Journal of the History of Economic Thought, Volume 22, Number 1, 2000

MAKING SENSE OF ADAM SMITH'S INVISIBLE HAND: BEYOND PARETO OPTIMALITY AND UNINTENDED CONSEQUENCES

BY

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I. INTRODUCTION

Smith explicitly spells out the term "invisible hand" in only three texts, each in a different work. What is embarrassing to neoclassical welfare theory is that these explicit references have little to do with what came to be understood by the metaphor. In particular, the explicit reference to the invisible hand in *The Wealth of Nations* (*WN*) is not about the efficiency of the market in allocating resources. Rather, it is about, ironically, how impediments in the international capital market generate great benefits.

Adam Smith's notion of the invisible hand, probably his best legacy for social theory and public policy, has gone through many transformations at the hand of economists. The paper takes issue with two interpretations of the invisible hand. As currently used by neoclassical economists, the invisible hand signifies the first welfare theorem, i.e., competitive equilibrium guarantees (under some strict conditions) Pareto optimality. The invisible hand metaphor is also used by social scientists, especially by followers of Friedrich Hayek's spontaneous order (see Khalil 1997a), to denote the phenomenon of unintended consequences, such as the advancement of the public good via the pursuit of private gain.

The paper offers an alternative interpretation. For Smith, the invisible hand is rather identical to what he calls on many occasions the "wisdom of Nature." It is true that Smith employs the term loosely and sometimes confusingly. The confusion arises from the twin meaning of the word "nature." In some contexts the word denotes the natural world or its creator—as opposed to the artificial world created by man. In this sense, the wisdom of nature is the same as the wisdom of the Author of nature, God. In other contexts the word "nature" expresses human nature and decisions based on sentiments which rather have far-reaching benefits. The paper does not distinguish the two meanings and

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ISSN 1042-7716 Print; ISSN 1469-9656 Online/00/010049-15

probably, for Smith, the two are fused if we consider human nature and sentiments to be part of the natural world.

If we disregard the reference to the author of nature, however, Smith's wisdom of nature signifies a much neglected phenomenon in modern decision theory. Many human decisions are prompted by passions, immediate gratifications, and emotions—which are the bread-and-butter of economists. However, what amazed Smith is that such passions and sentiments engender far-reaching benefits. This observation is well-known to students of Smith. What is not recognized, and what the paper shows, is that, for Smith, the connection between the immediate sentiment and the far-reaching benefit is not accidental. The invisible hand, as interpreted here, amounts to the idea that there is a connection, although vaguely sensed by the decision maker, between sentiments, ranging from admiration of the rich to love of country, and far-reaching consequences, such as political stability. The apotheosis of this proposed interpretation of Smith's invisible hand as about the wisdom of nature is the sexual drive. The drive connects copulation and procreation—a phenomenon which fascinated Smith (*TMS*, I.ii.1.2).[1] The connection might have been explicit in the past, or the mind is not sharp enough to reveal what is sensed intuitively—an issue not discussed by Smith given that evolutionary biology was not part of the intellectual heritage of his time.

To understand the wisdom of nature one has to consult Smith's implicit discussions of the invisible hand in *The Theory of Moral Sentiments* (*TMS*) rather than focus on the three explicit references to the term. For Smith, the "wisdom of Nature" is not about a global teleology, where every element of the universe, animate and inanimate, is designed to act in a way which meets the goal of an external designer. Rather, Smith's teleology is of the intermediate range. For Smith, nature is wise in the sense that decision makers, which include for Smith non-human organisms, adopt behavior for a purpose. Such a teleology is not different from J.B. Lamarck's (1809; see Khalil 1993, 2000) notion of volition. What is invisible about the "wisdom of Nature" is that the connection between action and its full beneficial consequence can be ambiguous to the decision maker; i.e., the actor may not be explicitly or mentally aware of the far-reaching advantage of action.

To defend the proposed view, the paper commences with an exegetical analysis of the only three texts where Smith explicitly mentions the phrase "invisible hand." This analysis underlines what many students of Smith have already concluded: Smith's invisible hand differs from the neoclassical thesis about the efficiency of markets (the first welfare theorem). The rest of the paper focuses on the much-neglected difference between unintended consequences and the proposed invisible hand understood as about the wisdom of nature. Section two briefly distinguishes the two interpretations of the invisible hand. Section three sketches examples that support the proposed interpretation of the invisible

[1] All references are to The Glasgow Edition of the Works and Correspondence of Adam Smith, which identifies the book or part, chapter, section, and paragraph numbers. The abbreviations follow the ones suggested by The Glasgow Edition: *WN* for *The Wealth of Nations* (Smith 1776); *TMS* for *The Theory of Moral Sentiments* (Smith 1759–90); *EPS* for *Essays on Philosophical Subjects* (Smith 1795).

https://doi.org/10.1080/104277100112554 Published online by Cambridge University Press

hand as about the wisdom of nature. Section four focuses in detail on one example: how the sentiment of admiration of the rich and powerful gives rise to political order which is beneficial to human welfare. Before the conclusion, section five distinguishes the invisible hand problem from the issue of compatibility of human motives.

II. THREE TEXTUAL REFERENCES TO THE "INVISIBLE HAND"

The only appearance of the invisible hand metaphor in *The Wealth of Nations* is when Smith discusses the prosperity of the national economy and how it would not be impaired if free trade is allowed to reign. Ironically, Smith uses the issue of market imperfection to justify the working of the invisible hand:

> [E]very 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 domestick to that of foreign industry, he intends only his own security; and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention (*WN*, IV.ii.9).

Smith is arguing that free trade will not hurt the national economy because most investors would prefer the security of their domestic economy over foreign ones, even when the domestic economy provides a lower return relative to the foreign ones. It is clear that Smith is assuring his readers that investors, given that they are rational, have a bias toward the national economy because of lower risk, lower transaction costs, and so on. That is, all economies could have a uniform distribution of risk, while traders do not find them equivalent. Each trader finds, *ceteris paribus*, his national economy more attractive. To note, the fact that agents act rationally in favor of their national economy is not equivalent to the thesis that the outcome is allocatively efficient—especially when risk is distributed uniformally across countries. This distinction is based on the standard delineation between individual efficiency, which is always upheld by the well-known assumptions of the standard theory of choice, and market efficiency, which need not be guaranteed. The fact that agents act rationally does not mean the market outcome is optimal—as in the case of externalities, increasing returns to scale, rent seeking, and so on.

Of more importance, Smith is discussing the prosperity of, rather than the optimal allocation of resources within the national economy. The two concerns are not the same. The prosperity criterion involves value judgments about what to produce and how to distribute it among producers. In contrast, the Paretian criterion entails a technical judgment of defining the production possibility frontier with a given endowment. In addition, if the resources of a country are allocated efficiently *à la* Pareto, it does not mean that the country is prosperous. A poor country can satisfy the Pareto criterion, i.e., lie at the production possibility frontier, while a prosperous country can be inefficient from the

https://doi.org/10.1080/104277100112554 Published online by Cambridge University Press

standpoint of Pareto optimality. Certainly, institutional changes in poor countries may entail improvement. But it would not be Pareto improvement. This is similar to the fact that the discovery of a new resource may entail improvement, but not of the Pareto kind which supposes that constraints have not changed. The discovery rather involves pushing outward the production possibility frontier.

Lastly, Smith's text in *WN* does not lend a gentle hand to the modern efficiency logic. Ironically, Smith argues that the invisible hand works because of market frictions and *personal* biases which prevent the full flow of capital across national boundaries. In effect, the invisible hand protects the country with the lower profit rate because of biases against investment in foreign markets. In this manner, capital does not move to locations where it is most needed. Such a disequilibrium may not be characterized as Pareto-inefficient in case it arises from imperfect information which is part of the constraint set. Nonetheless, the misallocation of resources across nations nurtured by the invisible hand can hardly be an example of the wonder of the market mechanism.[2]

A more dramatic finding is that the explicit reference of the invisible hand in *WN* does not exemplify Smith's view of the invisible hand as exhibited especially in *TMS* as demonstrated below. The proposed interpretation finds that the invisible hand is about the wisdom of nature. It is not about unintended consequences—irrespective of how beneficial they are. In *WN*, it is true that love of security and gain guarantees that local capital would not totally flee a country when its rate of return is lower than the international rate. While self-interest can advance the national good, this is an argument about unintended consequences. As I interpret Smith's sense of the invisible hand below, it is not about unintended consequences, but rather about the wisdom of nature: how some far-reaching consequences are somehow, but vaguely, connected to immediate gratifications. The far-reaching result of reproduction with connection to the sexual drive serves as the exemplar of my understanding of Smith's sense of the invisible hand.[3]

The second explicit reference to the invisible hand, in *The Theory of Moral Sentiments*, fails to confirm the modern interpretation of the invisible hand as about Pareto optimality. It also fails to confirm the proposed interpretation below of the invisible hand as about the wisdom of nature. The reference appears when Smith discusses the problem of the distribution of the produce of land. For Smith, given the limits of the human stomach, the landlord cannot eat all the

[2] In other texts, Smith readily recognized the cases when public interest is not served by the pursuit of self-interest. To correct such market failures, he advocated government intervention. The cases of market failures are not reviewed here for the simple reason that the invisible hand, as reinterpreted here, is not mainly about market efficiency to start with. In any case, such cases have been amply exposed in a long stream of literature stretching from Jacob Viner (1926), Andrew Skinner (1979), Nathan Rosenberg (in O'Driscoll 1979), Joseph Persky (1989), Spencer Pack (1991), Richard Stone (1992), David Reisman (1998), to Keith Tribe (1999).

[3] Of course, one can theorize that sexual gratification is an end in itself, and maybe the reproductive function of sex appeared later in evolutionary history. But insofar as one proposes that reproduction is the ultimate end, one can use the sexual drive, as Smith did, as an exemplar of the invisible hand or the wisdom of nature.

produce of his land. This physical limitation induces him to share the surplus—in exchange for services—with the poor:[4]

> The rich only select from the heap what is most precious and agreeable. They consume little more than the poor, and in spite of their natural selfishness and rapacity, though they mean only their own conveniency, though the sole end which they propose from the labours of all the thousands whom they employ, be the gratification of their own vain and insatiable desires, they divide with the poor the produce of all their improvements. They are led by an invisible hand to make nearly the same distribution of the necessaries of life, which would have been made, had the earth been divided into equal portions among all its inhabitants, and thus without intending it, without knowing it, advance the interest of the society, and afford means to the multiplication of the species (*TMS*, IV.1.10).

To caution, such a usage of the invisible hand metaphor hardly entails that the poor would receive an adequate allotment of the fruits of the land. Smith fails to note that an adequate distribution depends on the terms of trade between the poor and the rich. Given the output, welfare depends on the number of poor people who have no access to land relative to the number of rich people. At best, the invisible hand metaphor here assures us that some of the dispossessed will not starve if the rich have food which surpasses the size of their stomachs.

Even if the terms of trade were favorable to the poor, the invisible hand metaphor in this text signifies the unintended consequence of limited stomachs, i.e., Engel's law and the development of services as income rises. The invisible hand metaphor here does not appear to be about the wisdom of nature: Limited stomachs could not have been adopted by decision makers in order to ensure that every member in the community does not go starving. However, if one interprets limited stomachs as another way of expressing the law of declining marginal utility, and hence related to sentiments, the invisible hand metaphor can be seen as about the wisdom of nature. In this sense, the diffusion of food can be interpreted as an insurance arrangement among agents who do not know *ex ante* who would end up being rich and who would end up being poor. The rich abide *ex post* by such an insurance arrangement because, acting on immediate gratifications, the passion for services offered by the poor exceeds the desire for food after some point.

The third and last explicit mention of the invisible hand is in his famous essay "The History of Astronomy," published posthumously in *Essays on Philosophical Subjects* (*EPS*). He employed it in connection with another issue, the appeal to Jupiter or other Gods to explain irregular events:

> Fire burns, and water refreshes; heavy bodies descend, and lighter substances fly upwards, by the necessity of their own nature; nor was the invisible hand of Jupiter ever apprehended to be employed in those matters. But thunder and

[4] Syed Ahmad (1990, p. 139) considers the physical limit of the stomach to be a fourth meaning, beside the three explicit ones, of the invisible hand—which explains the title of Ahmad's note. An invisible hand argument, however, requires that the agent acts according to some benefit which engenders a gain beyond the perceived benefit. Thus, the physical limitation of the stomach does not qualify as an instance of the invisible hand.

https://doi.org/10.1080/104277100112554 Published online by Cambridge University Press

> lightning, storms and sunshine, those more irregular events, were ascribed to his favour, or his anger (*EPS*, Astronomy.III.2).

Again, astonishingly (see Macfie 1971, pp. 595–96), the invisible hand of Jupiter as imagined by savages is not behind the order of nature, but rather is behind disorderly nature. That is, the invisible hand in this text is a capricious hand that stops and disturbs the regular order of cause and effect. Thus, this mention of the invisible hand neither confirms the neoclassical interpretation nor the proposed interpretation below. Although it is superficial, there is one connection between the explicit mention of the invisible hand in *EPS* and the proposed interpretation. Namely, the metaphor in *EPS* is related to the Deity, which Smith conceives as an absent landlord who can rely on the invisible hand to do his job.

In this light, Smith's three explicit references to the "invisible hand" do not add up to a unified notion. Maybe future research can unearth why Smith used the term in an inconsistent manner. Meanwhile, we can only work with the three texts, and these texts do not provide a uniform sense of the term. In any case, none of these references lends support to the modern understanding of the metaphor as about the first law of welfare economics. In fact, to unearth the meaning of the invisible hand, one should paradoxically disregard the three explicit references to the invisible hand and examine the implicit discussions of an invisible hand, especially in *TMS*. In these implicit discussions Smith is in awe of how long-term benefits are somewhat and vaguely connected to the apparently myopic motives. In these references Smith repeatedly alludes to the wisdom of the "Author of nature" who instills in us short-term concerns, which in fact are related to long-term and far-reaching benefits.

III. WISDOM OF NATURE VERSUS UNINTENDED CONSEQUENCES

The phenomenon of unintended consequences of action (see Merton 1936) does not coincide with Smith's invisible hand as about the wisdom of nature. Examples of unintended consequences include self-defeating laws such as the alcohol prohibition in the USA in the 1920s, collapse of four empires that took part in World War I, negative campaigning which may back-fire on the campaigner, self-fulfilling prophecy in stock market panic, the reversal of misfortunes of a president because of terrorism or foreign war, and so on. Another example, which Smith furnishes, concerns how love of security prevents the full outflow of national capital, as seen earlier. Another illustration, also from Smith, is how the propensity to exchange engenders unintentionally the advantages of division of labor:

> This division of labour, from which so many advantages are derived, is not originally the effect of any human wisdom, which foresees and intends that general opulence to which it gives occasion. It is the necessary, though very slow and gradual consequence of a certain propensity in human nature which has in view no such extensive utility; the propensity to truck, barter, and exchange one thing for another (*WN*, I.ii.1).

To start with, there is no reason why unintended consequences must be

https://doi.org/10.1080/104277100112554 Published online by Cambridge University Press

beneficial. In contrast, the invisible hand understood as wisdom of nature, there is a reason why the far-reaching consequences are usually beneficial. Namely, there is a connection, although vaguely apparent to the actor, between the immediate goal and the long-term well being of the actor. Stated differently, in the case of unintended consequences the actor is totally ignorant of the consequences or, if aware, he cares very little about them. In the case of the invisible hand as wisdom of nature, while the actor is mainly motivated by the immediate sentiment or passion, such a passion is somewhat connected, either vaguely or intuitively, to the far-reaching beneficial consequence about which the actor also cares.

For a consequence to be an invisible hand problem as understood here, the long-term outcome, and not only the immediate gratification, must be desired by the actor. For example, the political order which arises from the admiration of the successful is related, although nebulously, to the motive of the actor, viz., to see successful men in positions of authority. Similarly, the greater sympathy people have toward the needs of children relative to the elderly is somewhat, although not explicitly, connected to the idea that children have greater potential than the elderly. Likewise, while the actor acts on sexual appetites, he also desires the raising of children who are the outcome of the sexual appetites.

While self-interest can advance the public good, which is not necessarily an axiom, this is an argument about unintended consequences rather than about the wisdom of nature. The wisdom of nature, as this paper interprets Smith's sense of the invisible hand, is evident when far-reaching consequences are somehow, but vaguely, connected to the set of incentives. Again, the sexual appetite with respect to reproduction may serve as the exemplar of the invisible hand. In contrast, when agents truck and barter, they are exclusively motivated by the extra gain. Agents may become aware of the unintended consequence of such an exchange, i.e., the furthering of the division of labor. Nonetheless, such awareness would not make the consequences part of the set of their incentives or desires, even in the vague sense. Stated differently, the actor may have his wise or foolish reasons to behave in a particular way. For such a behavior to be called an instance of the invisible hand, the "unforeseen" benefit must also be connected to the desires of the actor.

IV. SOME ILLUSTRATIONS OF THE "WISDOM OF NATURE"

To support the proposed interpretation, we need to examine closely *The Theory of Moral Sentiments*. This book abounds with illustrations of the "wisdom of Nature." To mention a few, Smith notes the wisdom behind the asymmetry of affection between the parent and the child: The parent has greater affection toward the child than *vice versa* (*TMS*, III.3.13; VI.ii.1.3). He argues that such an asymmetry is beneficial for the reproduction of human society. In addition, Smith observes that sympathy with the pain or with the anger of an injured person is usually weaker than the original anger. This relative weakness prompts the angry person to tone down his anger to let others to sympathize with him (*TMS*, II.i.5.8). Although such a moderation of anger is mainly prompted by the

https://doi.org/10.1080/104277100112554 Published online by Cambridge University Press

desire to receive sympathy, it is beneficial for the agitated person since it brings him back to his senses.

Further, Smith maintains that failures in the natural course of sentiments and events justify the intervention of "general rules" (*TMS*, III.4.3). Such rules act as norms that make behavior consistent over time, i.e., not the subject of mood fluctuations and sudden coldness of temper. Also, general rules act to prevent agents from falling into "self-deceit" in the sense of hiding from themselves the injustices of their emotional outbursts (*TMS*, III.4.6). In addition, general rules are needed to ensure the distribution of income according to merit, i.e., as natural events would dictate if left to themselves (*TMS*, III.5.9–10). To note, Smith stresses that these general rules are not imposed on humans as external commandments. Rather, they arise from everyday experiences and judgments (*TMS*, III.5.3). In fact, Smith conceives religions as simply further articulations of rudimentary general rules (*TMS*, III.5.4–7).

In addition, Smith finds wisdom behind the limited capacity to sympathize with the misfortune of others. Since we are not usually in a position to alleviate the observed misfortune, what is the use of greater sympathy (*TMS*, III.3.7)? Moreover, Smith justifies the asymmetry of emotions towards injustice and unkindness: While humans feel furious toward injustice, they only feel resentful of selfishness in the sense of unkindness and lack of beneficence. For Smith, while human society can subsist without kindness, it cannot subsist without justice (*TMS*, II.ii.3; see Khalil, 1998). Further, Smith defends the class biasness of our views of the public interest: It checks the tendency towards constant and irresponsible innovations; i.e., class biasness provides continuity in political affairs (*TMS*, VI.ii.2.10). Smith also defends man's desire to receive the praise of others—even though he dedicates a chapter ridiculing vanity and the pursuit of praise (*TMS*, III.2). Such a desire could correct one's excessive self-evaluation of one's ability (*TMS*, III.2.28).

As these examples illustrate, the invisible hand notion signifies the suitability of sentiments and their unintended, beneficial outcomes. Such sentiments may range from love of praise-worthiness, love of children, to altruism and self-love. However, the best exemplification of the work of the invisible hand, which Smith detailed the most, is how the simple sentiment of admiration occasions political order.

V. ADMIRATION: THE INVISIBLE ORIGIN OF POLITICAL ORDER

Smith notes that the "great disorder in our moral sentiments" originates from the high regard people feel toward fortune. Such a deformed admiration usually engenders aggrandizement and obsequiousness (Khalil 1996; see Hueckel 1998, pp. 219–20). However, if admiration is geared towards the ranking of ability, rather than fortune and actual possessions, it would express a normal, agreeable sentiment. Such an agreeable sentiment is acceptable because it expresses the burning drive of ambition to attain a higher station.

The drive to improve one's condition is a healthy occupation and, in fact, defines what it means to be alive. Smith observes that the abandonment of such

a drive, and the contentment with a station which is lower than what one is capable of, is "worse than death" for many mortals:

> For to what purpose is all the toil and bustle of this world? what is the end of avarice and ambition, of the pursuit of wealth, of power, and preheminence? Is it to supply the necessities of nature? The wages of the meanest labourer can supply them. We see that they afford him food and clothing, the comfort of a house, and of a family. If we examined his oeconomy with rigour, we should find that he spends a great part of them upon conveniences, which may be regarded as superfluities, and that, upon extraordinary occasions, he can give something even to vanity and distinction. What then is the cause of our aversion to his situation, and why should those who have been educated in the higher ranks of life, regard it as worse than death, to be reduced to live, even without labour, upon the same simple fare with him, to dwell under the same lowly roof, and to be clothed in the same humble attire? Do they imagine that their stomach is better, or their sleep sounder in a palace than in a cottage? The contrary has been so often observed, and, indeed, is so very obvious, though it had never been observed, that there is nobody ignorant of it (*TMS*, I.iii.2.1).

Smith's argument is straightforward. Given the ambitious desire of a higher station, one naturally admires agents who have the ability to attain the desired station. Such an admiration for Smith, as Glenn Hueckel (1998, pp. 218–19) records, is not motivated by the utility which one may gain from the admired person. It rather stems from the love of perfection, which the admired seems to approximate. The admiration turns into a more rigid status structure when some agents realize that their ability is limited and, hence, the desired station is not within their reach. In case economic dependency develops between low-status and high-status agents, the admiration turns into allegiance in the sense of political subordination. The invisible hand is at work here: The connection, which usually escapes the consciousness of agents, is between the ambition drive which they try to entertain, on one side, and the hidden end, i.e., political subordination which occasions political order, on the other.

Smith uncovers the connection when he notes that the wisdom of God—euphemism for the invisible hand—works through admiration, the "folly of man," to afford political order:

> Fortune has in this … great influence over the moral sentiments of mankind, and, according as she is either favourable or adverse, can render the same character the object, either of general love and admiration, or of universal hatred and contempt. This great disorder in our moral sentiments is by no means, however, without its utility; and we may on this, as well as on many other occasions, admire the wisdom of God even in the weakness and folly of man. Our admiration of success is founded upon the same principle with our respect for wealth and greatness, and is equally necessary for establishing the distinction of ranks and the order of society (*TMS*, VI.iii.30).

While the "foolish admiration" of success allows low-rank agents to imagine themselves in the higher station, it facilitates subordination to superiors:

> By the admiration of success we are taught to submit more easily to those superiors, whom the course of human affairs may assign to us; to regard with

> reverence, and sometimes even with a sort of respectful affection, that fortunate violence which we are no longer capable of resisting; not only the violence of such splendid characters as those of a Caesar or an Alexander, but often that of the most brutal and savage barbarians, of an Attila, a Gengis, or a Tamerlane. To all such mighty conquerors the great mob of mankind are naturally disposed to look up with a wondering, though, no doubt, with a very weak and foolish admiration. By this admiration, however, they are taught to acquiesce with less reluctance under that government which an irresistible force imposes upon them, and from which no reluctance could deliver them (*TMS*, VI.iii.30).

To wit, Smith dedicates a chapter to the rise of rank in society (*TMS*, I.iii.2). Smith starts with the spontaneous sentiment of the admiration of high-rank agents:

> The man of rank and distinction … is observed by all the world. Every body is eager to look at him, and to conceive, at least by sympathy, that joy and exultation with which his circumstances naturally inspire him. His actions are the objects of the public care. Scarce a word, scarce a gesture, can fall from him that is altogether neglected (*TMS*, I.iii.2.1).

Upon such admiration, the political order of society is based:

> Upon this disposition of mankind, to go along with all the passions of the rich and the powerful, is founded the distinction of ranks, and the order of society. Our obsequiousness to our superiors more frequently arises from our admiration for the advantages of their situation, than from any private expectations of benefit from their good-will … We are eager to assist them in completing a system of happiness that approaches so near to perfection; and we desire to serve them for their own sake, without any other recompense but the vanity of the honour of obliging them. Neither is our deference to their inclinations founded chiefly, or altogether, upon a regard to the utility of such submission, and to the order of society, which is best supported by it (*TMS*, I.iii.2.3).

In another chapter, the respect of the rich and powerful, rather than the relief of the misery of the misfortunate, is the basis of political order in society:

> The distinction of ranks, the peace and order of society, are, in a great measure, founded upon the respect which we naturally conceive for the former [the rich and powerful]. The relief and consolation of human misery depend altogether upon our compassion for the latter [the poor and wretched]. The peace and order of society, is of more importance than even the relief of the miserable. Our respect for the great, accordingly, is most apt to offend by its excess; our fellow-feeling for the miserable, by its defect. Moralists exhort us to charity and compassion. They warn us against the fascination of greatness (*TMS*, VI.ii.1.20).

Smith continues and argues that our fascination with the rich and misfortunate at the expense of the wise and virtuous is *not* totally misguided:

> This fascination, indeed, is so powerful, that the rich and the great are too often preferred to the wise and the virtuous. Nature has wisely judged that the distinction of ranks, the peace and order of society, would rest more securely upon the plain and palpable difference of birth and fortune, than upon the

> invisible and often uncertain difference of wisdom and virtue. The undistinguishing eyes of the great mob of mankind can well enough perceive the former; it is with difficulty that the nice discernment of the wise and the virtuous can sometimes distinguish the latter. In the order of all those recommendations, the benevolent wisdom of nature is equally evident (*TMS*, VI.ii.1.20).

In other words, given that people may have different opinions about whom has the greatest wisdom or virtue, political order would be unstable if it was based on such intangible criteria. But the political order would be more stable if based on tangible criteria such as wealth and power where there is less disagreement. The myopic admiration of the rich and powerful affords order without any *ex ante* clear intent on the part of agents. In short, the set of human motives and sentiments afford a consequence which is not explicitly part of the set.

VI. THE INVISIBLE HAND VERSUS THE PROBLEM OF COMPATIBILITY OF MOTIVES

To appreciate further the proposed sense of the invisible hand, a clarification is in order. Smith's invisible hand in the sense of wisdom of nature entails that whatever is the motive, the far-reaching consequence is somehow connected to the motive. The motive can be altruism, self-interest, love of country, attainment of political power, pride, honor, and so on. As such, the invisible hand should not be confused with another issue, viz., the centrality of private pursuits, rather than benevolence, in securing cooperation as expressed in Smith's famous statement:

> 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).

To note, Smith is not highlighting something unique about market-oriented societies. One can hardly find any society where exchange is solely based on benevolence. The *quid pro quo* system is not exclusive to market-oriented societies. In pre-capitalist and in traditional societies—where the gift system rather than the market dominated the mechanism of exchange—agents still behaved primarily according to self-interest, as they do in market-oriented societies. The difference is that in traditional societies the gift played a more complicated and pivotal role than in modern societies. In traditional societies, agents used the gift as part of an intricate system of reciprocity. Besides its other familiar roles, the gift acted as a loan where the recipient was expected to reciprocate. Although such a function does not exclude the use of the gift to solidify social cohesion and loyalty, this function cannot be sustained without the regard to self-interested ends (Kollock 1994; Khalil 1997b).

The confounding of the invisible hand with the issue of how cooperation harmonizes and advances self-interest stems from the failure of commentators to realize that the supposed Adam Smith Problem involves *two* separate problem areas. The confusion of the two problems is not limited to nineteenth-century

https://doi.org/10.1080/104277100112554 Published online by Cambridge University Press

scholars (Oncken 1897) who found *WN* and *TMS* as inconsistent. It is also common among many twentieth-century students of Smith who generally see the two books as congruous (Viner 1928; Taylor 1960, p. 78; Brown 1991; Evensky 1987, 1993).

The first, dubbed the "compatibility problem," involves the apparent incompatibility of *WN*, which stresses self-interest, and *TMS*, which stresses sympathy.[5] This problem involves the conception of human motivations and the extent of their compatibility and, hence, does not concern this paper. The second problem, coined the "orderliness problem," concerns the issue of the invisible hand, whose solution is the focus of this paper. The orderliness problem involves another apparent inconsistency. Namely, Smith celebrated the working of the invisible hand. But he also envisioned a role for the State beyond the security of property and the enforcement of justice (see Khalil 1998). As alluded to earlier, Smith invoked general rules in order to redistribute income in ways which nature would have preferred. Also, the large literature on Smith has uncovered the variety of roles that the State plays in the regulation of the economy (e.g., Viner 1928; Rosenberg 1979).[6]

To stress the difference between the two apparent Adam Smith Problems, the orderliness problem persists even if agents behave exclusively according to beneficent sentiments and public spiritedness. In this case, agents act according to sympathetic sentiments and passions and, hence, it would not entail that economic order, the rule of law, and public prosperity are ensured. Also, if people act exclusively according to public spiritedness, they may disagree on what is the public interest, which may generate political anarchy.[7]

I concur with modern students of Smith, from Overton Taylor to Jerry Evensky, who unmask the supposed Adam Smith Problem and do not see *WN* and *TMS* as incongruous. However, the congruity thesis should be based on the compatibility of motivation issue rather than on the invisible hand. Namely, as I proposed elsewhere (Khalil 1990), sympathy should not be equated with

[5] As argued elsewhere (Khalil 1990), the compatibility problem disappears once one realizes that "sympathy" is not only a motivation to assist others but also a method of occupying an impartial station from which one can also sympathize with his own circumstance or welfare. In this sense, for Smith, there is no difference between the pursuit of the interest of the self and the interest of agents about whom the self cares.

[6] Jacob Viner (1928) added a twist to the orderliness problem when he read the world in *TMS* to be harmonious, while in *WN* to be beset with anarchy and conflict. A.L. Macfie (1967, ch. 6) has argued the opposite: he viewed *TMS* to be engulfed with strife, while *WN* is propagated with harmony. Both readings suppose that Smith's invisible hand assumes that order means harmony, which is not the case.

[7] Interestingly, Smith insightfully states that public interest is better protected if we do not have most people eagerly interested in public spiritedness:

> Nor it is always the worse for society that it [public end] was not part of it [human motive]. 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 publick good. It is an affectation, indeed, not very common among merchants, and very few words need be employed in dissuading them from it (WN IV.ii.9).

This observation is elaborated by Sir James Steuart on the ground that too much public spiritedness may stir passion and political discord (Steuart 1767, p. 222).

altruism. Such an equation is the source of the presumed opposition of altruism and self-interest and, corollary, the assumed opposition of Smith's two books. Rather, for Smith, sympathy is the basis of both altruistic acts and self-interested acts. Sympathy is the basis of self-interest when the agent finds it valid and even dutiful to be sympathetic with his own well-being. This issue about compatibility of motives has little to do with the invisible hand problem, the focus of the essay.

VII. CONCLUSION

Smith's invisible hand differs from the notion of Pareto optimality arising from the Arrow-Debreu economy of competitive equilibrium (e.g., Hahn 1982). This should not imply that Pareto optimality is misguided or of a lesser consequence than Smith's invisible hand. The claim here is rather more modest. Each kind of invisible hand simply deals with a different problem.

It is embarrassing to find that the only mention of the term "invisible hand" in *The Wealth of Nations* actually signifies how market impediments guarantee social tranquility, which is contrary to the efficiency dictated by competitive markets. The two other explicit employments of the term have little to do with Pareto efficiency. The full meaning of Smith's invisible hand has to be gleaned from texts, mostly in *The Theory of Moral Sentiments*, where Smith did not employ the term explicitly. In these texts, Smith wonders about the "wisdom of Nature" in the sense of the suitability of mundane sentiments to their beneficial outcomes, even when agents are not fully conscious of the connection between the two. Smith's teleological theory is of the intermediate kind. It attributes purpose only to the decision-maker. It does not attribute purpose to every element of the universe.

To illustrate the "wisdom of Nature," the paper focused on Smith's discussion of the ramification of the sentiment of admiration toward a desired rank. Smith argues that the admiration of the rich, or any other rank, stems from the admirer's ambition to attain such a rank. The ambition turns into respect and maybe allegiance once the admirer realizes his inability to become rich or whatever is the coveted goal. The respect allows the agent a glimpse, via imaginative sympathy, of the wonder of attaining such a desired but unattainable stage. In this case, Smith simply unravels the ultimate psychological basis of political order. Such order simply stems from the frustrated ambition of humans. As such, the connection between the drive, viz., ambition, and the consequence, the authority of the state, lies in the nature of being an agent struggling to attain greater and greater terrains. Such a trait is endemic and universal.

Smith's invisible hand revolves around the question of order. The question became central to social theory once Vico's thesis—viz., the affairs of men are made by men and not by gods—was taken seriously (Khalil 1997a). To understand Smith's invisible hand, the paper clarified that the issue is not about the object of action, i.e., whether it is motivated by self-interest or altruism. Rather, given the motivation, the issue is whether the agent is entering into a symmetrical exchange, as typified by the market, or into

an asymmetrical contract of submission, as typified by the polity, in the sense of political authority and its subjects. The admiration of higher rank is not a political contract by itself. However, it is the basis upon which agents may surrender a part of their autonomy to the statesman or entrepreneur, which in effect builds an organization with a unified goal. While Smith used the notion of the invisible hand to discuss a variety of sentiment-outcome connections, it can be the basis to articulate a theory about the political order.

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