Adam Smith's Invisible Hand Argument

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ABSTRACT. Adam Smith is usually thought to argue that the result of everyone pursuing their own interests will be the maximization of the interests of society. The invisible hand of the free market will transform the individual's pursuit of gain into the general utility of society. This is the invisible hand argument.

Many people, although Smith did not, draw a moral corollary from this argument, and use it to defend the moral acceptability of pursuing one's own self-interest.

Smith does use the invisible hand argument; however, a close reading of the *Wealth of Nations* reveals that Smith thought the interests of merchants and manufacturers were fundamentally opposed to those of society in general, and that they had an inherent tendency to deceive and oppress society while pursuing their own interests. How can these two views of what results when merchants and manufactures pursue their self-interest be made compatible? It is argued that the invisible hand argument when applied to merchants and manufacturers, (its application to labour and landlords is only mentioned briefly), is extremely restrictive, and that similar restrictions must apply to the moral corollary. In particular, the invisible hand argument applies only to investing capital in one's own country for maximum profit.

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Introduction[1]

It is common practice in the business world today to justify pursuing profits and self-interest by quoting Adam Smith's invisible hand argument. Pursuit of one's own interests is morally justified, it is said, because the invisible hand of the market place will ensure that this will result in the general good of society. An empirical study of the ethical thinking of sixty top managers found that the majority "explicitly or implicitly rely on the 'invisible hand' of the market." ("Ethics and Economic Success", p. 3). This result will surprise no one; the invisible hand argument is ubiquitous.

But what did Smith really say about the invisible hand? And what did he say about the morality of self-interest? These questions are well worth investigating, for Smith was a moral philosopher by profession, and his writings deal with ethics as much as economics.

This paper is an attempt to examine three issues. Firstly, we will consider how Smith used the invisible hand argument, and how this compares with the use of the argument today. Secondly, we will have to deal with a major problem with the invisible hand argument in Smith's writings. There are numerous passages in *The Wealth of Nations* in which Smith directly states that the interests of business people (merchants and manufacturers as he calls them) are in fundamental conflict with the interests of society as a whole, and that business people pursue their personal goals at the expense of the public good. These passages seem blatantly to contradict the invisible hand argument; is Smith guilty of a major contradiction? Thirdly, I want to examine the important question of what,

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exactly, are the moral implications of the invisible hand argument. Regardless of Smith's view of the argument, discussing his writings highlights the fact that the invisible hand argument does not justify what many contemporary users of the argument think it justifies. Part three of this paper examines which self-interested actions are, and which are not, compatible with the invisible hand of the marketplace.

This paper will not be proposing any new interpretation of Adam Smith's writings; my concern is more with the invisible hand argument as an argument than with analysing Smith's writings at great length. All the issues of Smith interpretation dealt with here are discussed in the vast scholarly literature about Smith. In referring to that literature, I will aim at identifying the best or most thorough source rather than at completeness. This paper is not intended as a survey of Smith scholarship.

I. The invisible hand argument

A. *The invisible hand argument in Smith's writings*

Smith uses the phrase 'invisible hand' three times in his writings; first once in his essay *History of Astronomy* (II.2),[2] once in his main work of moral philosophy, *The Theory of Moral Sentiments* (TMS IV.i.10), and finally once in *The Wealth of Nations* (WN IV.ii.9). On the first two occasions, his use of the phrase is not in the context of what today we would call the invisible hand argument, but I will have occasion to comment on the second of these occurrences later in the paper. In *The Wealth of Nations*, he does use the phrase in something like the modern sense. Here is the entire passage in which it occurs:

> 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, every individual necessarily labours to render the annual revenue of the society as great as he can. 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 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 IV.ii.9)

This passage is clearly a version of the invisible hand argument; it says that if all individuals pursue their own interests without regard to the general good of society, then the "invisible hand" of the free market will cause this to result in the promotion of the public interest. The argument is embedded in an economic or business context; it refers to employing capital, and afterwards twice repeats the phrase "to direct (or 'directing') that industry," by which Smith also means investing capital. (Capital is for Smith a form of accumulated industry, and "that industry" refers in this passage to capital, and possibly also to the capitalist's current efforts and activities.) A capitalist "intends only his own gain" when choosing investments, clearly a pursuit of his or her own interests. But the unintended result is the promotion of the "public interest," which Smith equates with rendering "the annual revenue of society as great as he can." Thus this passage seems to support the standard interpretation of Smith as a defender of the invisible hand argument.

Although they do not include the phrase 'the invisible hand,' other passages of *The Wealth of Nations* support the standard interpretation using slightly different language. For example, earlier in the same section he writes using the phrase "own advantage" for "greatest value", and "most advantageous to society" for "public interest":

> Every individual is continually exerting himself to find out the most advantageous employment for whatever capital he can command. It is his own advantage, indeed, and not that of society 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 IV.ii.4)

There are far too many similar passages in the *Wealth of Nations* to quote them all. In total, these passages seem clear; by pursuing their own interests or advantage, people unintentionally and unknowingly promote the public interest, or that which is most advantageous to society. It is common usage to refer to this as the invisible hand argument.

However, the argument as stated so far is only part of the invisible hand argument; it is the empirical portion that states what will in fact happen if everyone pursues their own interests – we have not yet draw any moral conclusions from it. It is an empirical claim because it predicts that in certain situations (a free market), certain types of actions (everyone pursuing their own interests), will cause a certain result (promoting of the public good). Raphael cites the causal aspect of the invisible hand argument as an example of "a kind of natural law in economics" (1979, p. 87), thus firmly identifying this argument as being for Smith a scientific (or empirical) theory. This means that Smith ought to advance empirical evidence in support of the theory; and this he does, not in the invisible hand passage itself, but throughout the *Wealth of Nations* as a whole. Smith, I think, would view all the evidence he cites about human nature, and all the vast historical evidence he cites about actual markets and economies, as support for the argument. For my purposes, identifying this version of the invisible hand argument as empirical distinguishes it from the moral forms of the argument I will discuss next.[3]

The moral forms of the invisible hand argument arise because some people think the argument has a moral corollary that follows directly from it; that is, if by everyone pursuing their own interests the advantages of society are maximized, then surely everyone ought, and this is a moral ought, to pursue their own interests. If it is thought too strong a conclusion to say one is morally obliged to pursue one's own interest, some might accept the weaker claim that one is morally permitted to pursue one's self-interest. Note that neither the weak nor the strong form of this moral corollary claims that one ought or may pursue *only* one's own interests. That conclusion would involve further empirical claims, and some sort of utilitarian moral premise. The moral versions of the invisible hand argument are probably more common today than the straightforward empirical version, but before dealing with contemporary uses of the argument, I want to relate the argument to Smith's moral views.

Smith nowhere uses the invisible hand argument to draw moral conclusions; as we have seen, he speaks only of the empirical form of the argument. Since Smith was a moral philosopher by profession, and his writings are suffused with moral theories and sometimes moral admonitions, this lack of interest in the moral implications of the invisible hand deserves comment. Two topics need commenting on here: the relationship between Smith's moral writings and his economic work, and his views on the morality of self-interest.

B. *Smith's moral and economic writings*

Smith's views on moral philosophy, or ethics, are primarily stated in the *Theory of Moral Sentiments*, published in 1759 and revised by Smith for the sixth edition in 1790. His main economic writing is, of course, the *Wealth of Nations*, published in 1776. Note that his book on moral sentiments was published before the *Wealth of Nations*, but that revisions made to it in the last year of Smith's life tell us that he did not change his views significantly on moral issues while writing about economics.

In the *Theory of Moral Sentiments*, Smith identifies the basis of all morality as the inherent and natural tendency humans have to 'sympathise' with the feelings of others. By sympathy, Smith means a perception of similarity in the feelings of two people. We inherently approve of any such correspondence of feeling, and disapprove of a lack of correspondence. For example, if a person is the victim of gross injustice, spectators (by imagining themselves in the victim's place) tend to sympathise with the victim's feeling of resentment, although the spectators feel it less than the victim. Thus the victim and the spectator can agree that resenting the injustice is morally acceptable, provided the victim curtails their resentment to a level an impartial spectator can sympathise with. This sympathy is the basis of all moral beliefs for Smith.

When writing about economics in *The Wealth of Nations*, the principle underlying people's economic behaviour is self-interest in the form of a constant drive to improve one's social and economic condition. Self-interest and sympathy are very different principles, and this has led scholars (especially in Germany in the late nineteenth and early twentieth centuries) to question the consistency of Smith's moral writings, and to wonder if Smith changed his mind about human motivation while writing the *Wealth of Nations*. This is known as 'Das Adam Smith Problem'.

Since at least the middle of the twentieth century, scholars have been in general agreement that Smith was consistent and that he did not change his mind (cf Campbell, p. 69; Haakonssen, p. 51, fn. 19; Hartwell, p. 125; Macfie, 1967, pp. 104–108; Winch, p. 167). The contradiction is only apparent because Smith is in fact dealing with two different issues. In *The Theory of Moral Sentiments*, he is trying to describe the origins of our judgements of moral approval and disapproval, and the origins of our moral ideas. He is not trying to explain moral motivation, or human motives of any sort. Sympathy underlies moral judgements and moral ideas; Smith never claims it is an important motivator of human actions (although, of course, moral judgements once made may have some motivational force).

In Smith's economic writings, self-interest is the main motivator of human economic activity; here it is a motive for action, not the basis of judgement or the origin of ideas. It is, by the way, not the only motive for actions even in economics: laziness, imprudence, benevolence can all motivate, but in economics, self-interest predominates. In other areas of human activity, such as politics, it is not clear that self-interest is the dominate force (Winch, pp. 164–169).

'Das Adam Smith Problem' resolves itself when we realize that sympathy is the origin of moral judgements, and self-interest underlies economic motivation. Scholars these days tend to be dismissive of this issue; Haakonssen says, it is now "futile to take any more rides on that old hobby-horse 'sympathy v. self-interest' in Smith" (p. 51, fn. 19).

C. *The Morality of self-interest*

If Smith does not use the invisible hand argument to justify the moral permissibility of pursuing one's own self-interest, what then were his views on the morality of self-interest? Firstly, we can safely say that Smith was aware of the possibility of using the invisible hand to justify self-interest; it was a topic moral writers of his day often addressed in the context of criticising Bernard Mandeville. In the *Fable of the Bees*, first published in 1714, Mandeville had argued that the personal vices of greed, avarice, envy, etc. were public virtues in that they led people to the kind of activities that drove all thriving economies. The sub-title of the *Fable* is "Private Vices; Public Benefits". Mandeville and Smith differed in that for Mandeville, the kind of self-interest which dominates economic activity is described as a type of moral vice, though it is obviously part of Mandeville's purpose to change that view. Luxury, as the vice of pursuing and flaunting personal material wealth was known, had been thought a socially harmful vice since Roman times. By the mid-eighteenth century in Britain, many writers had accepted Mandeville's proposed change and considered the pursuit of luxury as morally neutral; (for example, Hume's comments are discussed by Haakonssen, p. 38). In so far as modern business people use the invisible hand argument to show that the pursuit and flaunting of personal wealth should not be viewed as a vice (or sin), they are referring to a form of the argument which originates with Mandeville, not Smith. However, it is precisely this argument that Smith uses in the invisible hand passage in the *Theory of Moral Sentiments.*[4] In that book, Smith talks about the landlords' taste for 'luxury', or what since Veblen has been know as 'conspicuous consumption'; he does not, like he does in *The Wealth of Nations*, talk about business people pursuing profit. His contempt for luxury is apparent, but he stops short of calling it a vice, and in this the influence of Mandeville is seen. But to extend this moral neutrality from luxury to the moral neutrality of self-interest in the economic sense, we need to turn to another area of Smith's philosophy.

For Smith, pursuit of economic self-interest is not inherently immoral, though it would be immoral if it led to vicious actions, or if it excluded all other motivation. Indeed, Smith considers a proper degree of prudence to be a virtue. Self-interest for smith is more likely to lead people to help others that to harm them; it leads, for example, the butcher, the baker, and the brewer to feed me, not to hurt me:

> It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages. (WN I.ii.2)

In itself, Smith views the motive of self-interest as morally neutral; its degree and direction are matters for moral approval or disapproval. But it is not the invisible hand that Smith uses to establish this moral neutrality; instead, Smith argued against the inherent immorality of self-interest using the concepts of natural liberty and natural law. The concept of natural law is confusing in Smith's writing because he slid between two concepts – a descriptive and a prescriptive concept of law (Campbell, p. 59; Raphael 1975, p. 74; Winch, p. 65). On the one hand, there is the idea of natural law as it is used by science (or natural philosophy); that is, as a description of an empirically perceived regularity in nature. (We have already seen that Smith viewed the invisible hand as a natural law in this sense.) On the other hand, there is the idea of what would normally happen if humans did not interfere by instituting meddlesome and impertinent regulations. His concept of natural liberty is a good example of this latter idea. It is clearly a moral idea in that it gives a prescriptive idea of what ought to happen; governments ought not try to control the natural course of economics and society. Campbell (p. 59) points out that Smith not only confuses the descriptive and prescriptive ideas of natural law, but seems to think the prescriptive use is the more fundamental. Self-interest is justified by natural liberty, which (like natural justice) in turn is according to (prescriptive) natural law. Smith derived this line of thinking, though he vastly modified it, from the natural law tradition (Raphael 1985, p. 74), especially from the writings of Grotius and Pufendorf which Smith studied as a student in Glasgow (Macfie 1967, p. 25).

In conclusion, Smith did not morally justify self-interest by using the invisible hand argument, although he was familiar with Mandeville's view that the private vice of luxury could be a public benefit, and though he repeated a similar argument in the invisible hand passage in *The Theory of Moral Sentiments*. Instead, Smith based his belief in the moral neutrality of self-interest on its consistency with natural liberty, a concept which he derived from the natural law tradition.

D. *The invisible hand argument today*

The invisible hand argument in both its empirical and moral forms is so ubiquitous in current business ideology that I offer only a few examples to show the nature of references to it. To start, consider this summary of the moral form of the argument from an article frequently published in textbooks on business ethics:

> A deliberate amorality in the executive suite is encouraged in the name of systemic morality: the common good is best served when each of us and our economic institutions pursue not the common good or moral purpose, advocates say, but competitive advantage. Morality, responsibility, and conscience reside in the invisible hand of free market system, not in the hands of the organizations within the system, much less the managers within the organizations. (Goodpaster and Matthews, pp. 187–188)

Goodpaster and Matthews attribute this view to Milton Friedman, and Milton Friedman no doubt is one champion of this 'amorality in the executive suite' in that he sees the pursuit of profits as the sole social responsibility of corporations, (though Friedman makes clear that this pursuit must be done "while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom" (Friedman 1970, p. 153)). It comes as no surprise then, that Friedman thinks the invisible hand the most important idea in Smith's writings, and claims others are of the same opinion. Before quoting Smith's invisible hand passage, he says:

> Smith's . . . great achievement – as Hayek and others so eloquently pointed out – is the doctrine of the 'invisible hand', his vision of the way in which the voluntary actions of millions of individuals can be coordinated through a price system without central direction. (Friedman 1978, p. 17)

Friedman appears to believe in the empirical truth of the invisible hand argument, and it can be argued that he also accepts the moral version of it. In arguing that business ought to pursue only profits, he could be thought to support the strong form of the moral corollary, namely, that the invisible hand places people and companies under a positive moral obligation to pursue only their own interests. However, in other places, Friedman justifies the exclusive pursuit of profits by invoking a natural right of people (including shareholders) to pursue their own interests and to do with their property as they want to (1970, pp. 153–155). As we have seen, Smith also relies on natural rights to justify the moral neutrality of self-interest.

In modern economics, the most serious use of the invisible hand argument, or a closely related argument, comes in welfare economics, where it is 'proved' that a free market system will lead to the optimal use of resources for Pareto optimal production. This work has frequently been directly linked to Smith and the invisible hand despite the fact that the notion of Pareto optimality is a long way from Smith's phrase of "render[ing] the annual revenue of the society as great as he can". Gibbard, for example, says:

> Much of the work of theoretical welfare economics consists in investigating claims that free exchange produces optimal incentives. This work elaborates and assesses Adam Smith's claim that under a system of free exchange, economic agents act "as if guided by an invisible hand" [sic] to produce an outcome that is best in some sense. (Gibbard, p. 26)

In itself, this is only a version of the empirical form of the argument, but it has been used as the basis of moral claims, (Gibbard, p. 26; Sen, pp. 9–10). Welfare economics has of course been criticised; I wish merely note the close relationship some of its central tenets have to the invisible hand argument. [5]

Current uses of the invisible hand, especially by business people who attribute it to Adam Smith, tend to use the moral corollary of the argument to justify the morality of pursuing self-interest. I refer again to the European study that found that 60% of senior managers interviewed on ethical issues referred to the invisible hand. Part III of this paper will examine just what the moral corollary of the argument is, but first it is necessary to return to Smith and deal with a major problem with attributing the invisible hand argument to him.

II. Smith's opinion of merchants and manufacturers

Attributing the invisible hand argument to Smith seems straightforward and uncontentious, until one reads the rest of *The Wealth of Nations* and discovers passages that appear to undermine the whole idea of the invisible hand and thus of its moral corollary. The most forceful of these passages is the following:

> The interests of this third order [those who live by profit], therefore, has not the connection with the general interest of society as that of the other two [labourers and landlords]. . . . The proposal of any new law or regulation of commerce which comes from this order [those who live by profit], ought always to be listened to with great precaution, and ought never to be adopted till after having been long and carefully examined, not only with the most scrupulous, but with the most suspicious attention. It comes from an order of men, whose interest is never exactly the same with that of the publick, who have generally an interest to deceive and even to oppress the publick, and who accordingly have, upon many occasions, both deceived and oppressed it. (WN I.xi.p.8–10)

It seems clear from this passage that Smith thinks the pursuit of their own interests by merchants and manufacturers (in other words, business people and presumably corporations) does *not* lead to a promotion of the public interests; indeed, he thinks their interests generally conflict with the public's interest, which leads them in pursuing their own interests "to deceive and even to oppress the publick". Curiously, this conflict applies only to the interests of merchants and manufacturers, business people who earn their living from profit, but not to labourers or landlords:

> The interests of the first of those three great orders [the landlords], it appears from what has been just now said, is strictly and inseparably connected with the general interests of society. . . . The interests of the second order, that of those who live by wages, is as strictly connected with the interests of society as the first. . . . The interests of this third order [those who live by profit], . . . has not the same connection with the general interest of society as that of the other two. (WN I.xi.p.8–10)

Throughout WN I.xi.p and elsewhere, Smith argues that landlords and labour benefit from rising total revenue in society, and that their interests are therefore identical with the public good. On the other hand, "It is the natural effect of improvement . . . to diminish the real price of almost all manufactures" (I.xi.o.1). Because of this, the interests merchants and manufacturers are inherently opposite to the public good.

The interest of business people, we now see, is to deceive and oppress the rest of society. If business people pursue their own interests, the interest of the general public will suffer. Where does this leave the empirical claim of the invisible hand argument, let alone the moral corollary? Is Smith inconsistent?

A. *Labourers, landlords and merchants*

Firstly, as noted, it is the interests of only the merchants and manufacturers which conflict with general good of society; labourers and landlords, if they pursue their true self-interest, promote the good of society. Should the invisible hand argument therefore be applied only to landlords and labourers and not to business people?

This is certainly not what Smith intends, for in the invisible hand passage, and in other similar passages, he makes it clear that he is talking about the pursuit of self-interest by maximizing the return on invested capital, an activity primarily in the hands of the merchants and manufacturers. In the invisible hand passage quoted near the start of this paper, the key phrases are:

> every individual . . . endeavours . . . to employ his capital . . . and so to direct that industry [i.e. capital] that its produce may be of the greatest value, . . . (WN IV.ii.9)

The invisible hand sentence itself repeats the phrase "by directing that industry in such a manner as its produce may be the greatest value." Smith is clearly talking about people investing their capital to obtain maximum profit, and investing capital is the very activity which defines merchants and manufacturers as an order of society.

Smith would not want to confine the invisible hand argument only to merchants and manufacturers; his views on the free movement of labour geographically and between industries would seem to indicate that it also applies to workers who seek to maximise their wages; and invisible hand passage in the *Theory of Moral Sentiments* explicitly applies it to landlords. However, since the interests of labour and of landlords are identical with the public good, it is only with merchants and manufacturers (whose interests conflict with the public good) that Smith seems to be contradicting his own invisible hand theory. The rest of this section, therefore, deals only with merchants and manufacturers.

B. *Individual and aggregate group interest*

One possible solution to the apparent contradiction comes from noting that the main passage in support of the invisible hand talks in terms of "every individual," and says (note the singular pronoun) "he intends only his own gain." The main passage that claims that business people's interests conflict with society's refers to them not individually, but as an "order of men." Would it be possible that their individual interests support, but their group interests conflict with, the general interests of society?

This, however, will not do. It draws a distinction between individuals and "orders of men" that Smith in fact explicitly refers to on more than one occasion, but he does so with the opposite intent to that which is required here. Smith's empirical claim about the invisible hand is based on the observation that people do in fact pursue their own interests; and that we should rely on this motive for our bread and meat more than any other (WN I.ii.2).

But Smith is also aware that not everyone all the time can be relied on to pursue their own interests; they may not have the information or the understanding, especially if they are labourers (WN I.xi.p.9), or they may be too indolent and "incapable of that application of mind" (WN I.xi.p.9), especially if they are landlords. Or they may be imprudent or silly. However, this imprudence of certain individuals does not affect the cumulative result because in aggregate, the effect will be determined by the prudent majority:

> . . . though the principles of common prudence do not always govern the conduct of every individual, they always influence the majority of every class or order. (WN II.ii.36, also WN II.iii.27).

It is the aggregated interests of individuals that makes the invisible hand work. But it is the aggregated interests of the merchants and manufacturers which he says oppresses society.

I have been using the words 'group' (or 'order of men') and 'aggregated', and studiously avoiding the phrase 'class interests' for good reason. Smith frequently used terms like 'landlords' and 'merchants and manufacturers' to refer to social groups, but his concept of group interests was the aggregate of the interests of the members of the group.

The concept of class interests is different from this. Class interests allows the possibility that one course of action may be in the best interests of each individual in the class if they act on their own, but a different course of action is in the interests of the class as a whole. To go looking for this concept of class interests (and class consciousness) in Smith's writings is to commit the error that Winch warned about (p. 165) – the error of seeking comments on nineteenth (and twentieth) century political debates in an eighteenth century writer.

In aggregate, merchants and manufacturers are the people we can most rely on to pursue their own interests; they are the least likely to be lazy, ignorant, or imprudent. I conclude, therefore, that the apparent contradiction between the invisible hand and the oppressive interests of the merchants and manufacturers cannot be resolved by the distinction between individual and aggregated group interests. Nor can the concept of class interests be attributed to Smith.

C. *Resolution of the contradiction*

Instead, I will argue that the consistency between the invisible hand argument and the desire of merchants and manufacturers to oppress society depends on the invisible hand argument referring only to a very narrowly defined form of pursuing one's own interests. To see the consistency, we need to return to the point mentioned above, that the invisible hand argument applies to the investment of capital for maximum profit. The passages apply it only to the investment of capital (Macfie 1967, pp. 101 and 103). On the other hand, when Smith says that the interests of the merchants and manufacturers are served by oppressing society, he is referring to their interest in having monopolies, restrictive trade practices, price fixing conspiracies, and constraints on labour organizations. In general, merchants and manufacturers seek restrictions on the natural freedom of all people to openly and equally compete; in other words, restrictions on the free market.

In support of this interpretation of oppression as seeking restrictions on free markets, one could almost footnote *The Wealth of Nations*, passim. But, in particular, Book I, Ch. x, Part II deals with how corporations of traders and manufacturers combine to restrict wages, and how the poor law has a disruptive effect on the movement of labour. Most of Book IV deals with restrictions on foreign trade – import duties and prohibitions, bounties, drawbacks, and restrictions on trade with colonies. Merchants benefit from these restrictions, and they vehemently oppose a policy of free trade which would do away with them, though such a free trade policy would greatly benefit society in general:

> Not only the prejudices of the public, but what is much more unconquerable, the private interests of many individuals, irresistibly oppose it [freedom of trade]. (WN IV.ii.43).

Free trade benefits society in general, regulation benefits particular individuals; the invisible hand cannot function when merchants and manufacturers pursue or defend regulation rather than profits in a free market.

Smith refers to restrictions on the free market in general as monopolies, and his scathing passages criticizing merchants and manufacturers for pursuing their own interests at the expense of society have to do with merchants and manufacturers seeking monopolies. For example, within a few pages, he talks of the "wretched spirit of monopoly" (WN IV.ii.21), and complains of "the sophistry of merchants and manufacturers who are always demanding a monopoly against their countrymen." (WN IV.ii.38). A hint of personal resentment comes through when he remarks on the

> "zeal and unanimity with which master manufacturers set themselves against every law that is likely to increase the numbers of their rivals in the home market; . . . or to diminish in any respect the monopoly which our manufacturers have obtained *against us*." (WN IV.ii.43; emphasis added).

This resentment is not so much due to personal cost, but to the insolence of the merchants and manufacturers.

In short, merchants and manufacturers benefit society when they invest their capital for maximum profit; they harm society when they combine to form monopolies, or when they deceive legislators into granting monopolies to them.

This conclusion is not very surprising; the invisible hand only works if there is a free market, and monopolies are by definition restrictions on the free market. The important point is that for Smith, it is generally in the interest of merchants and manufacturers to disrupt free markets to the detriment of society. The pursuit of their private interests is *not* in the general interests of society. If this is true, then neither the strong nor the weak forms of the moral corollaries follow from the invisible hand argument.

III. Moral implications of the invisible hand

Many people currently use Smith's invisible hand argument to morally justify greed, avarice, and the unbridled pursuit of money. Can Smith be used in this fashion? This resolves into two questions: first, can Smith's concept of the invisible hand be applied to current economic reality in a way that moral conclusions can be drawn from it? Second, what are these moral conclusions? It is the purpose of this part of the paper to show that the actions morally justified by the invisible hand are much more restricted than many who use it think.

A. *The current applicability of Smith's invisible hand*

The current moral use of Smith's invisible hand rests on three assumptions which need to be stated clearly before the moral corollary can be examined.

First, defenders of any moral corollary of the invisible hand must assume that the empirical version of the invisible hand argument is correct; they must assume that in a free market, if all investors try to maximize their return on investments (subject to risk), then the total revenue of society will be maximized. It must also be assumed that maximizing the total revenue of society is in the general interests of society or the public good; Smith uses these phrases interchangeably. That free markets will maximize total revenue is not normally now defended by economists. Welfare economics instead talks in terms of optimal use of resources to achieve Pareto optimal production. However, if the invisible hand achieves only Pareto optimality and not maximum total revenue, then the second part of this assumption becomes more difficult to make. One can perhaps assume that maximized revenue is a public good, but Pareto optimality tells us little. Pareto optimality is consistent with both grossly unequal distribution and sub-maximum total revenue. Depending on initial endowments, there are an infinite number of Pareto optimal outcomes, all of which are themselves Pareto non-comparable; welfare economics can provide no moral reason for any one of them to be preferred (Broadway and Bruce, p. 4). Drawing the moral corollary seems to require Smith's stronger claim about maximum revenue.

Note also that this assumption is restricted to individuals maximising their return on investment. In other respects, especially in seeking restrictions on the free market, the interests of merchants and manufacturers conflict with the general interests of society. This must be accepted by the invisible hand's modern defenders because it is essential to Smith's view; since the invisible hand can only function in free markets, any actions which disrupt free markets cannot be justified by the invisible hand. Smith also thought that such disruptive actions are in fact in the interests of business people; the behaviour of modern business people indicates they think this too.

Smith also advanced the perhaps now contentious view that only the interests of merchants and manufacturers conflicted with the public good, and that the since landlords and labour benefited when the total revenue of society was increasing, the interests of those two groups were always identical with the public good (above, p. 14). This section will confine the discussion to business people; the application of the invisible hand argument to landlords and labour would be too lengthy, but more to the point, it is not as important in this section because the invisible hand is seldom if ever used today to justify morally the pursuit of self-interest by labour and landlords.

Second, to make this a moral discussion, we must make explicit the moral assumption that underlies the invisible hand based justification of greed; namely, that it is morally permissible to act in any way which promotes the general interests of society. Possibly one needs to add the constraint that there should be no over-riding moral reasons which, in particular cases, conflict with self-interest; but I will not look at this constraint further. Note also that I will discuss only the weak form of the moral corollary, that is, that one is morally permitted to pursue self-interest, not that one is obliged to. The strong form complicates the discussion, and is seldom maintained, although it could be argued that Friedman accepts a version of it.

Finally, those who use the invisible hand argument as the basis for moral claims are generally applying it to behaviour in our current society. They are assuming that the current economic system in North America is close enough to a Smithian free market that the moral corollary of the invisible hand ought to guide behaviour in contemporary society.

Accepting for the sake of argument these assumptions of the invisible hand's defenders, we now ask: which sorts of self-interested behaviour can be morally justified? And which cannot? Let us examine several typical types of actions of merchants and manufacturers in more detail. In each case, I will endeavour to give Smith's comments on that type of behaviour, and will also indicate the types of behaviour in the modern business world which would seem to be similar.

B. *Investing for profit*

The most obvious case of justified self-interest is that merchants are morally permitted to invest to maximize their profits. But a closer reading of Smith puts a severe constraint on even this. In context, the invisible hand argument clearly states that only if business people invest in their own country will the invisible hand maximise revenue. Must this restriction apply to the moral use of Smith's theory today? It would be a major restriction given the current international mobility of capital.

There are two reasons Smith restricted investment to one's own country. First, because "the industry of the society [ie. nation] can augment only in proportion as its capital augments" (WN IV.ii.13; also .12), he thought such a restriction would maximise the total revenue of a nation, and he was, of course, enquiring into "The Nature and Causes of the Wealth of Nations".

That the debate should be cast in national terms had already been determined by mercantilists and physiocrats. Second, Smith restricted investment to one's own nation because the invisible hand could only function within a free market of goods, capital and labour, and there was no international free market. Smith's defence of free trade was an argument in favour of such a market, but he had no hopes of its being established, (WN IV.ii.43). The overall argument of *The Wealth of Nations* implies that if an international free market could be established in goods, labour, and capital, then the same-nation restriction would be lifted on capital investment.

In today's world, we may be closer to an international free market in goods, and for all practical purposes we have free movement of capital, but labour movement across national boundaries is tightly restricted. Therefore, a free market does not exist internationally, the invisible hand cannot operate internationally to maximize global revenue, and so the same-nation restriction should still apply.

It may be thought that another question needs asking: is it moral to prefer the public good of one's own country over the public good of global society? It would be difficult to defend any moral theory which gave moral preference to one national group (even one's own) over other people. However, this question is irrelevant to the same-nation restriction on capital investing. Because international free markets do not exist today, the invisible hand cannot work on an international level, and hence cannot be used to justify investing abroad. Where international markets do exist, such as in the EEC, then the same-nation restriction would apply to the extended free market, not to the old national boundaries. Smith's argument implies this, and his attitude to Scotland, which had united with the rest of Britain only a few years before Smith was born, is clearly that it was to be seen as an economic unit with the rest of Britain. The same-nation restriction is really a restriction on investing in the same free market area, however widely that free market be extended. The moral corollary of the invisible hand in this respect must follow the invisible hand's ability to function.

C. *Colluding and combining*

The second conclusion that follows from our premises is that merchants and manufacturers are not justified by the invisible hand in pursuing their interests by combining with each other, explicitly or tacitly, to restrict trade, form monopolies, lower wages, or raise prices. That Smith thinks merchants and manufacturers have a habit of doing this is clear:

> People of the same trade seldom meet together even for merriment or diversion, but the conversation ends in a conspiracy against the publick, or in some contrivance to raise prices. (WN I.x.c.27)

This is explicit conspiracy to fix prices. It is, of course, now illegal in most countries, but that hardly stops it. In the oil industry, for example, Marshall Clinard suggests that "Price-fixing appears to be Big Oil's way of life." (Clinard, p. 39).

Smith also talks of tacit collusion amongst merchants and manufacturers, especially when discussing how they reach agreement on keeping wages down:

> Masters are always and every where in a sort of tacit, but constant and uniform combination not to raise the wages of labour above their actual rate. (WN I.viii.13).

Tacit agreement, especially with respect to pricing, is taught in many MBA courses today. Marketing courses teach that price wars are to be studiously avoided, which is to recommend tacit agreements, (Beckman, p. 329; Schnaars, p. 105). Some say the entire point of modern marketing is to avoid competition based on price, (Schnaars, p. 4).

D. *Monopolistic competition*

Not all non-price competition involves tacit agreements, but some other forms of non-price competition disrupt the invisible hand and so cannot be morally justified using that basis. The point to much advertising is to create monopolistic competition that allows abnormal margins by replacing price competition by familiarity, image, fear, guilt, sexual fantasizing, etc. Other tactics can be used to keep competition from being based on price. Control of technology and standards are used in the computer industry. Consider how IBM, Compaq, and Apple fought furiously to keep personal computers from being a price based commodity. There is an argument for extending the invisible hand of the free market from competition based solely on price, to competition based on such things as quality, availability, or design. Smith generally talks only in terms of price competition; he says, for example, ". . . it always is, and must be the interest of the great body of people to buy whatever they want of those who sell it cheapest." (NW IV.iii.c.10) Probably he would have agreed with these sorts of extensions, and he might not have seen them as an extensions at all. The question I am briefly raising is whether all forms of modern marketing (for example, fear advertising or attempts to control technical standards) are really in the best interests of society; that is, are they all compatible with the invisible hand? Will the invisible hand work if we extend price competition to other forms of competition? It has not been shown by Smith or his contemporary defenders that it will.

E. *Monopolies*

Smith despised monopolies. More than anything else, monopolies show the conflict between the general interests of society and the private interest of merchants and manufacturers.[6] For Smith, there were various ways of achieving monopolies. Governments granted them to companies such as the East India or Royal African companies, tariffs and trade prohibitions gave local merchants a monopoly in home markets, merchants in Britain had a monopoly on most colonial trade, and, as already dealt with, merchants and manufacturers explicitly or tacitly collude to form monopolies.

Since monopolies conflict with the general interest of society, the pursuit of them cannot be morally justified by the invisible hand argument. In North America today, governments supposedly do not give out monopolies, except in businesses where it is thought competition will not function (such as local telephone service); those monopolies they do allow are carefully regulated. Also, there are laws against colluding, and companies that dominate their industries live in constant fear of anti-trust suits. Consider the fate of AT&T, and the court battles of IBM or K. C. Irving.

There are other business practices common today which, though perhaps not illegal, cannot be considered morally innocent. Some business people attempt to create monopolies by market power – consider the attempt of the Hunt family to corner the world's silver market. The Hunts were pursuing their self-interests within a free market and yet trying to achieve a result clearly not in the best interests of society as a whole.

Another way of achieving a monopoly is buying out the competition. In 1984, after several years of stiff competition, Harlequin bought out Simon & Schuster's Silhouette, their main and only serious competitor. ("Harlequin Enterprises Limited", p. 3). Since then, Harlequin has had a worldwide dominance in the market for romance novels which, though not a total monopoly, is close to one. Harlequin, needless to say, is very profitable. Granted, their only defense in keeping their market position is the good business practice of serving their customers, and further they do not appear to be in violation of any law. Harlequin is, moreover, a highly moral company; for example, they withdrew a profitable business from one country rather than pay bribes to government officials (Galloway). But the question we need to ask is: is this market dominance in the interests of society, or at least that portion of society that reads Harlequins? Smith would say that the customers had been better off when there was stiff competition with Silhouette based on price, quality, and distribution. The pursuit of market dominance by acquisition was in the interests of Harlequin, but not in the interest of society. The invisible hand argument would not justify pursuing the company interests in this case. This does not mean it is immoral; it only says that it has not yet been shown to be permissible.

F. *Lobbying*

Another way that modern businesses pursue their self-interests is by lobbying governments for, amongst other things, trade barriers, tax exemptions, subsidies, development grants, bailouts, export subsidies, and loan guarantees. Scandals over illegal political contributions and government-industry collusion indicate that companies do more than lobby in the pursuit of their interests. All of these activities are in the interests of corporations, but all of them place restrictions on the free market. Hence here too the pursuit of their own interests by business people conflicts with the general interests of society. The activity of lobbying government by business is not in the general interest, and so this particular form of self-interested activity is not justified by the invisible hand argument.

Smith would agree with this. All self-interested lobbying of government by merchants and manufacturers he sees as an attempt to "deceive and oppress" society (WN I.xi.p.10). We can say 'all' because for Smith the interests of society and of merchants and manufacturers are in fundamental conflict; capitalists are "an order of men, whose interest is *never* exactly the same with that of the public, . . ." (WN I.xi.p.10, emphasis added).[7]

Some people today would agree with Smith; here is the *Economist's* advice to the newly elected president of the United States:

> As he prepares for government, the most important thing for Mr. Clinton to do is curb his appetite for advice. Least of all should he listen to businessmen. For perfectly understandable reasons, they want just one thing from government: preference. ("After the Market", p. 13)

None of this lobbying pursuit of self-interest can be justified by the invisible hand.

Conclusion

Adam Smith did advance an argument closely resembling the invisible hand argument frequently attributed to him by business people today; however, he only advanced the empirical form of the argument, he did not draw any moral conclusions from it. He thought that in a free market economy, individuals each investing capital to maximise their profits (and also choosing employment to maximise their wages), would lead to the general good of society. The constant drive of most people to improve their economic and social condition provided the incentive for individuals to direct their economic activities towards wealth production, and this ultimately would increase the overall wealth of society.

But the nature of this argument must be noted closely; it applies only to economic activities such as investing capital. It does *not* apply to the pursuit of self-interest in general, or to the pursuit of self-interest in any area outside of economic activities. Smith thought the general pursuit of self-interest by business people in particular was in fundamental conflict with the public good, and he thought that if business people successfully pursued their interests in other areas, the results would be disastrous. In particular, if business people pursued their self-interest in the political arena, they would only seek the overthrow of the free market system for their own benefit and everyone else's loss. Smith had nothing but contempt for a nation governed by shopkeepers (WN IV.vii.e.63).

Smith did not feel the need to draw moral conclusions from the invisible hand argument because his view of natural liberty made it redundant. However, that does not mean that contemporary business people are in error when they use Smith to support a moral belief. If the empirical version of the invisible hand argument is accepted as true, and if we add a common utilitarian moral premise, one can in fact draw from it the moral conclusion that the pursuit of self-interest is morally permissible. However, the invisible hand argument does not justify all self-interested actions. It is very, very restrictive; all it says is that it is permissible to invest one's money in one's own country so as to maximize the return. If one uses the general good of society as a criterion for establishing moral permissibility, which the moral version of the invisible hand argument does, then from Smith's analysis of how the free market works it follows that pursuing one's self-interest by seeking monopolies, investing in safe havens abroad, combining tacitly or explicitly, cornering a market, or lobbying government in any form, are not morally justified.

But before ending this article, one more comment on Adam Smith's beliefs about self-interest is called for. We have been equating the pursuit of self-interest with the constant drive people have (according to Smith) to try to improve their social and economic condition. In fact, he says this drive is founded on an illusion. Smith thinks neither wealth nor social prestige will increase anyone's happiness. The drive to improve one' condition is only self-interested because of a false belief about what is truly in one's interest.

> If we consider the real satisfaction which all these things ['the palaces and economy of the great'] are capable of affording, . . . it will always appear in the highest degree contemptible and trifling. But we rarely view it in this abstract and philosophical light. . . . The pleasures of wealth and greatness, when considered in . . . [a more natural or normal] view, strike the imagination as something grand and beautiful and noble, of which the attainment is well worth all the toil and anxiety which we are so apt to bestow on it.
>
> And it is well that nature imposes upon us in this manner. It is this deception which rouses and keeps in continual motion the industry of mankind. (TMS IV.i.9–10)

It is not self-interest that the invisible hand caresses into the public good, but the illusion of self-interest.

Notes

[1] This article is a greatly expanded version of Trent University Administrative Studies Working Paper 92-02 entitled "Insolent Merchants and the Invisible Hand; Adam Smith's Justification of Self-interest in *The Wealth of Nations*". I would like to thank students and colleagues (especially D. Newhouse, D. Torgerson, and J. Wearing) for comments and suggestions, Frank Rotering for extremely useful criticisms, and Knud Haakonssen for bibliographic information.

[2] All references to Smith's writings are to the Glasgow Edition (Oxford University Press; and Liberty Press, Indianapolis). Numbers refer to book, part, chapter, section (as appropriate) and paragraph. Abbreviations: TMS = *Theory of Moral Sentiments*; WN = *The Wealth of Nations*.

[3] For discussions of Smith's views on scientific theory, and the relation of these views to his moral theories, see Raphael, 1979, passim, and Campbell, Part I. Campbell discusses the invisible hand on pages 60–62, and self-interest on pages 64–66.

[4] The invisible hand passage in the *Theory of Moral Sentiments* reads as follows:

> The capacity of his [the proud and unfeeling landlord's] stomach bears no proportion to the intensity of his desires, and will receive no more than that of the meanest peasant. The rest he is obliged to distribute among those, who prepare, in the nicest manner, that little he himself makes use of, among those who fit up the palace in which this little is to be consumed, among those who provide and keep in order all the different baubles and trinkets, which are employed in the economy of greatness; all of whom derive from his luxury and caprice, that share of the necessities of life, which they would in vain have expected from his humanity or his justice. The produce of the soil maintains at all times nearly that number of inhabitants which it is capable of maintaining. 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 convenience, though the sole end which they propose from all the thousands which they employ, be the gratification of their own vain and insatiable desire, 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 necessities of life, which would have been made, had the earth been divided into equal proportions among all its inhabitants, and thus without intending it, without knowing it, advance the interests of society . . . (TMS IV.i.10)

[5] Outside of academia, the invisible hand argument, especially in its moral form, is ubiquitous. For some examples from the *Economist*, see "Who cares, Wins", Morgan, and "The Search for Keynes".

[6] One of the more powerful passages against those who seek or defend monopolies is as follows:

> That it was the spirit of monopoly which originally both invented and propagated this doctrine

[of tariffs and trade barriers], cannot be doubted; and they who first taught it were by no means such fools as they who believed it. In every country it always is, and must be the interest of the great body of people to buy whatever they want of those who sell it cheapest. The proposition is so very manifest, that it seems ridiculous to take any pains to prove it; nor could it ever have been called in question, had not the interested sophistry of merchants and manufacturers confounded the common sense of mankind. Their interest is, in this respect, directly opposite to that of the great body of the people. (WN IV.iii.c.10)

[7] Smith's description of merchants lobbying is worth quoting in full:

> Such as they were, however, those arguments [about restrictions on trade] convinced the people to who they were addressed. They were addressed to parliaments, and to the councils of princes, to nobles and to country gentlemen; by those who were suppose to understand trade, to those who were conscious to themselves that they knew nothing of the matter. That foreign trade enriched the country, experience demonstrated to the nobles and country gentlemen, as well as to the merchants; but how, or in what manner, none of them well knew. The merchants knew perfectly well in what manner it enriched themselves. It was their business to know it. But to know in what manner it enriched the country, was no part of their business. This subject never came into their consideration, but when they had some occasion to apply to their country for some change in the laws relating to foreign trade. (WN IV.i.10)

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