



Adam Smith's "Invisible Hand"

What was the most important document published in 1776? The Declaration of Independence is the easy answer for Americans, but many would argue that Adam Smith's "The Wealth of Nations" had a bigger and more global impact. On March 9, 1776, "An Inquiry into the Nature and Causes of the Wealth of Nations" (commonly referred to as simply "The Wealth of Nations") was first published. Smith, a Scottish philosopher [...], wrote the book to upend¹ the mercantilist system.

Mercantilism held that wealth was fixed and finite and that the only way to prosper was to hoard¹ gold and tariff² products from abroad. According to this theory, this meant nations should sell their goods to other countries while buying nothing in return. Predictably, countries fell into rounds of retaliatory³ tariffs that choked off⁴ international trade.

¹ (to) hoard – horten

² (to) tariff – verzollen (tariff/customs – Zoll)

³ retaliatory – vergelten, sich revachierend

⁴ (to) choke off – abwürgen

The Invisible Hand

The core of Smith's thesis was that humans' natural tendency toward self-interest (or in modern terms, looking out for yourself) results in prosperity. Smith argued that by giving everyone freedom to produce and exchange goods as they pleased (free trade) and opening the markets up to domestic² and foreign competition, people's natural self-interest would promote greater prosperity than with stringent government regulations. Smith believed humans ultimately promote public interest³ through their everyday economic choices.

“He (or she) generally, indeed, neither intends to promote the public interest nor knows how much he is promoting it. By preferring the support of domestic to that of foreign⁴ industry, he intends only his own security; and by directing that industry in such a manner as its produce⁵ 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,”

states Smith in “An Inquiry Into The Nature And Causes Of The Wealth Of Nations” (1776). This free-market force became known as the invisible hand [...].

The invisible hand is not actually a distinguishable entity. Instead, it is the sum of many phenomena that occur when consumers and producers engage in commerce⁶. Smith's insight into the idea of the invisible hand was one of the most important in the history of economics and remains one of the chief justifications for free market ideologies. The invisible hand theorem (at least in its modern interpretations) suggests that the means of production and

¹ (to) upend sth. – etw. umwälzen

² domestic – inländisch

³ public interest – Gemeinwohl, Allgemeininteresse

⁴ foreign – fremd, ausländisch

⁵ produce – Produkte, Erzeugnis

⁶ commerce – Handel

distribution should be privately owned, and that if trade occurs unfettered⁷ by regulation, in turn, society will flourish organically.

Source: Joy Blenman (2016): Adam Smith and “The Wealth of Nations” In: <http://www.investopedia.com/updates/adam-smith-wealth-of-nations/>. Last accessed: 16.03.2018.

Tasks:

1. Read the text on your own quickly and mark passages and terms you find difficult to understand.
2. Go over the text (each sentence) again. Look up difficult terms and try to explain each paragraph (you do not necessarily have to understand each word). Write down the key statement of each paragraph next to it.
3. Write an explanation of the invisible hand.
4. Take the quiz on the principle of the invisible hand (on Moodle) to check whether you have understood it.

⁷ unfettered – ungehindert, frei