

Chapter 8

The invisible hand

As we saw in the previous chapter, Adam Smith's political economy is based on a chain of three arguments. The first we called the Economizer Argument, or the claim that each person naturally seeks out the most economical use of the resources available to him to achieve his goals, whatever they are. Whatever one's goals, one wants to achieve them as efficiently as possible. Smith's claim is that no one needs to tell us to do this: we are psychologically constructed, as it were, to do so already. The second argument is the Local Knowledge Argument, which has a couple of steps. First is the claim that people tend to know their own goals and purposes, as well as opportunities and available resources, better than others. Next is the claim that in order to use resources wisely, decisions about how to use them must be based on this knowledge of people's goals, purposes, opportunities, and resources. It then follows that the person typically best-positioned to make such decisions is the individual himself—for he is the one who possesses the required knowledge. By contrast, if others made such decisions for one, they would necessarily have to base their decisions on less intimate familiarity with the relevant circumstances—and the further away the decision maker is (meaning the less the decision maker knows about the individual's situation), the worse the decision maker's decisions will be. Thus the default for Smith is to allow individuals to make their own decisions about how to allocate their resources to serve their ends, and allow third-party intervention only in exceptional and special cases, like children or the mentally infirm.

Now we come to Smith's third argument, which is based on the most famous passage in all of Smith's *Wealth of Nations*, indeed arguably in all of economics. Smith writes: "It is his own advantage, indeed, and not that of the society, which [each person] has in view. But the study of his own advantage naturally, or rather necessarily, leads him to prefer that employment which

is most advantageous to the society” (WN: 454). Smith continues that each individual “generally, indeed, neither intends to promote the publick interest, nor knows how much he is promoting it”; “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: 456). What is the “end” the individual promotes that “was no part of his intention”? The “publick interest.” Individuals have, of course, ends (or purposes), but they are personal and local. Smith’s claim in this famous passage is that in seeking to accomplish their personal and local ends, they are led to discover ways to serve *others’* ends as well—whether they care about those others or not. The Invisible Hand Argument hence finds a way to achieve the lofty goal of helping others from the humble motivation of self-interest.

How is this extraordinary feat accomplished? Recall Smith’s claim that the goal of increasing standards of living results from division of labor—but only within a “well-governed society.” As we saw, what Smith means by a “well-governed society” is one that protects the “3 Ps” of justice: person, property, and promise. In other words, it ensures that the only way I can get what I want from you is by appealing to *your* interests. If your person, property, and promise are protected, I cannot enslave you, I cannot steal from you, and I cannot defraud you. The only recourse I have, then, to get whatever goods or services you might be able to provide is by making you an offer. And since your 3 Ps are protected, you can, if you please, always say “no, thank you” to any offer I might make and simply walk away. This means that I have to ask myself: What can I offer you that *you* would think is valuable enough to cooperate with me? Given that each of us “stands at all times in need of the cooperation and assistance of great multitudes” (WN: 26), that means that each of us must, in a well-governed society, think constantly of the value we can provide to others—which we can know only if we are thinking about those others and not thinking only about ourselves. In such a society, Smith says, we become “mutually the servants of one another” (WN: 378). The genius of the Smithian market mechanism was that it could coordinate the disparate individual efforts of indefinitely many persons and manage to derive an overall benefit for the good of society from them.

To summarize Smith’s argument: because I seek to achieve my goals in the most efficient manner possible (as the Economizer Argument holds), I

am incentivized to make good decisions about how to achieve my goals using the resources available to me (as the Local Knowledge Argument holds), and hence, as long as we are living in a well-governed society that debars me from acting with injustice, I will be led to cooperate with you in ways that will be beneficial to you as well (as the Invisible Hand Argument holds).

In Smith's account, neither of us can benefit at the other's expense; rather, each of us can benefit only by benefitting the other. The result of these mutually voluntary, mutually beneficial transactions is that overall wealth increases, leading to general growth in prosperity. The more people whose "3 Ps" are protected, the more people all on their own entering into ever more mutually beneficial, or "positive-sum," transactions—leading to yet more wealth that can enable even more such transactions, and so on—creating a virtuous cycle of increasing prosperity for all. This is what Smith meant by "universal opulence" and "general plenty" (WN: 22).

Consider an additional important aspect of Smith's argument. Who will be the chief beneficiaries of this generally increasing prosperity? Not the emperor, king, lord, or baron—they already manage to get theirs, mostly by extracting it in "zero-sum," or even "negative-sum," transactions that benefit themselves at the expense of unwilling others. No, the primary beneficiary of this process is the everyday workman, who finds himself gradually and incrementally able to afford more and more of life's necessities and luxuries. It is his standard of living that stands to see the greatest gains, and his lowly station—which has been the situation of the majority of humanity throughout almost all of its history—which should be our chief concern. Smith believes he has discovered the key to unlocking a perhaps limitless engine of prosperity. Its salutary effects on the lives of common people is the moral mandate that drove Smith's political economy.

Smith's bold, even audacious, prediction in WN was that countries that adopted his recommendations would see all their citizens, including especially their poor, rise to heights of wealth and prosperity that even kings in his day could only dream of. He even went so far as to suggest, in 1776, that America, which at the time most enlightened thinkers in Europe considered a "barbaric" country, could one day surpass even the mighty British Empire in wealth—a laughable, even preposterous claim! And yet, what have the subsequent 241 years demonstrated?

How important is the “invisible hand”?

That phrase “invisible hand” occurs only once, however, in all of *The Wealth of Nations*. It occurs only two other times in Smith’s extant works: once in TMS (pp. 184–5) and once in an essay Smith wrote about the history of astronomy (Smith, 1982a: 49). If it occurs only so infrequently, one might wonder why so much subsequent attention has been paid to it. Is it really so central to Smith’s thought?

The answer is yes, it is absolutely central to Smith’s thought. Although the phrase “invisible hand” appears only a few times, the Invisible Hand Argument appears throughout his works. Here is the one occurrence of the phrase in TMS: the rich “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: 184–5). But the idea, if not the phrase itself, occurs throughout TMS. For example: “But by acting according to the dictates of our moral faculties, we necessarily pursue the most effectual means for promoting the happiness of mankind” (TMS: 166). “No qualities of the mind,” writes Smith, “are approved of as virtuous, but such as are useful or agreeable either to the person himself or to others; and no qualities are disapproved of as vicious but such as have a contrary tendency” (TMS: 188). Smith continues: “And Nature, indeed, seems to have so happily adjusted our sentiments of approbation and disapprobation, to the conveniency of both the individual and of the society, that after the strictest examination it will be found, I believe, that this is universally the case” (ibid.).

In addition to the one occurrence of the phrase in WN, quoted earlier, the idea is similarly found throughout Smith’s WN. Here are a few examples. “The houses, the furniture, the cloathing of the rich, in a little time, become useful to the inferior and middling ranks of people. They are able to purchase them when their superiors grow weary of them, and the general accommodation of the whole people is thus gradually improved” (WN: 347). Another example: “It is his own advantage, indeed, and not that of the society, which he has in view. But the study of his own advantage naturally, or rather necessarily leads him to prefer that employment which is most advantageous to the society” (WN: 454). One more: “It is thus that the private interests and passions of individuals naturally dispose them to turn their stock towards

the employments which in ordinary cases are the most advantageous to the society” (WN: 630). Many other examples could be adduced.

Smith similarly finds an Invisible Hand Argument, even if he does not use that exact phrase, in his short essay on the origins of languages, where he argues that languages change over time in response to individual language users’ changing circumstances, and that those changes create a language, as a system of spontaneous order, that enables others to use it for their purposes as well.⁶ Smith also makes a similar argument in his account of the nature, and development over time, of legal systems, including in particular the Roman and British systems of common law.⁷

In all these cases, we see the same central elements of his Invisible Hand Argument. First we have individuals making decisions in their own cases based on their localized knowledge about how to act and behave in order to achieve their goals, whatever they are. Given that people need the willing cooperation of others to achieve almost all of their goals, however, this necessarily leads them to seek out ways to provide others with incentives to cooperate with them—which typically means offering them something that they value. Thus the search to satisfy one’s own goals inevitably leads people to benefit others, even if benefitting others was, as Smith puts it, no part of their original intention. They may seek to benefit only themselves or those they care about, but they are thereby led, as if by an “invisible hand,” to engage in activities that simultaneously benefit others as well—even others they do not know, will never meet, and may even dislike. That is the genius, and power, of Smith’s Invisible Hand Argument: it offers a path for channeling the individual’s limited knowledge and self-interested concerns into benefit, even inadvertent benefit, to others.

6 Smith’s “Languages” essay is contained in Smith (1985). For commentary and further discussion, see Otteson (2002).

7 See Smith’s *Lectures on Jurisprudence* (Smith, 1982b). Note, however, that these are students’ notes from Smith’s lectures, not Smith’s own notes. We no longer retain Smith’s own lecture notes.