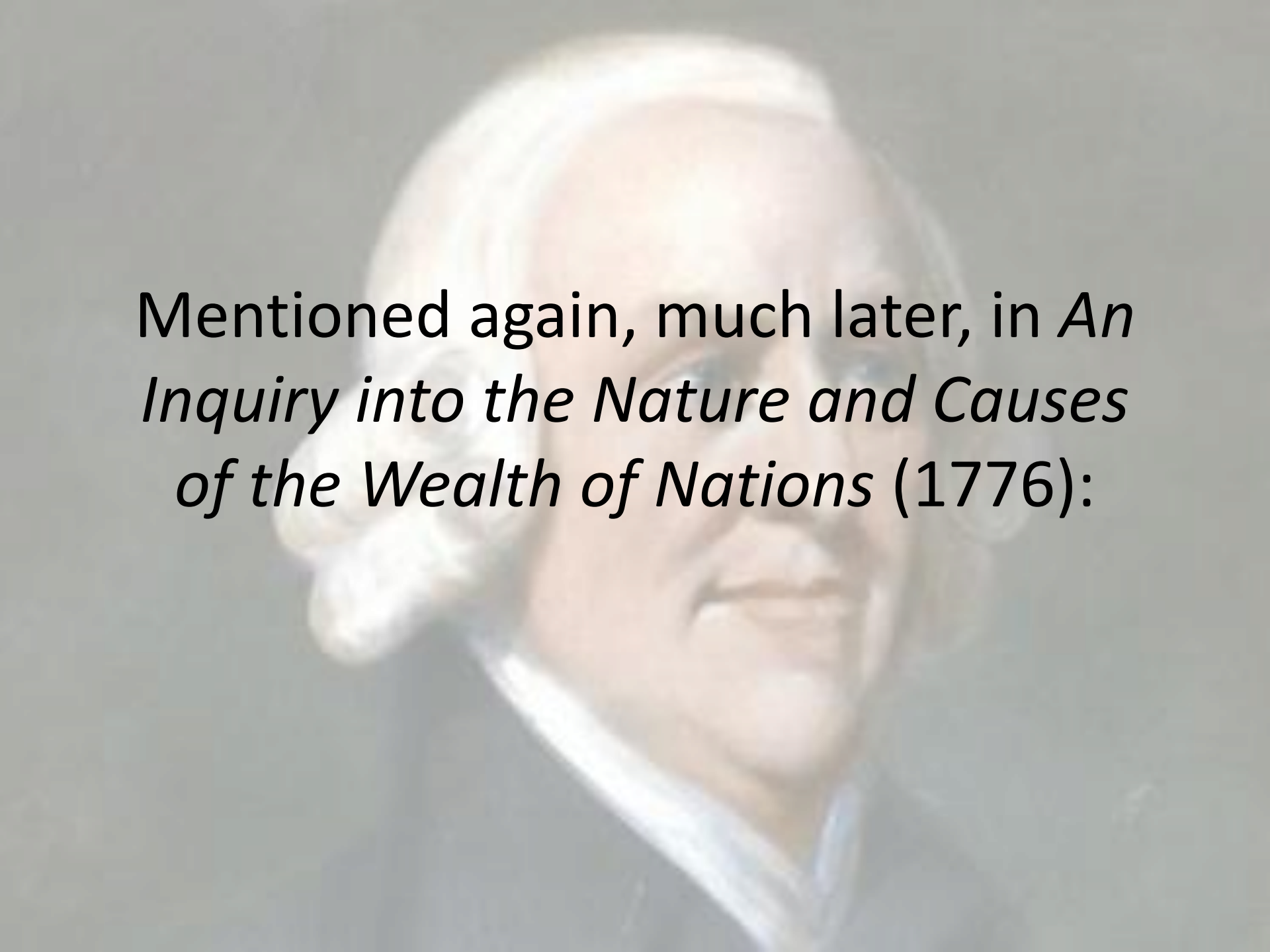
...And The 'Invisible Hand'

Adam Smith (1723-1790)

- Philosopher of the Scottish Enlightenment;
- Empiricist;
- Sentimentalist;
- Laissez faire economist?
- First use of 'invisible hand' metaphor in *The Theory of Moral Sentiments*:

First Mention: *The Theory of Moral Sentiments* (1759)

‘The rich only select from the heap what is most precious and agreeable. They consume little more than the poor, and in spite of their natural selfishness and rapacity, though they mean only their own conveniency, though the sole end which they propose from the labours of all the thousands whom they employ, be the gratification of their own vain and insatiable desires, they divide with the poor the produce of all their improvements. They are led by an **invisible hand** to make nearly the same distribution of the necessaries of life, which would have been made, had the earth been divided into equal portions among all its inhabitants, and thus without intending it, without knowing it, advance the interest of the society, and afford means to the multiplication of the species.’
(*TMS* 6th ed. p. 350)



Mentioned again, much later, in *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776):

Second Mention: *The Wealth of Nations*

‘As every individual, therefore, endeavours as much as he can both to employ his capital in the support of domestic industry, and so to direct that industry that its produce may be of the greatest value ... He generally, indeed, neither intends to promote the public interest, nor knows how much he is promoting it. By preferring the support of domestic to that of foreign industry, he intends only his own security; and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an *invisible hand* to promote an end which was no part of his intention.’ (WN Book 4, Chapter 2)



Greed is Good (sort of)?

...so let the free market rip!?



Not so fast

Try a closer look at the *Wealth of Nations*

Self-Interest and Market Economies

- Self-interest can be *socially useful*:
- ‘The central theme that inspires the *Wealth of Nations* is the notion that selfishness, however morally reprehensible, may nevertheless provide a powerful fuel to a ‘commercial society’... (Blaug 1997)
- But only in a market economy that is decidedly *not* free:
- ‘what distinguishes Smith’s ‘theory of economic development’...from more recent efforts in the subject is a continuous harking back to the framework of social institutions that harness and channel pecuniary motives.’ (Blaug 1997)

...But only in a decidedly *non*-pure free market economy:

‘Adam Smith was not satisfied to argue that a free market economy secures the best of all possible worlds. He was very much concerned with the specification of the exact institutional structure that would guarantee the beneficent operation of market forces ... the market mechanism would foster harmony but not unless it was surrounded by an appropriate legal and institutional framework.’ (Blaug 1997)

Smith on Public Expenses

- ‘Virtually the whole of Book V, chapter 1 ...is taken up with the problem of devising techniques for rewarding lawyers, clerks, judges, clergymen and teachers in such a way that the pursuit of their own interests will advance the interests of society as a whole.’ (Blaug 1997)
- And other public works expenses, like canals and highways...

So, what might Adam Smith say?

- Intra- and International actors are likely to pursue their own self-interest;
- An 'invisible hand' guides their self-interested action towards socially shared goals;
- Yet only with well-designed and effective global institutional structures will the 'invisible hand' be allowed to work its magic.