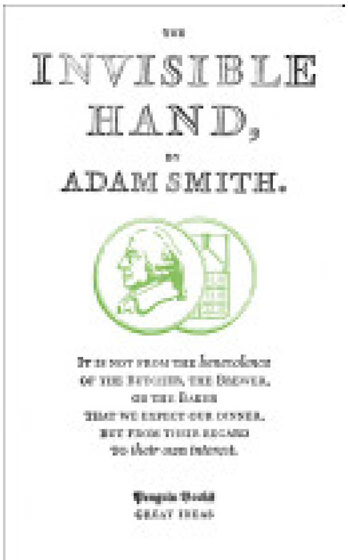

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Man Alone with Himself , Friedrich Nietzsche, Aug 7, 2008, Philosophy, 96 pages. Friedrich Nietzsche was one of the most revolutionary thinkers in Western philosophy. Here he sets out his subversive views in a series of aphorisms on subjects ranging from ....

In economics, the invisible hand of the market is a metaphor conceived by Adam Smith to describe the self-regulating behavior of the marketplace.[1] The exact phrase is used just three times in Smith's writings, but has come to capture his important claim that individuals' efforts to maximize their own gains in a free market benefits society, even if the ambitious have no benevolent intentions. Smith came up with the two meanings of the phrase from Richard Cantillon who developed both economic applications in his model of the isolated estate.[2]

He first introduced the concept in The Theory of Moral Sentiments, written in 1759. In this work, however, the idea of the market is not discussed, and the word "capitalism" is never used.[3] By the time he wrote The Wealth of Nations in 1776, Smith had studied the economic models of the French Physiocrats for many years, and in this work the invisible hand is more directly linked to the concept of the market: specifically that it is competition between buyers and sellers that channels the profit motive of individuals on both sides of the transaction such that improved products are produced and at lower costs. This process whereby competition channels ambition toward socially desirable ends comes out most clearly in The Wealth of Nations, Book I, Chapter 7.

The idea of markets automatically channeling self-interest toward socially desirable ends is a central justification for the laissez-faire economic philosophy, which lies behind neoclassical economics.[4] In this sense, the central disagreement between economic ideologies can be viewed as a disagreement about how powerful the "invisible hand" is. In alternative models, forces which were nascent during Smith's life, such as large-scale industry, finance, and advertising, reduce its effectiveness.[5]

The proud and unfeeling landlord views his extensive fields, and without a thought for the wants of his brethren, in imagination consumes himself the whole harvest ... [Yet] the capacity of his stomach bears no proportion to the immensity of his desires ... the rest he will be obliged to distribute among those, who prepare, in the nicest manner, that little which 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 thus derive from his luxury and caprice, that share of the necessaries of life, which they would in vain have expected from his humanity or his justice...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...

Elsewhere in The Theory of Moral Sentiments, Smith has described the desire of men to be respected by the members of the community in which they live, and the desire of men to feel that they are honorable beings. While Smith does not mention these social pressures in the above-cited discussion of the invisible hand, one might infer that the selfish and proud landlord hires servants in order to feel himself respected, and displays his wealth in a fine palace in order to gain the respect of others. In this sense, the invisible hand is in its first stage, a sort of system of social pressure that persuades the wealthy to do, of their own volition, what the society around them requires.

Adam Smith uses the metaphor in Book IV, chapter II, paragraph IX of The Wealth of Nations. In the often misquoted and poorly understood paragraph quoted below, Smith argues that a preference for the use of "domestic" industry over "foreign" industry to gain individual profit constitutes an "invisible" and benevolent hand that promotes the interests of the nation and society at large, while at the same time enriching the individual:

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. Nor is it always the worse for the society that it was not part of it. By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it. I have never known much good done by those who affected to trade for the public good. It is an affectation, indeed, not very common among merchants, and very few words need be employed in dissuading them from it.

The concept of the "invisible hand" is nearly always generalized beyond Smith's original discussion of domestic versus foreign trade. Milton Friedman, a Nobel Prize winner in economics, called Smith's Invisible Hand "the possibility of cooperation without coercion."[6] Kaushik Basu has called the First Welfare Theorem the Invisible Hand Theorem.[7]

The theory for the Invisible Hand states that if each consumer is allowed to choose freely what to buy and each producer is allowed to choose freely what to sell and how to produce it, the market will settle on a product distribution and prices that are beneficial to all the individual members of a community, and hence to the community as a whole. The reason for this is that self-interest drives actors to beneficial behavior in a case of serendipity. Efficient methods of production are adopted to maximize profits. Low prices are charged to maximize revenue through gain in market share by undercutting competitors. Investors invest in those industries most urgently needed to maximize returns, and withdraw capital from those less efficient in creating value. All these effects take place dynamically and automatically.[citation needed]

Some economists question the integrity of how the term "invisible hand" is currently used. Gavin Kennedy, Professor Emeritus at Heriot-Watt University in Edinburgh, Scotland, argues that its current use in modern economic thinking as a symbol of free market capitalism is not reconcilable with the rather modest and indeterminate manner in which it was employed by Smith.[8] In response to Kennedy, Daniel Klein argues that reconciliation is legitimate. Moreover, even if Smith did not intend the term "invisible hand" to be used in the current manner, its serviceability as such should not be rendered ineffective.[9] In conclusion of their exchange, Kennedy insists that Smith's intentions are of utmost importance to the current debate, which is one of Smith's association with the term "invisible hand". If the term is to be used as a symbol of liberty and economic coordination as it has been in the modern era, Kennedy argues that it should exist as a construct completely separate from Adam Smith since there is little evidence that Smith imputed any significance onto the term, much less the meanings given it at present.[10]

The one case in which he referred to the â€˜invisible handâ€™ was that in which private persons preferred the home trade to the foreign trade, and he held that such preference was in the national interest, since it replaced two domestic capitals while the foreign trade replaced only one. The argument of the two capitals was a bad one, since it is the amount of capital that matters, not its subdivision; but the invisible sanction was given to a Protectionist idea, not for defence but for employment. It is not surprising that Smith was often quoted in Parliament in support of Protection. His background, like ours today, was private enterprise; but any dogma of non-intervention by government has to make heavy weather in The Wealth of Nations.[11]

Economists have taken this passage to be the first step in the cumulative effort of mainstream economics to prove that a competitive economy provides the largest possible economic pie (the so-called first welfare theorem, which demonstrates the Pareto optimality of a competitive regime). But Smith, it is evident from the context, was making a much narrower argument, namely, that the interests of businessmen in the security of their capital would lead them to invest in the domestic economy even at the sacrifice of somewhat higher returns that might be obtainable from foreign investment. . . .

David Ricardo . . . echoed Smith . . . [but] Smith's argument is at best incomplete, for it leaves out the role of foreigners' investment in the domestic economy. It would have to be shown that the gain to the British capital stock from the preference of British investors for Britain is greater than the loss to Britain from the preference of Dutch investors for the Netherlands and French investors for France."[12]

The invisible hand is not a power that makes the good of one the good of all, and it is not any of a number of other things it is said to be. It is simply the inducement a merchant has to keep his capital at home, thereby increasing the domestic capital stock and enhancing military power, both of which are in the public interest and neither of which he intended. Smith's exposition discloses how his rhetorical sallies could disfigure his economics, confuse his argument for free trade, and make him play fast and loose with facts and the ideas of others. . . . [T]here is little or no support in what Smith wrote that can substantiate the interpretations it has been given, thus offering another example of how the words of a great man can mean different things to his readers and can be made into something that he himself would not recognize.[13]

Smith uses the metaphor in the context of an argument against protectionism and government regulation of markets, but it is based on very broad principles developed by Bernard Mandeville, Bishop Butler, Lord Shaftesbury, and Francis Hutcheson. In general, the term "invisible hand" can apply to any individual action that has unplanned, unintended consequences, particularly those that arise from actions not orchestrated by a central command, and that have an observable, patterned effect on the community.

Lord Shaftesbury turned the convergence of public and private good around, claiming that acting in accordance with one's self-interest produces socially beneficial results. An underlying unifying force that Shaftesbury called the "Will of Nature" maintains equilibrium, congruency, and harmony. This force, to operate freely, requires the individual pursuit of rational self-interest, and the preservation and advancement of the self.

Francis Hutcheson also accepted this convergence between public and private interest, but he attributed the mechanism, not to rational self-interest, but to personal intuition, which he called a "moral sense." Smith developed his own version of this general principle in which six psychological motives combine in each individual to produce the common good. In The Theory of Moral Sentiments, vol. II, page 316, he says, "By acting according to the dictates of our moral faculties, we necessarily pursue the most effective means for promoting the happiness of mankind."

Contrary to common misconceptions, Smith did not assert that all self-interested labour necessarily benefits society, or that all public goods are produced through self-interested labour. His proposal is merely that in a free market, people usually tend to produce goods desired by their neighbours. The tragedy of the commons is an example where self-interest tends to bring an unwanted result.

Moreover, a free market arguably provides numerous opportunities for maximizing one's own profit at the expense (rather than for the benefit) of others. The tobacco industry is often cited as an example of this: the sale of cigarettes and other tobacco products certainly brings a very good revenue, but the industry's critics deny that the social benefits (the pleasures associated with smoking, the camaraderie, the feeling of doing something "cool") can possibly outbalance the social costs.[citation needed]

Since Smith's time, the principle of the invisible hand has been further incorporated into economic theory. LÃ©on Walras developed a four-equation general equilibrium model that concludes that individual self-interest operating in a competitive market place produces the unique conditions under which a society's total utility is maximized. Vilfredo Pareto used an edgeworth box contact line to illustrate a similar social optimality.

The invisible hand is traditionally understood as a concept in economics, but Robert Nozick argues in Anarchy, State and Utopia that substantively the same concept exists in a number of other areas of academic discourse under different names, notably Darwinian natural selection. In turn, Daniel Dennett argues in Darwin's Dangerous Idea that this represents a "universal acid" that may be applied to a number of seemingly disparate areas of philosophical inquiry (consciousness and free will in particular). See also Social Darwinism.

If preachers have not yet overtly identified themselves with the view of the natural man, expressed by an eighteenth-century writer in the words, trade is one thing and religion is another, they imply a not very different conclusion by their silence as to the possibility of collisions between them. The characteristic doctrine was one, in fact, which left little room for religious teaching as to economic morality, because it anticipated the theory, later epitomized by Adam Smith in his famous reference to the invisible hand, which saw in economic self-interest the operation of a providential plan... The existing order, except insofar as the short-sighted enactments of Governments interfered with it, was the natural order, and the order established by nature was the order established by God. Most educated men, in the middle of the [eighteenth] century, would have found their philosophy expressed in the lines of Pope:

Naturally, again, such an attitude precluded a critical examination of institutions, and left as the sphere of Christian charity only those parts of life that could be reserved for philanthropy, precisely because they fell outside that larger area of normal human relations, in which the promptings of self-interest provided an all-sufficient motive and rule of conduct. (Religion and the Rise of Capitalism, pp. 191â€“192.)

Noam Chomsky argues that Smith (and more specifically David Ricardo) used the phrase to mean a "home bias" for investing domestically in opposition to outsourcing production and neoliberalism. In this interpretation, Smith meant that merchants in the act of "preferring the support of domestic to that of foreign industry" as if "led by an invisible hand", benefited society.[16][17]

In The Theory of Moral Sentiments (1759) and in The Wealth of Nations (1776) Adam Smith speaks of an invisible hand, never of the invisible hand. In The Theory of Moral Sentiments Smith uses the concept to sustain a "trickling down" theory, a concept also used in neoclassical development theory: The gluttony of the rich serves to feed the poor.

The rich â€¦ 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 [emphasis added] 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. When Providence divided the earth among a few lordly masters, it neither forgot nor abandoned those who seemed to have been left out in the partition. These last too enjoy their share of all that it produces. In what constitutes the real happiness of human life, they are in no respect inferior to those who would seem so much above them. In ease of body and peace of mind, all the different ranks of life are nearly upon a level, and the beggar, who suns himself by the side of the highway, possesses that security which kings are fighting for (emphasis added).[19]

Smith's visit to France and his acquaintance to the French Ã‰conomistes (known as Physiocrats) changed his views from micro-economic optimisation to macro-economic growth as the end of Political Economy. So the invisible hand in The Theory of Moral Sentiments is denounced in the

Wealth of Nations as unproductive labour. Walker, the first president (1885 to 92) of the American Economic Association, concurred:

The domestic servant â€¦ is not employed as a means to his master's profit. His master's income is not due in any part to his employment; on the contrary, that income is first acquired â€¦ and in the amount of the income is determined whether the servant shall be employed or not, while to the full extent of that employment the income is diminished. As Adam Smith expresses it "a man grows rich by employing a multitude of manufacturers; he grows poor by maintaining a multitude of menial servants."[20]

Smith's theoretical U-turn from a micro-economical to a macro-economical view is not reflected in The Wealth of Nations. Large parts of this book are retaken from Smith's lectures before his visit to France. So one must distinguish in The Wealth of Nations a micro-economical and a macro-economical Adam Smith. Whether Smith's quotation of an invisible hand in the middle of his work is a micro-economical statement or a macro-economical statement condemning monopolies and government interferences as in the case of tariffs and patents is debatable.

Adam Smith, the father of modern economics, is often cited as arguing for the "invisible hand" and free markets: firms, in the pursuit of profits, are led, as if by an invisible hand, to do what is best for the world. But unlike his followers, Adam Smith was aware of some of the limitations of free markets, and research since then has further clarified why free markets, by themselves, often do not lead to what is best. As I put it in my new book, Making Globalization Work, the reason that the invisible hand often seems invisible is that it is often not there. Whenever there are "externalities"â€”where the actions of an individual have impacts on others for which they do not pay, or for which they are not compensatedâ€”markets will not work well. Some of the important instances have long understood environmental externalities. Markets, by themselves, produce too much pollution. Markets, by themselves, also produce too little basic research. (The government was responsible for financing most of the important scientific breakthroughs, including the internet and the first telegraph line, and many bio-tech advances.) But recent research has shown that these externalities are pervasive, whenever there is imperfect information or imperfect risk marketsâ€”that is always. Government plays an important role in banking and securities regulation, and a host of other areas: some regulation is required to make markets work. Government is needed, almost all would agree, at a minimum to enforce contracts and property rights. The real debate today is about finding the right balance between the market and government (and the third "sector" â€“ governmental non-profit organizations.) Both are needed. They can each complement each other. This balance differs from time to time and place to place.[22]
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