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NOTES & COMMENT

Today's Most Mischievous Misquotation



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Adam Smith did not mean what he is often made to say

by [Jonathan Schlefer](#)

ONE of the most often distorted passages in economic literature is surely Adam Smith's aside about the invisible hand of the market. In *Economics*, which has been the leading college text on the subject since the 1950s, Paul A. Samuelson and William D. Nordhaus concocted a typical variant of Smith's actual remarks. They pulled them from the midst of a paragraph hundreds of pages into *The Wealth of Nations*, presumed to streamline the prose by chopping and splicing without using ellipses, and elevated the result into the theme of Smith's entire thousand-page book.

Every individual endeavors to employ his capital so that its produce may be of greatest

value. He generally neither intends to promote the public interest, nor knows how much he is promoting it. *He intends only his own security, only his own gain. And he is in this 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 society more effectually than when he really intends to promote it. [italics added]

This makes Smith sound as if he thought that the invisible hand always leads individuals who are pursuing their own interests to promote the good of society. He did not. He saw the interests of large capitalists as conflicting with those of the public: capitalists seek high profits, which corrupt and impoverish society. In another example the famous division of labor increases factory output but erodes the intelligence, enterprise, and character of workers. Smith's passage on the invisible hand says only that it operates "in this as in many other cases" -- not always, not even mostly.

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From the archives:

- ["Are Big Businessmen Crooks?" by Leland Hazard \(November, 1961\)](#)
"The author explains why sometimes Adam Smith's 'invisible hand' does not, in fact, promote society's best interests."

- ["How the World Works," by James Fallows \(December, 1993\)](#)
"Americans persist in thinking that Adam Smith's rules for free trade are the only legitimate ones. But today's fastest-growing economies are using a very different set of

The "case" that Samuelson and Nordhaus edited out is about trade, and on this Smith said something indeed strange to modern economists' ears. Before the passage that Samuelson and Nordhaus excerpted, Smith had argued that investment at home produces more "revenue and employment" than investment in foreign trade. In the key sentence about the invisible hand, which Samuelson and Nordhaus reworked into the italicized portion of the quotation, Smith further argued that self-interest does lead the entrepreneur to invest at home rather than in foreign trade.

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 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.

The invisible hand promotes the good of society by leading

rules."

• **"Toward a Global Open Society,"** by **George Soros** (January, 1998)

"A billionaire financier seeks to demonstrate that the interests of large capitalists need not conflict with those of the public."

entrepreneurs to invest at home rather than abroad.

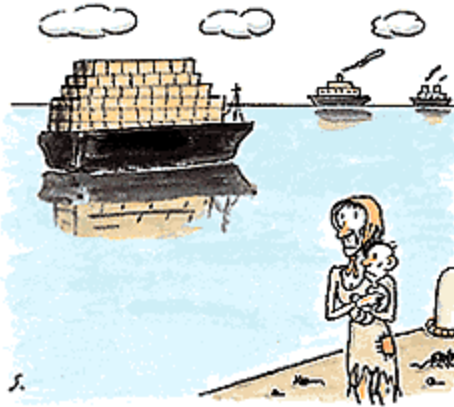
Was Adam Smith not a free-trader after all? That is the wrong question. We tend to lump trade policies into either of two categories: free trade or protectionism. Smith was concerned with a third category: mercantilism, a system and ideology, fostered by merchants, that both promotes and manages trade. *The Wealth of Nations* is an extended polemic against mercantilism.

Smith attacked the way British mercantilism divvied up the world into parcels, granting merchants corporate monopolies to trade with each: the Russia Company, the Hamburgh Company, the African Company, the South Sea Company, and that great bed of waste and corruption the East India Company. Lured by monopolistic profits, "private persons frequently find it more for their advantage to employ their capitals in the most distant carrying trades of Asia and America, than in the improvement and cultivation of the most fertile fields in their own neighbourhood." Smith likewise railed against fighting colonial wars "for the sole purpose of raising up a nation of customers." He raised a point that we might at least consider: is our globalization just a new mercantilism?

* * *

Smith held that a nation's wealth lies first in agriculture, to supply its people with ample food; second in domestic industry, to furnish everyday needs; and distinctly third in securing merchandise "of the finer kind" through trade. Unfortunately, Europe emerged from the Middle Ages in an "unnatural and retrograde" manner. Merchants in cities, relatively free from the repressive grip of feudal lords, began trading to secure luxuries from the Muslim empire and Byzantium. Gradually, urban artisans learned to manufacture local goods to replace traded articles. Only last did this commerce erode inefficient feudal estates, so that yeomen farmed their own plots, thereby raising yields and better feeding the populace. Powerful merchants who had led the way from feudalism were able to secure a system that put trade first, domestic manufacturing second, and agriculture last.

Smith's argument is ultimately about values -- not surprising given that before serving as commissioner of customs in Edinburgh, he was a professor of moral philosophy. Modern economists do not admit this sort of argument: if poor people buy traded merchandise "of the finer kind" rather than agricultural produce, then that is their system of values. Smith made judgments about values, which he saw mercantilism as distorting. The "enormous" sums spent on a reception for a new viceroy in



Peru served "to introduce ... the habit of vanity and expense upon all other occasions." Such distorted values in turn distort industry. Spain and Portugal, epitomes of mercantilism, sent galleons chasing after gold and silver while neglecting farming and manufacturing at home: "Have the exorbitant profits of the merchants of Cadiz and Lisbon augmented the capital of Spain and Portugal? Have they alleviated the poverty, have they promoted the industries of those two beggarly countries?"

British mercantilism was less damaging only because less extreme. Yet Britain squandered its treasury and the lives of its citizens in fighting the French and Indian War and the American Revolution, in Smith's view, so that its merchants could monopolize trade with the Colonies across the Atlantic. Elsewhere trading companies wielded sovereign power over foreign peoples for corrupt ends -- for example, increasing profits by burning spice crops. Although the English East India Company had "not yet had time to establish in Bengal so perfectly destructive a system" as the Dutch, Smith maintained that "the government of an exclusive company of merchants is, perhaps, the worst of all governments for any country whatever." He saw the limits of privatizing government services, to put it mildly.

Oppressive abroad, mercantilism was unjust at home.

It is the industry which is carried on for the benefit of the rich and the powerful, that is principally encouraged by our mercantile system. That which is carried on for the benefit of the poor and indigent, is too often, either neglected, or oppressed.

Large cloth manufacturers secured regulations favoring the import of yarn to cut their costs. This lowered the income of British spinners, "poor people, women commonly, scattered about in all different parts of the country, without support or protection." At the same time, by "extorting" subsidies from the government for exporting cloth, big manufacturers further increased their profits.

* * *

Smith's prescriptions for these ills are of debatable value, and extending them to our times is rash. Still, some things he said resonate across the centuries. Today's globalization, whatever its benefits, has a strange way of favoring the successors to those merchants and manufacturers who promoted mercantilism in Smith's day. Dani Rodrik, of the John F. Kennedy School of Government, at Harvard University, an economist who supports free trade, nevertheless concludes in a study of a large number of nations that "globalization reduces the ability of governments to spend resources on social programs; it makes it more difficult to tax capital; and a growing share of the tax burden is now carried by labor." In supposed exemplars of free trade like Argentina and Mexico, a cluster of powerful export firms backed by state subsidies are flourishing. Though Smith railed against such subsidies (or industrial policies), they probably did strengthen British industry, and today's global competition gives developing countries a better case for using them. The problem is that Argentina and Mexico, like England in Smith's day, have simply let the poor grow poorer.

From the archives:

- ["Do We Need to Be No. 1?"](#) by David M. Gordon (April, 1986)
"To generations

By 1980 industrial tariffs among the advanced nations were already low. The new wave of free trade seeks other forms of globalization that Smith might have called mercantilist. Our so-called Structural Impediments Initiative with Japan forced that country to let Toys R Us

schooled in neoclassical economics free trade sounds like an irresistible and probably irrefutable idea. But pure free-trade policies, which are still used as the intellectual benchmark of the debate, suffer from two critical flaws."

- "Jihad vs. McWorld," by Benjamin R. Barber (March, 1992)

"The two axial principles of our age -- tribalism and globalism -- clash at every point except one: they may both be threatening to democracy."

and other big commercial chains compete with mom-and-pop stores. Must we foist our dreariest institutions on the rest of the world? Regulations in treaties enforce trademarks that give multinationals a huge advantage over small local firms and arguably distort values. The Marlboro Man is alive and well on Third World television screens. Is this costly and excessive promotion not in some sense a modern counterpart to the installation of Peruvian viceroys or the East India Company's corporate privilege?

In other areas our treaties do promote free trade, but in ways that Smith, always guarded in his support of markets, would have regulated. Rules bar countries from blocking international financial flows like those that have triggered crashes and recessions in numerous nations. But only by limiting the ability of speculators to shuttle funds across borders in search of higher returns can a nation regulate interest rates. And Smith advocated regulating interest rates, limiting them to five percent in Britain in his day. Otherwise shortsighted bankers would seek exorbitant interest by lending to "prodigals and projectors," whose speculative schemes would lead to crashes. At five percent bankers would prefer making secure loans to "sober people" who invested in real production of goods and employed workers.

In some areas, including finance, protectionism is appropriate; in others, no doubt, free trade; in yet others, contra Smith, trade promotion. These matters should be considered on their merits, not lumped under the banner of globalization. As Smith said, "Those exertions of the natural liberty of a few individuals, which might endanger the security of the whole society, are, and ought to be, restrained by the laws of all governments."

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