

Adam Smith on the “Invisible Hand”

*One of the earliest and most influential theorists of free enterprise capitalism was Scottish economist named Adam Smith. In *The Wealth of Nations*, published in 1776, Smith argued powerfully against the prevailing policy of mercantilism. Under mercantilism, governments imposed strong guidance over a nation’s economic activities, heavily restricted foreign trade and protecting various kinds of domestic monopolies (businesses that have almost exclusive control over a product or industry). Smith was a fervent opponent of monopolies, and a strong supporter of free trade.*

In the following excerpt, Smith argues that government interference in business is almost always a mistake. However, he does allow for a few exceptions.

Every individual is continually exerting himself to find out the most advantageous employment [use] for whatever capital [money] he can command. It is his own advantage, indeed, and not that of the society, which he has in view. But the study of his own advantage naturally, or rather necessarily, leads him to prefer that employment which is most advantageous to the society...

Every individual...endeavors as much as he can both to employ his capital in the support of domestic industry [the business of his native country] and so to direct that industry that its produce may be of the greatest value; [thus,] every individual necessarily labors to render the annual [earnings] of the society as great as he can. He generally, indeed, neither intends to promote the public good, nor knows how much he is promoting it. By preferring the support of domestic to that of foreign industry, he intends only his own security; and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gains, 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...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 [pretended] to trade for the public good.

[Individuals can judge better than political leaders in which industry or product it would be profitable to invest their money.] The statesman [political leader], who should attempt to direct private people in what manner they ought to employ their capitals, would...[take on] an authority which could safely be trusted, not only to no single person, but to no council or senate whatever, and which would nowhere be so dangerous as in the hands of a man who [was foolish and conceited] enough to [imagine] himself fit to exercise it.

To give the monopoly of the home market to the produce of domestic industry, in any particular art or manufacture, is in some measure to direct private people in what manner they ought to employ their capitals, and must, in almost all cases, be either a useless or a hurtful regulation. If the produce of domestic [industry] can be brought there as cheaply as that of foreign industry, the regulation is evidently useless. If it cannot, it must generally be hurtful. It is the [rule] of every prudent master of a family, never to attempt to make at home what it will cost him more to make than to buy. The tailor does not attempt to make his own shoes, but buys them from the shoemaker. The shoemaker does not attempt to make his own clothes, but employs a tailor. The farmer attempts to make neither the one nor the other, but employs those different [craftspeople]. All of them find it for their interest to employ their whole industry in a way in which they have some advantage over their neighbors and to purchase with a part of its produce, or what is the same thing, with the price of a part of it, whatever else they have occasion for.

What is prudence in the conduct of every private family can scarcely be folly in that of a great kingdom. If a foreign country can supply us with a [product] cheaper than we ourselves can make it,

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better buy it from them with some part of the produce of our own industry, employed in a way in which we have some advantage...

There seem, however, to be two cases in which it will generally be advantageous to lay some burden upon [or tax] foreign, for the encouragement of domestic, industry.

The first is, when some particular sort of industry is necessary for the defense of the country...

The second case is when some tax is imposed at home upon the produce of [domestic industry]. In this case, it seems reasonable that an equal tax should be imposed upon the like produce of [foreign industry]...

Review Question

1. What did Adam Smith believe was the relationship between an individual's economic decisions and the economic interests of a nation?
2. What did Smith mean by the term "invisible hand"?
3. What was Smith's attitude regarding government regulation of a nation's economy?
4. In what situations did Smith feel that government could interfere with free trade?