Retrospectives
Ethics and the Invisible Hand

Jerry Evensky

This feature addresses the history of economic words and ideas. The hope is to deepen the workaday dialogue of economists, while perhaps also casting new light on ongoing questions. If you have suggestions for future topics or authors, please write to Joseph Persky, c/o Journal of Economic Perspectives, Department of Economics (M/C 144), The University of Illinois at Chicago, Box 4348, Chicago, Illinois 60680.

Introduction

As modern economists, we use Adam Smith’s “invisible hand” metaphor confident that we all know what it means in our discourse: it reflects our admiration for the elegant and smooth functioning of the market system as a coordinator of autonomous individual choices in an interdependent world. But in Adam Smith’s moral philosophy, the invisible hand has a much broader responsibility: if individuals are to enjoy the fruits of a classical liberal society, the invisible hand must not only coordinate individuals’ choices, it must shape the individuals into constructive social beings—ethical beings. Revisiting Smith’s metaphor provides a valuable lesson: the foundation of success in creating a constructive classical liberal society lies in individuals’ adherence to a common social ethics.¹

¹There is a growing interest in this subject. In recent years we have seen, for example, works by James Buchanan (1991), Amitai Etzioni (1988), Robert Frank (1988), Jane Mansbridge (1990), as well as Pope John Paul II’s Encyclical Letter “Centesimus Annus” address this issue. The presentation here builds on my earlier work (Evensky, 1987, 1989, 1992a, 1992b, forthcoming).

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I begin by presenting the philosophical basis for Smith's invisible hand, describing the sense in which the hand is invisible, and whose hand it is. I then describe the story Smith tells of the invisible hand creating and maintaining a constructive classical liberal society, and show how Smith's story evolved as his faith in the ability of the invisible hand to shape an appropriate ethical foundation waned. I conclude with some thoughts on the legacy of Adam Smith and of our predecessors in economic inquiry more generally.

The Philosophical Basis of the Invisible Hand

Smith did not believe that philosophers are engaged in discovering Truth. In his view, philosophers can only imagine what connecting principles give rise to the order we observe. To illustrate this point, Smith (1980, p. 42–43) contrasts a philosopher's perspective on nature with that of a spectator who is awed by the wonder of the special effects at an opera.

Upon the clear discovery of a connecting chain of intermediate events, it [our wonder] vanishes altogether. Who wonders at the machinery of the opera-house who has once been admitted behind the scenes? In the Wonders of nature, however, it rarely happens that we can discover so clearly this connecting chain. With regard to a few even of them, indeed, we seem to have been really admitted behind the scenes.

Nature's Truth lies in the machinery behind the scenes. "Philosophy . . . pretends [emphasis added] to lay open the concealed connections that unite the various appearances of nature," wrote Smith (1980, p. 51). The great philosophers are the ones who have the creativity to imagine what those "concealed connections" might be. And the greatest of all philosophers, according to Smith, was Sir Isaac Newton.

Smith's essay on the "History of Astronomy" concludes with a review of Newton's work. There Smith (1980, p. 104–105) asserts that Newton's representation of the connecting principles that order the physical universe "prevails over all opposition . . . with principles [that], it must be acknowledged, have a degree of firmness and solidity that we should look in vain for any other system." Smith sees Newton's work as a triumph of the imagination and is awed by its brilliance. In fact, Newton's representation is so powerful that it is easy to be seduced into using the language of Truth when one describes it. Nevertheless, Smith concludes his review of Newton's work with a reminder to his reader, and it seems to himself, that even this great philosophical triumph is

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2Smith actually uses the "invisible hand" metaphor only once in The Wealth of Nations (Smith, 1976a, p. 456), once in The Theory of Moral Sentiments (Smith, 1976b, p. 184), and once in the Essays (Smith, 1980, p. 49); but the image is central to his moral philosophy.
simply a flight of imagination, a great story. Smith (p. 105) writes:

And even we, while we have been endeavouring to represent all philosophical systems as mere inventions of the imagination... have insensibly been drawn in, to make use of language expressing the connecting principles of this one, as if [emphasis added] they were the real chains which Nature makes use of to bind together her several operations.

Smith seeks to do for moral philosophy what Newton had done for natural philosophy. He wants to tell a story of the connecting principles of the human order with commanding and compelling persuasive power. But, as with Newton, Smith's story does not begin with these principles. Both men take the story back to the origin of these principles, and it is here that we meet the "invisible hand". Newton and Smith believed that the connecting principles which give rise to the order we observe reflect the planning and handiwork of a designer. But who is the artificer that designed and constructed this great work? Smith and Newton both believed in the Deity as designer.

In the classic enlightenment analogy, the Deity is to the universe as the watchmaker is to a watch. In each case it is the hand of the designer that arranges the springs and pins and wheels, and sets the system in motion. But in both cases that hand is invisible to the spectator who observes only the product of the effort: the orderly progress of the hands of the watch, or of the sun, the moon, and the planets. We see nothing of the designer, we see only the effects of the design.\(^3\)

\(^3\)See (Smith, 1976b, p. 87) for an example of his use of this watchmaker image. This “design argument” (Hurlbutt, 1965) is expressed in eloquent and absolute terms by Cleanthes in David Hume's *Dialogues Concerning Natural Religion* (Hume, 1947, p. 143):

Look round the world: contemplate the whole and every part of it: you will find it to be nothing but one great machine, subdivided into an infinite number of lesser machines, which admit of subdivisions, to a degree beyond what senses and faculties can trace and explain. All of these various machines, and even their most minute parts, are adjusted to each other with an accuracy which ravishes into admiration all men, who have ever contemplated them. The curious adapting of means to ends, throughout all nature, resembles exactly, though it much exceeds, the productions of human contrivance; of human design, thought, wisdom, and intelligence. Since therefore the effects resemble each other, we are led to infer, by all rules of analogy, that the causes also resemble; and that the Author of Nature is somewhat similar to the mind of men; though possessed of much larger faculties; proportioned to the grandeur of the work, which has been executed. By this argument a posteriori, and by this argument alone, do we prove at once the existence of a Deity, and his similarity to human mind and intelligence.

Ironically, by the end of the *Dialogues*, Cleanthes' case is destroyed by the skeptic Philo. Smith's adherence to the philosophy of design seems more akin to that position taken by Hume's character Demea: it's a matter of faith, not proof.
The Invisible Hand and Ethics

Smith’s “invisible hand” metaphor reflects his view that he is representing the invisible connecting principles of the “immense machine of the universe” (Smith, 1976b, p. 236) that are the handiwork of the Deity. To fully appreciate the impact of this perspective on Smith’s moral philosophy, however, one must bear in mind that Smith (1976b, p. 166) saw the Deity as not only handy, but also benevolent.

The happiness of mankind, as well as of all other rational creatures, seems to have been the original purpose intended by the Author of nature, when he brought them into existence. No other end seems worthy of that supreme wisdom and divine benignity which we necessarily ascribe to him…

This is the Deity who endowed all humans with self-love, and in so doing set the spring that gives motion to human industry. This is the Deity who arranged the connecting principles such that the actions of all those seeking their own advantage could produce the most efficient allocation of resources, and thus the greatest possible wealth for the nation. This is indeed a benevolent designer.

Smith’s Wealth of Nations is the story of those socially desirable unintended consequences of individual action that result when events are allowed to follow their “natural course,” the course consistent with the Deity’s design. But while that course is natural, it is not inevitable (Smith, 1976b, p. 316):

Human society, when we contemplate it in a certain abstract and philosophical light, appears like a great, an immense machine, whose regular and harmonious movements produce a thousand agreeable effects. As in any other beautiful and noble machine that was the production of human art, whatever tended to render its movements more smooth and easy, would derive a beauty from this effect, and, on the contrary, whatever tended to obstruct them would displease upon that account: so virtue, which is, as it were, the fine polish to the wheels of society, necessarily pleases; while vice, like the vile rust, which makes them jar and grate upon one another, is as necessarily offensive.

For the wheels to turn easily, for the machine to run smoothly, there must be virtue. Human virtue is the sine qua non of the fruitful classical liberal society Smith envisioned.

In The Theory of Moral Sentiments, Smith explores the ethics consistent with the Deity’s design, the ideal of ethics, presenting his view of how an individual would in theory personally define and enforce that ethical position. With this limiting point of the ethical ideal as a reference, he then turns to the real.
Smith takes human frailty as a given and thus recognizes the impossibility of achieving the ideal in any individual, much less in society as a whole. For example, remembering his dear, recently deceased friend David Hume, Smith wrote: “Upon the whole, I have always considered him, both in his lifetime and since his death, as approaching as nearly to the idea of a perfectly wise and virtuous man, as perhaps the nature of human frailty will permit” (Smith, 1977, pp. 217, 221).

Smith saw Hume as a model of the kind of being society should seek to nurture. For, in Smith’s moral philosophy, it is the degree to which individuals in society approach the ethical limit that determines the degree to which society as a whole will enjoy the fruits of living in the classical liberal construct of the Deity’s design.

Much of *The Theory of Moral Sentiments* is dedicated to an examination of ethics at a social level. According to Smith, hope for improving human virtue and thus for improving society lies in social evolution and socialization. Social evolution brings the improvement of the human condition through stages: from the rude state of hunting and gathering, through the progressively more productive and refined stages of pasturage and agriculture, to the most advanced stage, a commercial society. Since each stage requires a progressively more refined system of human values, the movement of a society from stage to stage is simultaneous with the development of that society’s value system. For human progress to occur, each generation must refine the values it inherited from the last, and then must pass those enhanced values on to the next generation through the socialization of its children.

Smith sees each individual as being shaped by and in turn, given that person’s experience, shaping society. The dynamic and continuity of human social evolution derive from this coevolution: communities contribute the continuity as individuals come and go, and individuals contribute the dynamic to the degree that they draw on their extra-community experience to act on the community during their stay. This coevolution of individual and society makes human improvement possible, for through this process individuals and factions can meld into a community, sharing common values that provide common ground for constructive competition among all parties.

Smith recognized that any given society might move forward, and then stagnate or even regress. But at the level of humankind, we again encounter the power and beneficence of the invisible hand. It not only guides the elegant, frictionless ideal human society; the invisible hand guides the evolution of the human condition through the stages toward that ideal. Or so Smith saw it as a young man. Experience brought Smith more of an appreciation for the dynamic power of factions, and with that experience his faith in the dexterity and strength of the invisible hand seemed to fade.

In particular, prior to the 1770s, Smith did not fully appreciate the dynamic nature of mercantilism. It was upon his arrival in London (1773) to
publish *The Wealth of Nations* that he encountered first hand the stark reality of the growing influence of commercial interests in Parliament.\(^4\) This influence, reflected in the immense expense incurred in the wars to protect and preserve the colonies\(^5\) (a classic mercantilist policy), seems to have disabused Smith of much of his optimism.

The "Additions and Corrections" to *The Wealth of Nations*, published in 1784, represents the only major revision of that text. The focus of those changes is how mercantilism was distorting commercial society, the last stage in the sanguine dynamic Smith had envisioned as guided by the invisible hand. This concern represented more than a change of perspective from sanguine to skeptical; it struck at the heart of Smith's analysis. If the invisible hand would not guide society toward the ideal, how could we hope to get there? Smith addressed this question in revisions to *The Theory of Moral Sentiments* made in the last year of his life.

In the 30 years since the *The Theory of Moral Sentiments* was first published, Smith had made no significant revisions to that work. But in 1789, in advanced age and weakened frame, he set to that task. Smith made revisions throughout the text, but by far the most significant change was the addition of (Smith, 1977, pp. 319–20) "a compleat new sixth part containing a practical system of Morality, under the title of the Character of Virtue." In these revisions, Smith appeals to all citizens to put the well-being of the society before that of any particular faction to which they might belong, and he makes a special plea to those who might be statesmen to step forward and construct a moral society by deed and example.

Smith's conception of how to develop a moral society is driven by his notion that society is made up of a layered web of communities with divergent interests,\(^6\) and that these differences can be the seeds of destructive factions. He argues that to avoid this destructive tendency there must be a balance: the values of the society must respect the diversity of values among the communities it encompasses, and these communities' values must not undermine the

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\(^4\)See Kammen (1970, p. 10) for more on this "modern conception of interest."

\(^5\)About the policy of retaining the colonies, Smith wrote in the "Additions and Corrections" (Smith, 1976a, p. 661): "For the sake of that little enhancement of price which this monopoly [(the American colonial trade)] might afford our producers, the home-consumers have been burdened with the whole expense of maintaining and defending that empire. For this purpose, and for this purpose only, in the two last wars, more than two hundred millions have been spent. ... The interest of this debt alone is not only greater than the whole extraordinary profit, which, it ever could be pretended, was made by the monopoly of the colony trade, but than the whole value of that trade or than the whole value of the goods, which at an average have been annually exported to the colonies."

\(^6\)Society can be thought of as the Community-at-large. The scope of the Community-at-large depends on the level of analysis one has in mind. Smith sometimes writes in terms of nation states; but the ultimate scope Smith had in mind was the whole of human society, for his moral philosophy is a global analysis.
commitment of individuals to the core set of values that give order to society.7 In Smith’s view, this balance of respect and commitment is crucial for the society to be a constructive environment within which the individuals and groups that make up society can not only survive but flourish (Smith, 1976b, pp. 219–20, 235–37). And as they flourish, so too will society.

By the end of his life, Adam Smith was no longer looking to the invisible hand to guide society to the conditions necessary for a constructive classical liberal state. Instead, he called upon the visible hand of moral leadership from all individuals, and especially statesmen, to create those conditions and thereby that society. This appeal and the sacrifice he makes to present it (the work on the revisions weakened him so that he died within six months of completing them) reflect the centrality of ethics to his vision of a classical liberal society.

Smith’s Legacy and the Mentoring Past

The image of individual actions guided as if by an invisible hand to an unintended optimal outcome has been passed down to modern economic discourse. For example, listen to Arrow and Hahn in their introduction to General Competitive Analysis (1971, pp. vi–vii):

There is by now a long and fairly imposing line of economists from Adam Smith to the present who have sought to show that a decentralized economy motivated by self-interest... would be compatible with a coherent disposition of economic resources that could be regarded, in a well-defined sense, as superior to a large class of possible alternative dispositions. ... It is important to understand how surprising this claim must be to anyone not exposed to this tradition. The immediate “common sense” answer to the question “What will an economy motivated by individual greed and controlled by a very large number of different agents look like?” is probably: There will be chaos.

But the Smithian story told by Arrow and Hahn—and they are representative of modern economists—is an abridged edition. The spring that motivates action in Smith’s story has been carried forward, but much of the rest of his tale

7"Concern for our own happiness recommends to us the virtue of prudence; concern for that of other people, the virtues of justice and beneficence..." Beneficence "is the ornament which embellishes, not the foundation which supports the building. ...Justice, on the contrary, is the main pillar that upholds the whole edifice. If it is removed, the great immense fabric of human society must in a moment crumble into atoms." (Smith, 1976b, pp. 262, 86) In Smith’s moral philosophy the definitions of prudence, justice, and beneficence, and the standard for the proper balance of these sentiments were determined by the sympathy of an impartial spectator. The roots of this construct are in the same ground as John Rawls’ (1971) "veil of ignorance," for the virtue of an impartial spectator derives from the same lack of an invested location that the veil creates.
has been forgotten. Unfortunately, this has become the standard treatment of
the works of the great economists of the past. They are not read for the fullness
of their vision; they are cited for the pieces we have inherited.

This approach to our past reflects a modern sense that the development of
economic thought has been an inexorable progress toward greater understand-
ing. In this view, the greats among our predecessors have in their own time
pushed understanding of the world into new frontiers. Like other trailblazers of
the past, their once freshly cleared path is now well-trod and the cutting edge
lies far beyond. We appreciate them, not for where they reached, but for where
their efforts have allowed us to reach. The actual works of those greats are
treated as “classics,” cited by many, and read by few.

The cost of this approach to our past is the loss of much of our rich legacy.
The modern adaptation of Smith’s invisible hand story is, I believe, a case in
point. To tell that story without the ethical dimension is to lose much of its
richness and relevance. Smith’s story weaves self-love and the invisible hand
into a tale about the human condition that is much more telling than can be
developed with those concepts alone. He begins with an exploration of the
ethical ideal, moves on to the evolution of social ethics and socialization as a
dynamic that ameliorates the corrosive effects of human frailty, and then
develops this evolutionary foundation into a tale about the emergence and
functioning of an elegant and efficient classical liberal society. In Smith’s story
ethics is the hero—not self-interest or greed—for it is ethics that defend the
social intercourse from the Hobbesian chaos. Once the veil of “classic” is lifted
from Smith’s work, it can be read again as a thoughtful commentary on the
state of modern classical liberal societies, and as an underutilized resource for
the development of the models that economists use to analyze and construct
those societies.

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