

On the other (invisible) hand ...

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Abstract

The invisible hand as it appears in the *Theory of Moral Sentiments* is commonly treated as an afterthought in discussions of the version in the *Wealth of Nations*, but it deserves attention in its own right. I will argue that there is an entirely coherent (if not entirely plausible) economic argument underpinning the invisible hand of the *Theory of Moral Sentiments*. It is quite different from the invisible hand argument of the *Wealth of Nations*, not because of any conflict but because they address different questions. The argument in the *Theory of Moral Sentiments* allowed Smith to maintain an ironic distance from the inequality and greed that he saw around him while arguing that it did no harm, and allowed him to resolve, at least to his own satisfaction, an age-old debate about the ethical and political consequences of luxury consumption. Some of these themes were further developed in the *Wealth of Nations*, but without the phrase 'invisible hand', which was switched to a different part of the argument.

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Introduction

Adam Smith only used his most famous phrase, the ‘invisible hand’, three times: once in a non-economic context in an early, unpublished work on the history of astronomy;² once, this time in an economic context, in his first major work, the *Theory of Moral Sentiments*; and once (only once) in the *Wealth of Nations*. The invisible hand as it appears in the *Theory of Moral Sentiments* is commonly mentioned as an afterthought (if at all) in discussions of the version found in the *Wealth of Nations*, but it deserves attention in its own right.

The chronology of Smith’s works is important here. The *Theory of Moral Sentiments* was published in 1759, seventeen years before the *Wealth of Nations*. The invisible hand argument as presented in the earlier work must have been intended to stand alone. There is no question of any forward reference (‘as I will show in a work which I have not yet started to write’). However, Smith revised the *Theory of Moral Sentiments* extensively in the last years of his life, after writing the *Wealth of Nations*, but did not choose to make any significant change to the invisible hand passage, suggesting strongly that he saw no conflict between the two. The fact that he used the phrase only once in each book (and once in a quite different context in the unpublished *History of Astronomy*) strongly suggests that he did not regard it as a specific concept to be defined and re-used, but as a vivid phrase, used for emphasis. In both his main works, he an ‘invisible hand’ ensures that self-interested behaviour serves socially desirable ends, but the mechanism is quite different. In both works he writes of ‘an’ (not ‘the’) invisible hand. This paper is about the argument in the *Theory of Moral Sentiments* that leads up to the phrase. It does not claim to discover some metaphysical entity called ‘the invisible hand’.³

I will argue that there is an entirely coherent (if not perhaps entirely plausible) economic argument underpinning the invisible hand of the *Theory of Moral Sentiments*. It is quite different from the invisible hand argument of the *Wealth of Nations*, not because they are in conflict but because they address different questions. In the *Wealth of Nations*, Smith used the phrase at a key point in his critique of the ‘mercantile system’. In the *Theory of Moral Sentiments* he used it for emphasis in his attempt to resolve an age-old debate about the ethical, political and economic effects of luxury consumption. The argument as he presented it allowed him to maintain an ironic distance from the inequality and greed that he saw around him while arguing that ‘selfishness and rapacity’ (TMS 184)⁴ did no harm and that the temptations of luxury, however ‘contemptible and trifling’ they seem to a philosopher, play an essential role in economic and political development. These themes were further developed in the *Wealth of Nations*, but the phrase ‘invisible hand’ itself was switched to a different part of the argument.

I will first sketch the context of the debate over ‘luxury’ and show how Smith approached it rather indirectly with his claim that the pleasures of wealth were deceptive. I will then be in a position to outline the invisible hand argument as it appears in the *Theory of Moral Sentiments*, and identify the implicit assumptions Smith relied on. I will compare it briefly with the invisible hand argument of the *Wealth of Nations* and show how the issues raised in the *Theory of Moral Sentiments* reappear in the later work. Unless otherwise stated, the invisible hand discussed here is always that of the *Theory of Moral Sentiments*.

² In classical antiquity, suprising or miraculous events were ascribed to the gods, but regular and predictable events were not ascribed to the ‘invisible hand of Jupiter’ (1980 49).

³ It is sometimes convenient to write ‘the invisible hand of the *Theory of Moral Sentiments*’, but only as a shorthand for ‘the argument presented in the *Theory of Moral Sentiments* which contains the phrase, “an invisible hand”’.

⁴ Smith’s main works are cited as TMS (1976a) and WN (1976b).

Luxury

The invisible hand passage in the *Theory of Moral Sentiments* is couched in deliberately loaded language. Despite his 'natural selfishness and rapacity', the 'proud and unfeeling landlord' is led by his 'luxury and caprice' to 'advance the interest of society' (TMS 184–5). His eighteenth-century readers would have recognized immediately that Smith was responding to a debate over 'luxury' which went back (literally) thousands of years but 'probably reached its highest peak in British history in the years 1756–63' (Sekora 1977 66), that is, just when the *Theory of Moral Sentiments* was completed and published.

To modern ears the word 'luxury' is fairly bland and positive (if often misused by advertisers), but it was not so in the eighteenth century. For more than two millennia, luxury (or its equivalent in other languages) had been a derogatory term with a wide and rather ill defined meaning.

Plato is a good starting point. He argued that the basic necessities of life are few – simple clothing (but even that only in winter), a plain vegetarian diet, and so on. A community which adopted a simple life could be small, self-sufficient, and free of conflict. On the other hand, a desire for consumption beyond bare necessities opened the way to a potentially unlimited variety of luxuries, hence to trade, the use of money, and an unlimited desire to accumulate wealth. A luxurious city would be 'fevered' and uncontrollable (*Republic*, Bk 2). Greek and Roman philosophers, historians, and moralists followed his lead in condemning luxury, as did Christian writers, from Augustine in the fifth century to Aquinas in the thirteenth century. Chaucer wrote about the 'foule lust of luxurie' and Shakespeare used the word 'luxury' sixty times, almost always negatively, often associated with lust and sexual depravity (Sekora 1977 46–7).

In this now largely forgotten tradition, the word 'luxury' implies moral condemnation of what was seen as a sort of addiction to consumption spending, novelty and fashion (think of words like 'lust', 'greed', and 'extravagance'). The evils that were said to follow from luxury were many and various, including corruption, softness, effeminacy, and military weakness. Sermons, of course, are not always effective and moralists could always find examples to condemn, but few spoke out in favour of luxury before the early modern period.

By the seventeenth and eighteenth centuries the world was changing, with growing trade, a wider range of goods, and a growing number of people able to afford at least modest luxuries. Luxury was flourishing as never before, and nowhere more so than in London, which was displacing Amsterdam as the primary centre of trade in Northern Europe.⁵ Small wonder that the old view came under fire. Barbon (1690), for example, echoed the distinction between limited needs and unlimited wants which goes back to Plato, but approved of the 'infinite' wants of the mind, which stimulate trade. 'Man naturally Aspires, and as his Mind is elevated ... his Wants increase with his Wishes, which is for every thing that is rare, can gratifie his Senses, adorn his Body, and promote the Ease, Pleasure, and Pomp of Life' (14).

Bernard Mandeville's *Fable of the Bees: Private Vices, Publick Benefits* (1988) was by far the best known (and most scandalous) contribution to this new literature. Mandeville's trick was to define virtue very narrowly – only behaviour guided solely by rational, impersonal ethical considerations counts as virtuous – and to argue that (almost) all human behaviour is self-interested and therefore counts as vice. Apparent examples of public spirit are explained by the desire for fame or the fear of shame. Any desire for consumption beyond bare necessities is defined as vice, but this vice is a 'publick benefit' because without it there would be no economic development, no trade, and so on. Keynes (1936, 359–62) read Mandeville as pointing towards a theory of effective demand. Alternatively, one could argue that people have no reason to earn more than they plan to spend, so a decline in luxury demand will be

⁵ Perhaps surprisingly, Holland did not produce a distinctive justification of luxury (De Vries 2003). That task was left to England.

matched by a corresponding decline in aggregate supply. Mandeville hinted at the latter, but did not argue it through. In particular, he had almost nothing to say about agriculture, the largest sector of the economy.

One (widespread) response to Mandeville was outrage – he was making excuses for vice. Another was to accept the substance of his argument but to deny that (moderate) luxury spending should be counted as a ‘vice’. This was the line taken by Montesquieu, Melon and Forbonnais in France and by Dr Johnson, Francis Huchison and David Hume in Britain (among others). Of those whose works are still remembered, Rousseau is an exception in that he substantially followed Mandeville but took the claim that commercial societies were immoral seriously. To Rousseau the savage lived a good life, while in a ‘civilized’ society ‘we have nothing but a deceitful and frivolous exterior, ... pleasure without happiness’ (cited by Smith 1980 253–4). Smith had reviewed Rousseau for the *Edinburgh Review* (1980 250–4), and may well have been, at least in part, responding to him in writing the invisible hand section of the *Theory of Moral Sentiments* (Ignatieff, 1984, 111–2; Schliesser, forthcoming).

It is tempting to assume that the argument against luxury had been refuted, at least in Britain. Heckscher, for example, in his classic study of mercantilism refers to a ‘deep rooted belief in the “utility of luxury”’ among mercantilist writers (1935 208), but a wider study of the eighteenth-century literature on luxury shows that the larger part of it was still in the traditional moralistic mould (Sekora 1977 111). Smith had to pick his way carefully if he was not to alienate his readership.

Smith’s treatment of luxury owed much to David Hume, who had argued, only a few years earlier, that agriculture could produce a surplus, in the sense that a given number of people working in agriculture could produce enough to feed themselves and more, but that the surplus would only be produced if there was some reason to do so. Farmers do not want to eat all they could produce but they (or the landlords) want to consume luxuries, thus creating jobs in manufacturing and services and also providing an incentive to maximize agricultural output (Hume 1752, Brewer 1997, 1998). Francis Hutcheson, Smith’s teacher, had previously hinted at a similar argument: if the land were equally divided and used only to produce luxuries, there would be ‘no knowledge of arts [and] no agreeable amusements or diversions’ (1726 139). Both Hutcheson and Hume restricted their criticism to spending beyond the individual’s means, but Smith seems not to have been entirely satisfied with this solution, given the huge inequalities in eighteenth-century Britain and the triviality of much luxury spending by the very rich.

Baubles and trinkets

The *Theory of Moral Sentiments* is a work of moral philosophy, concerned primarily with the judgements we make about our own and other people’s behaviour. In building up his argument Smith noted that we admire success and that the ‘great purpose of human life which we call bettering our condition’ is largely based on the desire to be admired. Never the less, the ostentatious life of the aristocracy clearly still puzzled him. Why should wealth be so desired?

He approached the question through a discussion of beauty, crediting Hume⁶ with the observation that things may seem beautiful because they are useful, and thus remind us of the pleasure they give. To give an example (mine, not Smith’s) a roaring fire may seem

⁶ To be exact, he did not name Hume, but credited ‘an ingenious and agreeable philosopher, who joins the greatest depth of thought to the greatest elegance of expression, and possesses the singular and happy talent of treating the abstrusest subjects not only with the most perfect perspicuity, but with the most lively eloquence’ (TMS 179).

beautiful because we remember (or anticipate) the pleasures of sitting by a warm fire on a cold day. Smith's key move was to extend the argument by claiming that things may seem beautiful (admirable, desirable) because they serve their purpose well, even if the purpose they serve is trivial. He claimed originality for this extension (which 'has not, so far as I know, been yet taken notice of by any body': TMS 180). His example was watches – people who are notoriously unpunctual may still pride themselves on having a very accurate and expensive watch.⁷ A modern equivalent might be someone who buys a powerful four-wheel drive vehicle to tackle the suburban streets and the supermarket car park.

He then took the argument a step further, generalizing it to cover the whole of what he called the 'oeconomy of greatness', the lifestyle of the great eighteenth century magnates with their country houses, armies of liveried servants, elaborate clothes, wigs, coaches, and all the rest of it. To Smith these were no more than 'baubles and trinkets', and guaranteed no real happiness. To drive the point home, he made up a little story about a poor but ambitious boy who struggles throughout his life to achieve real wealth but, having done so, looks back in old age and sees that it was pointless.

Smith knew that few would see it like that. We are seduced by the attractions of wealth, however illusory, and a good thing too.

The pleasures of wealth and greatness ... strike the imagination as something grand and beautiful and noble. ... 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. It is this which first prompted them to cultivate the ground, to build houses, to found cities and commonwealths, and to invent and improve all the sciences and arts, which ennoble and embellish human life. (TMS 183)

This is clearly, in modern usage, an invisible hand argument (though the phrase has yet to come). Note too that although Smith attached little value to individual wealth he clearly did not despise the results of development at the level of the system as a whole – the sciences and arts 'ennoble and embellish human life'.

The invisible hand

The invisible hand itself is only one of three surprising and important claims made in an astonishing, page-and-a-bit long, paragraph. The first of these is the claim, quoted already, that the delusive attractions of 'wealth and greatness' rouse 'the industry of mankind', changing 'the whole face of the globe' (TMS 183–4). The invisible hand argument itself follows, and the paragraph is rounded off with Smith's claim that unequal wealth does not affect human happiness (to be dealt with in the next section).

The invisible hand argument is presented in the longest, central, section of the paragraph. The key linking sentence refers specifically to the productivity of agriculture. 'The earth by these labours of mankind has been obliged to redouble her natural fertility, and to maintain a greater multitude of inhabitants' (TMS 184). An eighteenth-century reader would be well aware of the immense inequality in the ownership of land, so even if the land is capable of maintaining a 'multitude of inhabitants', what assurance is there that it will actually do so? Smith's argument deserves quoting at some length.

It is to no purpose, that the proud and unfeeling landlord views his extensive fields. ... The capacity of his stomach bears no proportion to the immensity of his desires, and will receive no more than that of the meanest peasant. The rest he is obliged to distribute

⁷ As Dava Sobel's *Longitude* (1996) has reminded us, accurate time-keeping was at the cutting edge of technology in the eighteenth century.

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 oeconomy 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 produce of the soil maintains at all times nearly that number of inhabitants which it is capable of maintaining. The rich ... consume little more than the poor, and in spite of their natural selfishness and rapacity, though they mean only their own conveniency ... they divide with the poor the produce of all their improvements. (TMS 184)

Smith did not flatter the rich, but the merits of the outcome have nothing to do with the intentions of the landowners.

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. 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. (184-5)

Smith's argument is informal and full of rhetorical flourishes, but there is a definite economic argument underlying it which has rarely been examined in detail.

What is under discussion is the distribution of 'the produce of the soil', identified with the 'necessaries of life' and with food (since it is the capacity of the landlord's stomach that is adduced as evidence). In this part of the argument, the produce of the land is evidently treated as given, and assumed to consist entirely of food or, at least, necessities. The productivity of the land is promoted by the incentive effects of the desire for wealth, land ownership is unequal, but the landlord cannot eat more than the 'meanest peasant' (though he gets the pick of the crop).

Food consumption, then, is (approximately) proportional to the number of people. If population consists of families (of fixed size), units can be chosen such that one unit of land produces one unit of food per time period, enough to feed one family. To formalize the argument, let there be n units of land, enough to support n people, and assume that m families are needed to work the land. To present the simplest version of Smith's arguments, I assume for now that the population is (at least) equal to n , the number that the land will support, that land is used only to produce food while luxuries are produced by labour alone, and that non-landowners get only their subsistence ration of food, leaving the whole agricultural surplus in the hands of the landlords.

Landlords then get rent equivalent to $n - m$ units of food, enough to support $n - m$ families. The 'capacity of his stomach' limits the food consumption of each landlord to one unit. The remainder supports the 'oeconomy of greatness' by feeding the landlords' servants and those who produce the 'baubles and trinkets' of 'luxury and caprice'. The $n - m$ units they receive (in kind or, more likely, as the equivalent money payments) therefore support $n - m$ families (landlords, servants, luxury-goods producers) plus the m families engaged in working the soil, making a total of n . In Smith's words: 'The produce of the soil maintains at all times nearly that number of inhabitants which it is capable of maintaining' - in this simplified version, the word 'nearly' can be removed.

What if ownership of the land were equally divided? Smith gave no details. Each family would get one unit of land, enough to feed itself, which was all he strictly needed to show in order to make his case. Only m/n units of labour would be needed per unit of land, so each family could work less (with no luxuries produced; c.f. Hutcheson 1726 139), or they could use the spare time to produce minor luxuries for themselves, or $m - n$ families could

specialize in non-agricultural goods, renting their share of land to farmers and exchanging luxuries for food.

The ownership of land therefore affects the level and/or the distribution of luxury spending but an invisible hand ensures that necessities are evenly distributed to those who need them, through the luxury spending of the rich.

The critical assumptions are (a) that food consumption is independent of income (given enough income to be able to buy food at all), so that a landlord eats no more than a poor peasant, and (b) that any surplus of income over what is required for necessities will be spent on luxuries. Both are very much in the spirit of the luxury debate, in which necessities are seen as fixed by the physical facts of life, while the demand for luxuries is seen as unlimited. If landlords were physically able to eat the agricultural surplus personally, and chose to do so (perhaps becoming immensely large in the process?), the food would not be handed on to others, who would starve. Fortunately, the landlords cannot do this. Smith may, however, have been a bit complacent about the diet of different classes. It is reported that titled aristocrats were five inches taller than the population as a whole in 1800, presumably because of a better diet (Coatsworth 1996 6-7), but since titled aristocrats were a very small fraction of the population, this qualification would make little difference. Smith was aware of this qualification – he argued that the rich consume little more food than the poor, and hence that the soil maintains *nearly* the number it is capable of.

Wages must, of course, cover non-food necessities as well as food, and may well be enough to allow workers to enjoy some modest luxuries. Given the two assumptions listed above (fixed per-capita food consumption and non-satiation of demand for non-food luxuries), Smith's main result, that necessities are distributed equally, still stands, with non-food spending by non-landowners replacing some spending by landlords. There is, of course, no need for the landlords, or their agents, to collect the food and physically redistribute it (as some commentators seem to think). It is enough for landlords to collect money rent and use it to pay servants or to buy luxury manufactures. Markets will ensure that food is redistributed by trade from those who have (or could afford to buy) more than enough, to those who are able to offer something in return.

If there is any doubt about the reading presented here, confirming evidence is found in student notes on lectures given by Smith just a few years later, where Smith argued that a man who consumes £10,000 per annum 'appears to destroy what ought to give maintenance to 1,000 men', but in fact supports that number and is 'in no way prejudicial to society' (1978 194). The argument is spelled out in more detail than in the *Theory of Moral Sentiments* – for example, a rich man owns far more clothes than a poor man but wears each item less often before passing it on to others, so that in the end the use of clothing is distributed equally, just as food is (1978 194-5).

The argument as I have presented it (and as Smith presented it) treats (potential) food output as given. The assumption made here that non-food production requires labour only serves to ensure that luxury production redistributes food (or the ability to buy it) from landlords to those who produce luxuries for them, without subtracting from food output. Matters are not so simple if (a) luxury production itself requires land, thus competing with food production – for example, if landlords keep horses for sport and divert land and agricultural labour from food production to growing hay for horses. This case had already been considered explicitly by Cantillon (2001) in a work published a few years before the *Theory of Moral Sentiments*. (b) Similarly, the argument has to be qualified if the production of luxuries competes with food production for limited capital investment. There is evidence in the *Theory of Moral Sentiments*, and to a greater extent in Smith's lectures of a few years later, that he recognised that individuals needed capital in order to produce, but there is no evidence that he recognised capital scarcity as a significant constraint on output in aggregate at this stage. By the time he wrote the *Wealth of Nations* his view had developed significantly, and the allocation of investment between sectors is a central concern. It may be that Smith had not considered these cases when he wrote the *Theory of Moral Sentiments*, or simply that

he did not want to complicate the discussion in a book which is, after all, about moral philosophy, not economics. He did not see fit to qualify the argument when he revised the *Theory of Moral Sentiments* after writing the *Wealth of Nations*.

Something should also be said about population. In the paragraph under discussion, Smith argued only that the soil maintains as many inhabitants as it capable of doing, which 'afford[s] means to the multiplication of the species' (TMS 185). Population cannot long exceed the number that agriculture can feed, while if it is less than that number, the rich will find themselves unable to employ as many as they like. One might guess that wages would rise and food prices would fall, but Smith did not pursue the argument. His claim was simply that the (augmented) capacity of agriculture would allow for a growing population to expand. It is reasonable to suppose that he expected population to expand, given the chance. The *Wealth of Nations*, of course, takes the discussion of population and wages much further, but that was written long after the *Theory of Moral Sentiments*.

Wealth and happiness

The third and final claim made in the invisible-hand paragraph is that rich and poor are equally happy. Provided everyone gets their share of the necessities of life (and the invisible hand argument says that they do), the massive inequality which Smith saw around him, exemplified by the wealth of the great landlords, does not matter. In 'what constitutes the real happiness of human life', all are equal.

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. ... 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. (TMS 185)

Many will find this claim hard to accept. Can Smith really have meant it seriously? All the textual evidence in the *Theory of Moral Sentiments* says that he did. It is the second element of his response to the luxury debate. The invisible hand argument (of the *Theory of Moral Sentiments*) aligns him with the defenders of luxury – the desire for luxury motivates economic advance, and luxury spending creates jobs for the poor – but the claim that the illusory attractions of luxury bring no real happiness aligns him with traditional arguments against luxury, going back to classical antiquity, to the Stoics and Plato.

[T]he Stoics were, at least, thus far very nearly in the right; that, between one permanent situation and another, there was, with regard to real happiness, no essential difference Happiness consists in tranquillity and enjoyment. Without tranquillity there can be no enjoyment; and where there is perfect tranquillity there is scarce any thing which is not capable of amusing. But in every permanent situation, where there is no expectation of change, the mind of every man, in a longer or shorter time, returns to its natural and usual state of tranquillity.' (TMS 149)

What can be added to the happiness of the man who is in health, who is out of debt, and has a clear conscience? To one in this situation, all accessions of fortune may properly be said to be superfluous. (TMS 45)

It is critical to the argument, first, that there is a clear division between necessities, which are the precondition, if not the source, of happiness, and luxuries, which are mere 'baubles and trinkets' and, second, that even the poor get what they need. In the *Wealth of Nations* Smith famously argued that in 'civilised and thriving nations ... a workman, even of the lowest and poorest order, if he is frugal and industrious, may enjoy a greater share of the necessities and conveniences of life than it is possible for any savage to acquire' (WN 10). He had already formed this judgment when he wrote the *Theory of Moral Sentiments*.

The wages of the meanest labourer can supply ... 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 conveniencies, which may be regarded as superfluities, and that, upon extraordinary occasions, he can give something even to vanity and distinction. ... Do [people] imagine that their stomach is better, or their sleep sounder in a palace than in a cottage? The contrary ... is so very obvious ... that there is nobody ignorant of it. (TMS 50)

People think that wealth will make them happy, hence the incentives that drive economic advance, but the attractions of wealth are a deception and rich and poor are equally happy, hence the large inequalities of wealth which certainly existed are not a matter of concern. The invisible hand ensures that all are provided with the necessities of life, which is all that really matters.

Smith's approach is clearly quite different from that of modern mainstream economic theory, in which individuals are assumed to know what is good for them. It might be possible to represent Smith's argument by distinguishing between expected and realized utility. Expected future utility would increase with (expected future) consumption of luxuries even at very high (expected) income levels, by enough to outweigh the disutility of work, the risk of failure, and so on, thus providing the incentives that Smith stressed while, in the event, realized utility would reach a maximum at an income level sufficient to cover (adequate) spending on necessities, with zero marginal utility for luxury consumption. Realized utility, in Smith's story, depends mainly on a range of other factors independent of income and consumption. To try to represent Smith in these terms, however, is a somewhat artificial exercise.

After a very long period of neglect, economists have recently started to discuss happiness as an economic outcome again, using self-reported happiness data (e.g. Layard 2006). The evidence suggests that Smith was not wholly wrong. Cross section data for individuals does, it is true, seem to show a positive relation between income and happiness, though other factors (of a sort which Smith also emphasized) are more important. It would not be hard to explain this relation using factors which Smith discussed: he thought, for example, that a modest improvement in an individual's circumstances (as opposed to a permanent difference of level) would add to their happiness, especially if they felt they had earned it and if they were admired by their friends for it. In Smith's argument, it is not the additional consumption that matters, but the feeling of achievement and social recognition which it brings. Smith's approach could also account for the other main finding of the modern literature, that the relation between average happiness and income is very weak or even non-existent both in time series, (for country averages and for individuals, where data exists) and in cross sections comparing average responses for different countries, at least above some moderate level of per-capita income.

The hand of God?

Did Smith see the invisible hand as the hand of God? His religious views are notoriously hard to pin down, but it may well be that he did. Does this matter to our reading of his economic arguments? I shall argue that it does not.

The *Theory of Moral Sentiments* attributes the invisible hand to 'Providence' (TMS 185), which could be a synonym for God but could equally be a mere figure of speech. Elsewhere in the *Theory of Moral Sentiments* (but not in the *Wealth of Nations*) there are many passages which seem to suggest that the universe is ruled by a benevolent deity who has arranged that everything shall be for the best (Denis 2005). Whether this is Smith's own view is harder to determine. Consider, for example, the following.

The idea of that divine Being, whose benevolence and wisdom have, from all eternity, contrived and conducted the immense machine of the universe, so as at all times to produce the greatest possible quantity of happiness, is certainly of all the objects of human contemplation by far the most sublime. (TMS 236)

At first sight this looks like a clear statement of religious faith, and if the first three words and the final clause were removed, perhaps it would be. As it is, though, it is a description of a 'sublime' idea, which might or might not be true. On the following page, Smith remarked that 'the care of the universal happiness of all rational and sensible beings, is the business of God and not of man' (237) – so it is a subject of contemplation, but not really our business.

As Brown (1994) has noted, the *Theory of Moral Sentiments* is written in a 'dialogic style', in which Smith presents different points of view without always revealing his own position, at least initially. There are quite long stretches which present a particular argument as if it were Smith's, followed by qualifications or criticisms. To pick out a sentence or so and claim that it represents Smith's view is always dangerous. Smith often avoided the word 'God', using alternatives such as 'Nature', 'Providence', the 'Author of Nature', the 'all-wise Architect and Conductor' of the universe, and so on. There is nothing in any of his writings that convincingly identifies him as a Christian, still less as an adherent of any particular Christian church, but there is nothing to offend a Christian reader either. He had good reason to be cautious. A man had been executed in Edinburgh not so long before for religious dissent, and Hume was denied posts because he was suspected of atheism. One could ask, of course, why Smith should have included these theological references at all, if he did not believe them himself. A possible answer is that the *Theory of Moral Sentiments* was based on part of a lecture course which also included 'natural theology' (Macfie 1967 106; no record of the lectures survives), so some theological references were expected.

That said, it would be really rather surprising if Smith had not held some belief in a creator or designer, given the lack of any other convincing account of the origin and evolution of the universe and of living things at that time (Coase 1976 539). The main alternative to revealed Christianity (in its various forms) was Deism, or 'natural religion', a belief in a rather distant supreme being or creator whose existence has to be deduced by reason and observation rather than by revelation. Smith's texts do not commit him on this issue. It has been argued that changes in the final edition of the *Theory of Moral Sentiments* indicate a shift away from Christianity and towards natural religion (Raphael and Macfie 1976 19–20).

Smith's readers would have been familiar with the concept of a 'balance of nature', an idea which goes back to Aristotle, in the form 'nature does nothing in vain' (Schabas 2005, Lennox 2001 ch 9). Thus, the great botanist and taxonomist Linnaeus wrote 'by the Oeconomy of Nature we understand the all-wise disposition of the Creator in relation to natural things, by which they are fitted to produce general ends' (1762 p. 39) by 'assigning to each species certain kinds of food, and ... putting limits to their appetites' (p. 95). Note in particular the last clause, which is very reminiscent of Smith's invisible hand argument. Smith may not have read this particular work when he wrote the *Theory of Moral Sentiments*, though the Latin original was published in 1750. since his library has it in a later English translation. He did know other works of Linnaeus's and could have found similar ideas in many other sources. Smith's argument was not, of course, the same as Linnaeus's, since Smith wrote about human behaviour, but they sit comfortably together. The idea of a benevolent creator was almost universal at the time.

If Smith did think that the invisible hand (and other examples of desirable but unintended consequences) was the work of a benevolent 'Author of Nature', does our reading of his economic arguments change? The distinction between efficient and final causes is the key here. The classic example, cited by Smith himself, is the case of the watch which keeps time because of the arrangement of its wheels and springs (efficient cause) but which is so designed because the watchmaker intended it to keep time (final cause). We can understand the workings of the watch without knowing anything about the identity of the watchmaker,

just as we can now regard the apparent 'design' of living things as the work of natural selection, whether or not there is a designer.

In the invisible hand passage in the *Theory of Moral Sentiments* (and the one in the *Wealth of Nations*) Smith provided an economic analysis which can be assessed on its merits. Whether his inspiration was theological is neither here nor there (Fleischacker 2004). His summary of the stoic belief that 'immense machine of the universe' was designed to 'produce the greatest possible quantity of happiness' (cited above), on the other hand, rests wholly on faith, since no convincing efficient cause is provided.⁸

Other readings of the invisible hand

My reading of the invisible hand of the *Theory of Moral Sentiments* is based on the working assumption that Smith's arguments make sense, until shown otherwise, and that he meant what he wrote, though he might sometimes use rhetorical exaggeration to make his point more effectively. Not all scholars proceed on that basis. Two recent accounts contrast strongly with mine.

William Grampp's article (2000; see also Minowitz 2004) is mainly about the *Wealth of Nations*, but has a couple of pages on the *Theory of Moral Sentiments*. His reading of it makes Smith appear 'inconsequential and implausible' as he himself recognizes (463). According to him, when the 'unfeeling landlord ... in imagination consumes' the whole harvest (TMS 184) this is no figure of speech. The foolish landlords have the whole harvest delivered to them, and then find they cannot eat it all and have no option but to give it away to the poor. This is indeed implausible. Grampp recognizes that another reading is possible, that the rich employ the poor, but adds: '[I]f so, the poor get their income from working ... and an invisible hand is not needed to explain that.' (463). The problem seems to be that Grampp reads Smith as arguing that income comes to be equally distributed. In my reading it is consumption of necessities and, on average, happiness that are equalized, while money incomes and access to luxuries are not.

Emma Rothschild (1994, 2001) does not distinguish between the invisible hand of Smith's two main works, and does not examine his economic arguments in any detail. She argues that Smith's invisible hand is 'ironic' because it is 'the *sort* of idea he would not have liked' (1994 319). I concede immediately that Smith was indeed using (perhaps rather heavyhanded) irony as a literary device to make his point. The landlords' sole end is 'the gratification of their own vain and insatiable desires' (TMS 184) but they feed the poor and gain no real happiness themselves. We are meant to smile at their foolishness, but does this invalidate the invisible hand argument? Surely the opposite - unless the invisible hand did its work there would be starvation, with no joke and nothing to smile at.

Rothschild gives a number of reasons for thinking that Smith did not mean what he said. I shall comment on them in turn. (a) She argues that the word 'invisible' and the phrase 'invisible hand' had negative connotations in writings known to Smith. Should we not, however, judge Smith's usage by the actual passages in which he used the (entire) phrase? (b) She argues that the invisible hand implies a condescending or contemptuous attitude to individual agents, which is inconsistent with Smith's general attitude. However, Smith did in fact think that the attractions of wealth are a delusion, and discussed at length why we are deceived by it. He also discussed a variety of other forms of impulsive or short-sighted behaviour. If this is condescending, then it is what he really thought. That said, the invisible hand itself does not require agents to be foolish. They pursue their own aims and the

⁸ There has been much discussion of the role of religion and of final causes in Smith's work taken as a whole (see for example Viner 1972, Kleer 1995, Hill 2001 and Waterman 2002). I am concerned here only with the few pages containing the invisible hand argument.

desirable side effects are simply not their concern. (c) 'The invisible hand is un-Smithian', we are told, because it assumes that the theorist can see more than others (2001 124). Smith did in fact contrast an 'abstract and philosophical' viewpoint with everyday concerns (TMS 183), however 'un-Smithian' that may seem, but in any case, his description of the invisible hand does not require the observer to have some sort of esoteric knowledge hidden from others. Instead, Smith focuses on outcomes which the relevant agents have no reason to consider. In the argument of the *Theory of Moral Sentiments*, the rich landlord can presumably see that he is giving employment and hence subsistence to those he employs or whose products he buys, but the point is that his motives in so doing may be wholly selfish.⁹ (d) Some sorts of self-interested actions, such as lobbying for political privileges, do not serve the public good. This is certainly true, and would undermine any claim that self-interest always serves the common good, but that is not relevant to the specific invisible hand argument under discussion. (e) The invisible hand is deistic which, Rothschild asserts, Smith was not. This objection seems simply anachronistic. As noted above, Smith's religion presents difficult questions but it would be surprising if he had not had some sort of religious belief.

In sum, I see no reason to doubt that Smith's invisible hand arguments were intended to mean what they say.

The invisible hand in the *Wealth of Nations*

The phrase, 'an invisible hand' appears once in the *Theory of Moral Sentiments* and once in the *Wealth of Nations*. In both cases the invisible hand is credited with ensuring that (certain kinds of) self-interested actions have socially desirable results, but otherwise the passages in the two books which use the phrase have little in common. The invisible hand in the *Theory of Moral Sentiments* ensures that selfish luxury consumption acts to redistribute command over necessities by providing employment. The invisible hand passage in the *Wealth of Nations* deals with wealth-owners' investment choices, arguing that domestic investment is preferred to investment abroad for reasons of security, among others, and that since 'it is only for the sake of profit that any man employs a capital in the support of industry ... he will always, therefore, endeavour to employ it in the support of that industry of which the produce is likely to be of the greatest value', and hence that 'every individual necessarily labours to render the annual revenue of the society as great as he can' (WN 455-6).

The two invisible hands are different, but there is no necessary conflict between them. The rich man presumably seeks to maximize returns in order to spend on luxury (now or in the future) and a higher return means there is more to spend. It is true that the *Wealth of Nations* makes a case for saving as opposed to immediate consumption, but Smith was very clear that saving is invested and hence creates employment (for productive workers), so the *Theory of Moral Sentiments* argument about the employment-creating role of spending by the rich applies whether the rich devote their spending to immediate gratification or to investment designed to provide future returns.

What is in essentials the invisible hand argument of the *Theory of Moral Sentiments* is carried over to the *Wealth of Nations*, but without the phrase itself.

The rich man consumes no more food than his poor neighbour. ... The desire of food is limited in every man by the narrow capacity of the human stomach; but the desire of the conveniences and ornaments of building, dress, equipage, and household furniture, seems to have no limit or certain boundary. Those, therefore, who have the command of more food than they themselves can consume, are always willing to exchange the surplus, or, what is the same thing, the price of it, for gratifications of this other kind. What is over and above satisfying the limited desire is given for the amusement of those

⁹ On the distinction between unanticipated and unintended consequences, see Aydinonat (2006).

desires which cannot be satisfied, but seem to be altogether endless. The poor, in order to obtain food, exert themselves to gratify those fancies of the rich. ... The number of workmen increases with the increasing quantity of food, or with the growing improvement and cultivation of the lands. (WN 180-1)

The incentive effects of the desire for luxuries also surface in the discussion of the decline of feudalism in the *Wealth of Nations*, itself based on similar arguments in Hume (Brewer 1998). In the early middle ages when few manufactured luxuries were to be had, landlords neglected their land. When attractive manufactures came on the market, landlords had an incentive to improve their lands and to design tenancy contracts that would maximize returns. 'It is thus that through the greater part of Europe the commerce and manufactures of cities ... have been the cause and occasion of the improvement and cultivation of the country' (WN 422). The political side-effects were equally important. The great landlords shifted their spending away from maintaining gangs of armed supporters and 'sold their birthright ... in the wantonness of plenty, for trinkets and baubles, fitter to be the playthings of children than the serious pursuits of men', thus bringing about the decline of feudal power, 'a revolution of the greatest importance to the public happiness' (WN 421-2).

Smith's claim that wealth does not ensure happiness but that the attractions of wealth, however deceptive, are desirable because they stimulate economic development, has been little discussed in the literature on his economics but has been the subject of much debate in discussions of his political philosophy. Thus Nussbaum, in a paper (2000) mainly about the influence of Cicero, has argued that Smith was prepared to 'let the market do its worst' (pp. 199) because he thought that the poor do not really suffer. Against that, Fleischacker (2004) has argued that the invisible hand passage in the *Theory of Moral Sentiments* is no more than Smith's 'rough first stab at bringing his moral philosophy to bear on economics' (p. 108), and that it was much modified in the *Wealth of Nations*. The wider issues cannot be discussed at length here, but a few comments are in order. The invisible hand passage in the *Theory of Moral Sentiments* is little more than page long, and is indeed a brilliant sketch, not a fully developed and qualified economic analysis. It is indeed qualified in the later work in ways that Fleischacker indicates. By the time he wrote the *Wealth of Nations*, Smith had become convinced of the importance of capital accumulation, so regarded saving (and the matching investment) as more beneficial than the luxury spending implied in the *Theory of Moral Sentiments*. Against Nussbaum's reading, it is clear that Smith thought it important that common labourers should make a decent living (and that he thought they did, in Britain at least). Having said all that, it remains the case that Smith revised the *Theory of Moral Sentiments* very extensively after writing the *Wealth of Nations* and that he did not change the relevant passages. He cannot have thought that they were fundamentally misleading.

Conclusion

In the argument of the *Theory of Moral Sentiments*, taken on its own, the invisible hand is a digression. In Smith's wider vision, however, it is not a digression but a key link between his moral philosophy and the planned work which became the *Wealth of Nations*. The *Theory of Moral Sentiments* was based on lectures which also dealt with 'police' (economic policies). The record we have of his lectures a few years later (Smith 1978) shows that his economic ideas were not fully formed at that date, but he had (at latest in 1755) already drawn the conclusion that 'little else is requisite to carry a state to the highest degree of opulence from the lowest barbarism, but peace, easy taxes, and a tolerable administration of justice' (1980 IV.25).

He could hardly avoid tackling the issue of luxury, but he must have been in something of a quandary. On the one hand, he showed a 'consistent disdain for wealth and greatness' (Brown 1994 88) and a mistrust and contempt for the actions of the rich and powerful, which would tend to align him with the traditional moralistic condemnation of luxury. On the other hand, to support the traditional hostility towards luxury would contradict his

optimistic view of the economic achievements and prospects of commercial society. He must also have found it difficult to distinguish himself from Mandeville. The invisible hand of the *Theory of Moral Sentiments*, which ensures that the 'natural selfishness and rapacity' of the rich serves the interest of society (TMS 184–5), looks very like Mandeville's 'private vices, publick benefits' (1988). In a separate discussion elsewhere in the *Theory of Moral Sentiments*, Smith rejected Mandeville's definition which counted almost any self-interested action as a vice, but he must still have been uncomfortable with Hume's complacently dismissive remark: 'To imagine that the gratifying of any sense ... is of itself a vice, can never enter into a head that is not disordered by the frenzies of enthusiasm' (1987 268).

The invisible hand paragraph in the *Theory of Moral Sentiments* resolves any such difficulties. The desire for wealth, however deluded, drives economic progress, and the luxury spending of the rich ensures that there are jobs, and access to necessities, for the poor. Luxurious tastes do indeed benefit society, as Barbon, Mandeville and Hume had claimed, but the rich and ambitious themselves gain nothing in terms of real happiness.

Modern economists often claim Smith as an intellectual ancestor. Whatever may be said about the invisible hand of the *Wealth of Nations*, the invisible hand argument of the *Theory of Moral Sentiments* is fundamentally at odds with modern welfare economics. In the modern mainstream, individuals are assumed to know what is good for them, in the sense that they have a consistent set of preferences, that they act rationally on the basis of those preferences (and thus reveal their preferences by their actions), and that their welfare is improved by any movement to a preferred state. Smith's views could hardly be more different.

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