



UNIVERSITY OF OXFORD

**Discussion Papers in
Economic and Social History**

Number 101, August 2012

***SELF-INTEREST, SYMPATHY AND THE INVISIBLE
HAND: FROM ADAM SMITH TO MARKET
LIBERALISM***

Avner Offer

Self-interest, Sympathy and the Invisible Hand: From Adam Smith to Market Liberalism

Avner Offer

All Souls College, University of Oxford

avner.offer@all-souls.ox.ac.uk

(20 July 2012)

Abstract

Adam Smith rejected Mandeville's invisible-hand doctrine of 'private vices, publick benefits'. In *The Theory of Moral Sentiments* his model of the 'impartial spectator' is driven by not by sympathy for other people, but by their approbation. Approbation needs to be authenticated, and in Smith's model authentication relies on innate virtue, which is unrealistic. An alternative model of 'regard' is applied, which makes use of signalling and is more pragmatic. Modern versions of the invisible hand in rational choice theory and neo-liberalism are shown to be radical departures from the ethical legacy of Enlightenment and utilitarian economics, and are inconsistent with Adam Smith's own position.

Since the 1980s, public policy in English-speaking countries has been guided by two doctrines. The first is selfishness (or more grandly, ‘rational choice’), namely that people are motivated primarily by self-regarding interests which they pursue in market exchange. The second is that the primacy of self-regard is good. Adam Smith’s ‘invisible hand’ ensures that market exchange is socially efficient. Wherever possible, therefore, production, distribution, and exchange should be transacted in markets, and should respond to prices. I call these doctrines ‘market liberalism’. There is however a long-standing question as to whether Adam Smith’s notion of the invisible hand can be reconciled with his ethical motive of ‘sympathy’ in the *Theory of Moral Sentiments*.¹ I argue here that what matters in Smith’s conception of sympathy is not our sympathy *for* others. Rather, it is the sympathy of others *for ourselves*. This motivation reconciles selfishness and sympathy and is altogether more credible. It also has a bearing on the efficiency and ethical authority of the norms of self-interest and market freedom in the present.

Despite their venerable lineage and normative centrality, we do not know whether the doctrines of self-interest and market efficiency are true. Their core premises are insecure. It has never been proven that they are always more efficient than other arrangements; it is not even easy to define what such efficiency would consist of. As for self-interest, it is either an *a priori* axiom, or a psychological speculation. In reality, choices are not always intended to maximise economic advantage. Financial motivations are often crowded out by intrinsic ones, such as obligation, compassion, and public spirit. As for aggregate efficiency, those who buy and sell for their own advantage have no incentive to seek it, and it has never been proven that efficiency happens by itself.

¹ Montes, ‘*Das Adam Smith Problem*’.

The doctrines of selfishness and of market efficiency are sometimes presented as hard-nosed conceptions of immutable reality. It is supposedly not the business of the economists to make moral judgements. Implicitly, however, and often openly as well, these doctrines also imply ethical claims: self-regard and market payoffs are presented not only as true, not only as efficient, but also as just and proper. Milton Friedman wrote, ‘The ethical principle that would directly justify the distribution of income in a free market society is, “To each according to what he and the instruments he owns produces.”’² An alternative view is that both types of claims, from reality and from justice, are asserted because they are self-serving. Indeed that is what we should expect if we truly believed them. This critical view is also developed here.

Since selfishness and the invisible hand remain unvalidated, they provide a bad model of reality. Like other bad models, and because they are bad models, in a normative role they can serve to justify harm. A different normative model is sketched out below, which also comes out of Adam Smith. Economics today has arrived at what appears to be a blind alley: the doctrines of efficient markets and the policy norms they endorsed, have failed repeatedly and badly. They are not sufficient to explain the success of capitalism and its variants, and they do not account for its failures. I dwell on Smith here at some length, because his authority is claimed by market liberals as providing support for their doctrines, and also because his real doctrine is different, more attractive ethically and more compelling empirically. In his view, the drive for personal advantage is tempered by the quest for approbation. Individual well-being depends on interpersonal acceptance. In contrast, market exchange is efficient only when it is truly competitive and impersonal. In reality, and even in modern societies, such competitive and impersonal settings are the exception.

² Friedman, *Capitalism and Freedom*, 161-2.

Whenever there is personal interaction (as in a good deal of economic exchange), mutual obligation enters the calculus of advantage.

I

Every economic exchange creates a transient condition of dependence. Much of the time, this makes no difference: buyers and sellers have ways to police each other. Conventions, law, morality and regulation keep defectors in check. But when knowledge and bargaining power unequal, opportunities for duplicity and defection can open up. The doctrine of self-interest provides an adequate motive. Another justification for defection is that self-interest promotes collective welfare. As Mandeville put it in 1714, ‘Private Vices, [are] Publick Benefits’. ‘The worst of all the multitude,’ he wrote, ‘did something for the common good’.³

The two interlocking doctrines of self-interest and market efficiency carry through to the present day. But they true? We still don’t know. The primacy of self-interest is no more than speculation. The invisible hand remains an article of faith. As norms for conduct, these two doctrines are asymmetric in time. Self-interest is a licence for defection now. In contrast, the ‘Publick Benefits’ promised are remote and uncertain.

The concept of an ‘invisible hand’ is identified with Adam Smith. The two most famous passages in *The Wealth of Nations* align it with the interests of the businessman who

... 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. Nor is it always the worse for the society that it was no part of it. By pursuing his own

³ Mandeville, *Fable of the Bees*, p. 9, line 17.

interest he frequently promotes that of the society more effectually than when he really intends to promote it.⁴

Note that Smith's criterion is not the benefits for the individual, but for society. The other famous passage says,

It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own but of their advantages.

These lines can be taken as a warrant for self-seeking. In the spirit of Mandeville, do your worst, it is only for the best.

But Smith held Mandeville in contempt. Mandeville, he wrote disapprovingly, 'seems to take away altogether the distinction between vice and virtue, and of which the tendency is, upon that account, wholly pernicious... All public spirit, therefore, all preference of public to private interest, is, according to him, a mere cheat and imposition upon mankind.'⁵

Smith opens his first book, *The Theory of Moral Sentiments*, by invoking our capacity for 'sympathy': 'How selfish soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortune of others.'⁶ In this passage, 'sympathy' is independent of, and as real, as selfishness. These generous opening words impart a benign aura to the book. But the claim is a little puzzling. How soever attractive such innate benevolence might be, it is not entirely credible as a prime motivator.

⁴ Smith, *Wealth of Nations*[henceforth, WN], vol. 1, IV, ii.

⁵ Smith, *Theory of Moral Sentiments* [henceforth, TMS], VII.ii.4.6.

⁶ TMS, I.i.1.1.

The primacy of sympathy is more believable, however, if what really matters is not our sympathy *for others*, but the sympathy of others *for ourselves*: ‘nothing pleases us more than to observe in other men a fellow-feeling with all the emotions of our own breast.’⁷ Note that ‘nothing pleases us more’. The motivational primacy of other people’s sympathy is meant here literally.

What are the advantages which we propose by that great purpose of human life which we call bettering our condition? To be observed, to be attended to, to be taken notice of with sympathy, complacency, and approbation, *are all* the advantages which we can propose to derive from it. It is the vanity, not the ease, or the pleasure, which interests us.⁸

As a motive that is equally compelling as self-interest, the approbation of others is more credible than benign altruism. But in order to gratify, the approbation of others has to be genuine. Unmerited approbation is not valued.⁹ It needs to be authenticated. That is why Smith opens his argument by asserting the existence of unilateral sympathy. This is necessary for his model to work: for the sympathy of others to be credible, we need to believe that they have the capacity for unilateral sympathy. And for this capacity to be credible in others, we need to observe it in ourselves. Our capacity to sympathise *with* others, has to be assumed in order to make the sympathy *of* others credible to us. This need for approbation is wired in: ‘Nature, when she formed man for society, endowed him with an original desire to please and an original aversion to offend his brethren... She rendered their approbation most

⁷ TMS, I.i.2.1.

⁸ TMS, I.iii.2.1. Italics added.

⁹ TMS, III.2.7.

flattering and most agreeable to him for its own sake; and the disapprobation most mortifying and most offensive.’¹⁰

How to authenticate the approval of other people? We do not have access to their minds. But we can see into our own. Smith uses the device of ‘the impartial spectator’. Approbation needs to be deserved (in an echo of the Golden Rule, ‘As every man doth, so shall it be done to him.’)¹¹ In order to take satisfaction in praise, one needs to have earned it. Individuals know whether they are praiseworthy better than an external observer. They should wish for no more praise than a well-informed and fair-minded stranger might be willing to accord: ‘We endeavour to examine our own conduct as we imagine any other fair and impartial spectator would examine it.... We suppose ourselves the spectators of our own behaviour, and endeavour to imagine what effect it would, in this light, produce upon us.’¹² The agent views his own conduct as other people might see it, and cannot, in fairness, claim any special consideration, unless it was truly deserved. This point of view, of the ‘impartial spectator’, is internalised so that the sense of desert no longer depends on the presence or absence of actual praise.¹³ For this model to work, Smith needs to assume that the individual not only has a natural desire for praise, but also an innate desire to *be* virtuous: ‘Nature has endowed him not only with the desire of being approved of, but with the desire of *being* what ought to be approved of.’¹⁴ But that may be a step too far: is this really credible? Even Smith admits that the capacity for sympathy is not restricted to the virtuous and the humane.¹⁵

¹⁰ TMS, III.ii.6.

¹¹ TMS, II.ii.1.10.

¹² TMS, III.1.2, III.1.5.

¹³ TMS, III.1.5.

¹⁴ TMS, III.2.7, italics added.

¹⁵ TMS, I.i.1.1.

A similar concept to ‘sympathy’ is provided in my own account of ‘the economy of regard’.¹⁶ In economics it is assumed that individuals form their preferences independently of each other. In contrast, the concept of ‘regard’ implies that they form their preferences in response to each other. The ultimate benefit is self-worth. As Smith argued, self-worth requires the validation of others. The term ‘regard’ has two meanings: The first is ‘to be noticed’. The second is ‘to be valued’. Validation needs to be independent and impartial. Instead of relying on self-validation by the ‘impartial spectator’, it is achieved by evaluating the signal of approbation. A good signal, in theory, is one that is difficult to make and difficult to fake. Hence, the recipient should be in a position to evaluate it.¹⁷ Approbation is communicated as a signal from the counterparty, by means of a ‘gift’ (the term is applied to any voluntary transfer). The glow of acknowledgement in the cycle of reciprocal exchange is the authentication device.

Regard takes many forms: attention, acceptance, respect, reputation, status, power, intimacy, love, friendship, kinship, sociability. Withholding it signifies indifference and rejection. To convey authentic regard, a genuine signal requires discrimination and effort. But it does not require virtue. Regard can motivate anyone, villains as well as the virtuous, and is sustained so long as it is reciprocated. This is less demanding, and more realistic, than assuming, as Smith needs to do, that people are imbued with ‘the real love of virtue, and the real abhorrence of vice.’¹⁸ But Smith was right to perceive that some level of shared virtue helps to motivate the cycle of reciprocity. Nevertheless, if social norms are benign, then a good deal of co-operation,

¹⁶ Offer, ‘The Economy of Regard’.

¹⁷ Camerer, ‘Gifts as Economic Signals’

¹⁸ TMS, III.2.7

prosocial behaviour, and reciprocity, can be motivated by the quest for approbation alone.

For Smith, ethical obligation does not mean self-denial: it is grounded in the pursuit of personal benefit, in ‘reflected self-interest.’¹⁹ Ethical norms have consequently evolved as part of human nature. This is also consistent with recent experimental findings, which have shown that the commitment to fairness is widespread, but falls short of being universal.²⁰ For Smith, sympathy is an objective of self-interest.

The ‘invisible hand’ is invoked only once in *The Wealth of Nations*. Its effectiveness is understated: it is merely ‘not always the worse for society’; and it does not *necessarily* promote the interests of society, it only does so ‘frequently’. The miraculous powers it has subsequently acquired may not have been intended by its author.²¹ In contrast, the ‘impartial spectator’ (the internalised norm of propriety), is invoked sixty-six times in Smith’s first book, *The Theory of Moral Sentiments*, and its authority, the authority of conscience, is taken as binding. It was also Smith’s final word: a revised sixth edition was published just before his death.

The contradiction is real. How to square the doctrines of *laissez-faire* and ‘natural liberty’ with those of moral obligation that seem to coexist in Smith, and even more so, how to square the difference between Smith and Mandeville? My response is that much of the time we do not have to choose. The invisible hand applies where markets are impersonal and competitive, and where they trade in uniform commodities. In contrast, the impartial spectator’s ethical norms apply whenever

¹⁹ Montes, ‘Das Adam Smith Problem’, p. 74.

²⁰ Camerer and Fehr, ‘Measuring Social Norms and Preferences Using Experimental Games’.

²¹ Grampp, ‘What did Smith Mean’; Rothschild, *Economic Sentiments*, ch. 5; Samuels et al., *Erasing the Invisible Hand*.

exchange is mediated by personal relations. Approbation may be valued highly, but impersonal markets cannot supply it.²²

This is demonstrated in Smith's chapter, 'Digression concerning the Corn Trade And Corn Laws', in *The Wealth of Nations*.²³ In the British *ancien regime*, the grain trade was regulated by means of maximum prices and restrictions on export and hoarding. Their purpose was to prevent extreme price rises in times of shortage. E.P. Thompson regarded these arrangements as a reciprocal 'moral economy', in which the poor provided deference, and the rich guaranteed subsistence.²⁴ Smith argued that these regulations were misguided, and that a free market was more likely than any regulator to ensure subsistence, except in the most extreme circumstances. Grain production and trade, the largest industry in the country, was too extensive for any monopolist to capture. Merchants who raised prices above the competitive level would be undercut by the others.

The popular belief that merchants hoarded grain deliberately in times of dearth gave rise to food riots; the fear of riot deterred respectable traders, and the business therefore attracted 'an inferior set of dealers... together with a number of wretched hucksters'.²⁵ The accusation of impropriety became self-fulfilling. The implication is that in impersonal, competitive markets, virtue does not matter; it makes little difference that the grain trade middlemen are short on virtue. The impersonal discipline of competitive markets made them serve the public good.

²² Offer, 'The Economy of Regard', 454, 467; Nieli, 'Spheres of Intimacy' applies the impartial spectator in the case of personal intimacy, the invisible hand for impersonal relations. Viner has an analogous concept of 'social distance'. (Viner, *The Role of Providence*, pp. 80-82). The latter two are cited in Montes, 'Das Adam Smith Problem'.

²³ WN, IV.v.b, p. 524.

²⁴ Thompson, 'Moral Economy'.

²⁵ WN, IV.5.47, 541.

II

The advocates of market liberalism naturally concurred in this analysis. The Mont Pèlerin Society is an influential and well-funded global society of academics, businessmen, and their acolytes, all of them hostile to the welfare state, which has assembled annually since 1947.²⁶ In 1976, it went to Scotland to commemorate the bicentenary of the *Wealth of Nations*. In one of the papers presented, the Chicago economist Ronald Coase explained

For that extensive division of labour required to maintain a civilised standard of living, we need to have the co-operation of great multitudes, scattered all over the world. There is no way in which this cooperation could be secured through the exercise of benevolence. Benevolence, or love, may be the dominant, or, at any rate, an important, factor within the family or in our relations with colleagues and friends, but as Adam Smith indicates, it operates weakly or not at all when we deal with strangers... The great advantage of the market is that it is able to use the strength of self-interest to offset the weakness and partiality of benevolence.²⁷

Milton Friedman also differentiated between the intimate sphere where obligation was appropriate, and the impersonal one, where it was impractical.

On the moral level, Smith regarded sympathy as a human characteristic, but one that was itself rare and required to be economised. He would have argued that the invisible hand was far more effective than the visible hand of

²⁶ Hartwell, *A History of the Mont Pèlerin Society*; Walpen, *Die Offenn Feinde*; Mirowski and Plehwe, *The Road from Mont Pèlerin*.

²⁷ Coase, 'Adam Smith's View of Man', (1976) fol. 13, Hayek Papers 163/4.

government in mobilising not only material resources for immediate self-seeking ends but also sympathy for unselfish charitable ends.²⁸

Friedman's assertion that love is scarce may have come from an essay by Robertson, 'What do Economists Economize On?'²⁹ But Smith himself never regarded sympathy as being scarce. He considered it to be innate and universal.

Like Friedman, Coase also twisted the existence of benevolence into an argument against collective provision:

this should not lead us to ignore the part which benevolence and moral sentiments do play in making possible a market system. Consider, for example, the care and training of the young, largely carried out within the family and sustained by parental devotion. If love were absent and the task of training the young was therefore placed on other institutions, run presumably by people following own self-interest, it seems likely that this task, on which the successful working of human societies depends, would be worse performed.³⁰

So much for education and schools. In this market-liberal argument, everything hangs on relative scale of impersonal markets, in comparison with the aggregate scale of those forms of exchange that involve personal interaction.

Chicago economists assume that impersonal markets predominate. This is also suggested by the common usage which implies that we live in competitive market societies. But for one thing, a good deal of commercial activity is anything but competitive. And incentives of regard continue to pervade large sectors. They dominate production and exchange within the household (including the creation and

²⁸ Friedman, 'Adam Smith's Relevance for 1976' (1976), Hayek Papers 163/3

²⁹ Robertson, 'What Do Economists Economize on?'

³⁰ Coase, 'Adam Smith's View of Man', p. 13.

raising of children), and those segments of production which depend on personal interaction: health, education, personal care, small teams, relational salesmanship, family farming, the military, the professions, and hierarchical bureaucracies of various kinds. The boundaries of self-regard, pseudo-regard, and authentic regard shift in response to technological conditions, modes of production, cultural norms and personal preferences. Overall, taking the imputed money value of household production (including childcare), not-for-profit activity, and public and collective goods, less than half of the imputed money value of final welfare is allocated through markets.³¹

In advanced societies, people have deliberately avoided impersonal markets for most of their satisfactions. Even within markets, a good deal of exchange involves interpersonal interaction, e.g. in marketing, hospitality, and personal services. The share of services has come to dominate output in western developed societies, and services typically require interpersonal interactions and trust. Teachers, doctors, lawyers, waiters, hairdressers, salespeople and financial managers too, all owe the client a duty of care. Hence, both Mandeville and Smith can be right at the same time, in different sectors and activities. The challenge for policy is not to get the invisible hand to displace the impartial spectator, or vice versa, but to identify the appropriate sphere and scope for each. As the relative share of commodity production declines in advanced societies the impartial spectator's duty of care only gains in importance.

III

In view of the enduring influence of the invisible hand doctrine, and of Smith's authority, one might assume that it is founded on compelling analysis. Most of his argument, as in the Corn Trade chapter, is descriptive: Smith's 'System of Natural

³¹ Roughly quantified in Offer, 'Economy of Regard'.

Liberty' is appropriate to competitive markets, which can discipline market traders. Analytically, however, invisible hand statements take the form of causal propositions: action A leads to result B – they imply a mechanism at work. But Smith did not try to show *how* it worked, except, as above, by anecdote, example, or assertion. The invisible hand itself is alchemy—a felicitous phrase but without any Newtonian clockwork behind it.³²

And so it has remained. The invisible hand is at the heart of economics, and provides a social justification for the primacy of self-regard. But it is no more than an article of faith. Taken as a formal theorem, for almost two centuries nobody was able to prove it. In the 1950s, the 'Two Theorems of Welfare Economics', were proven mathematically by Arrow and Debreu. These theorems were proclaimed as the final demonstration of the invisible hand theorem.³³ They show that every general equilibrium is associated with a state of Pareto efficiency (in which no one can be made better off without someone else being made worse off). This notion of efficiency has generally been adopted as the touchstone of economic performance. Like other economic terms which diverge from their ordinary meanings, Pareto efficiency is quite different from the lay concept of efficiency, which is defined by the relation between input and output. The Two Theorems, the purported proof of the invisible hand postulate, are not in fact such a great advance: the proof is clever and difficult, but it only obtains if there are always markets open for all goods and prices available to everyone until the end of time. Such conditions are not easy to satisfy.

Furthermore, the criterion of Pareto efficiency is not particularly attractive.³⁴

The point of departure is a demonstration by Edgeworth that for two persons trading with each other there is a deal that maximises their joint payoff (in fact, the deal has

³² Montes, 'Newton's Real Influence'.

³³ Arrow and Hahn, *General Competitive Analysis*, p. 5.

³⁴ Bromley, 'The Ideology of Efficiency: Searching for a Theory of Policy Analysis'.

such a single solution only under restrictive assumptions, and is otherwise indeterminate).³⁵ Likewise, in the two theorems of welfare economics, there is a general equilibrium (of all simultaneous trades in the economy) that maximises collective payoffs for every set of initial endowments. When the butcher and the baker are trading bread and meat in order to make their sandwiches, the joint maximum is easy to measure. But what units can be used to measure *everybody's* satisfaction or utility? How can we compare even the value of a single dollar, for the rich and for the poor? If it is 'willingness to pay', that surely depends on 'ability to pay', that is to say, on initial endowments and their ownership. The rich can always outbid the poor. And why should the property rights of the rich be taken as prior? As Bentham pointed out, property is created by society and depends on it.³⁶ If one person has everything and everybody else has nothing, then welfare will be raised by redistributing from one to all, even at the expense of pre-existing claims.

The Pareto criterion of so-called efficiency endorses existing property rights and the status quo, and does not take into account what other distributions might be more equitable or could provide more welfare overall. Indeed, no objective criterion for maximizing welfare overall is provided. Every person is the sole judge of their own welfare. Every person has a veto, and can cry a halt. The criterion is undemocratic. It is equivalent in this respect to the principle of unanimity demanded by Public Choice advocates such as James Buchanan. And like Public Choice doctrine, its main effect is to provide legitimacy and protection for the existing distribution of property, however acquired, and however unequal.

But the pre-requisites even for this underwhelming notion of efficiency are non-existent. Kenneth Arrow (himself one of the two authors of the welfare theorems) has

³⁵ Mirowski, 'Introduction', in Edgeworth and Mirowski, *Edgeworth on Chance*, pp. 24-29.

³⁶ Bentham, 'Principles of the Civic Code', Bowring edition, i, 307, 309

written that ‘a complete general equilibrium system, as in Debreu (1959), requires markets for all contingencies in all future periods’. Another High Theorist (and Arrow’s co-author), Frank Hahn, wrote that ‘the complete market hypothesis is completely falsified’.³⁷ John Williamson, the senior IMF economist who had coined the term ‘Washington Consensus’, has written,

One does not have to be some sort of market fundamentalist who believes that less government is better government and that externalities can safely be disregarded in order to recognize the benefits of using market forces to coordinate activity and motivate effort. This is a proposition that is such a basic part of economic thinking *that it is actually rather difficult to think of a work that conclusively establishes its truth*. But there are a variety of indirect confirmations.³⁸

This is just it. Theorists agree that general equilibrium cannot be made to work.³⁹ That markets are the best systems of delivery is not a universal truth, and depends on local circumstances. And perfection cannot be achieved incrementally. It is all or nothing. Short of the invisible hand there is only the ‘Second-Best’.⁴⁰ Even in theory, the economy does not improve incrementally as railways (for example) are privatized.

In classical economics from Adam Smith to John Stuart Mill, the object of policy was not the various interests of individuals, but the welfare of society. Smith insisted on the primacy of the common good over self-interest,

The wise and virtuous man is at all times willing that his own private interest should be sacrificed to the public interest of his own particular order or society.

He is at all times willing, too, that the interests of this order or society should be

³⁷ Arrow, ‘Economic Theory and the Hypothesis of Rationality’, p. 72. Hahn, ‘Reflections on the Invisible Hand’, p. 121.

³⁸ Williamson, ‘A Short History of the Washington Consensus’, p. 26. Italics added.

³⁹ Ackerman and Nadal, *The Flawed Foundations of General Equilibrium*.

⁴⁰ Lipsey and Lancaster, ‘General Theory of Second Best’.

sacrificed to the greater interest of the state sovereignty, in which it is only a subordinate part.⁴¹

Note the role for virtue and wisdom: man is not the slave of desire. He is capable self-command, and of acknowledging a greater good beyond himself. This is also consistent with nineteenth-century Utilitarianism, an other-directed ethical doctrine endorsed by most English Victorian economists, whose precept was ‘The Greatest Good of the Greatest Number’. Like Smith and Hume, Bentham, Mill, Jevons, Sidgwick, Marshall, Edgeworth, and Pigou also held a view not unlike the Stoic doctrine that, in the words of Smith, ‘We should view ourselves, not in the light in which our own selfish passions are to place us, but in the light in which any other citizen of the world would view us.’⁴²

In contrast, more recent economics makes a virtue of self-regard: it prides itself on being counter-intuitive. Concern for others is soft minded ‘cheap talk’. It may be an ethical injunction, but that is only a ‘value’. Those who want to understand the world are told to separate ‘ought’ from ‘is’. Modern social science prides itself on ‘Value Freedom’.⁴³ Scientists describe things as they are, not as they ought to be. But the tough-minded economist who has no time for ethics is also making an ethical stand. The Pareto-efficiency criterion has nothing to say about prior distribution, which it takes as given. It is silent about equity. That is an ethical position, which relies on the counter-intuitive assumption that well-being is entirely subjective and cannot be compared from one person to another. For Lionel Robbins, an influential exponent of neoclassical doctrine in the 1930s, ‘me-first’ was founded on the

⁴¹ TMS, VI.ii.3.3.

⁴² TMS, III.3.11

⁴³ Bromley, ‘the Ideology of Efficiency’, pp. 89-91.

‘Indisputable Facts of Experience’.⁴⁴ Following on Robbins, in standard microeconomic theory, e.g. in the theory of household consumption, ‘me-first’ is simply taken as a premise which needs no justification.

But the facts of experience are no such thing. Others have different intuitions.⁴⁵ As an empirical postulate, self-interest is tautological: any choice observed can be attributed to self-interest. If, however, it means that everyone is always maximising a material or financial or market advantage, then it is manifestly untrue. The psychological model of unbounded self-regard is not credible. Friendship, love, loyalty, charity, patriotism, civility, solidarity, integrity, impartiality, which are ubiquitous and compelling, depend on the premise of unbounded self-regard being wrong. The family, religion, the workplace, the judiciary, the state, the nation, military service—some of the most powerful and enduring institutions assume that people will not always put themselves first. And values are not inscrutably subjective. The focal points of market prices and their elasticities indicate a broad social consensus on what is valuable. Market-liberals themselves have realized that for microeconomics to have any predictive power, it is necessary to assume that preferences are ‘assumed not to change substantially over time, not to be very different between wealthy and poor persons, or even between persons in different societies and cultures.’⁴⁶ They have extended this into macroeconomics with the device of ‘representative agent’, i.e. a model of the economy as a whole in which multitudes of people are assumed to act as one. And in advocating business-friendly de-regulation, market liberals are happy to use cost-benefit analyses based on ‘willingness to pay’, and have no problem aggregating dollars which have very different subjective values to different people.

⁴⁴ Sugden, ‘Can Economics Be Founded on ‘Indisputable Facts of Experience?’

⁴⁵ Sugden, *op. cit.*

⁴⁶ Becker, *The Economic Approach to Human Behavior*, p. 5.

IV

The self-regarding actor re-appeared in a particularly de-socialised guise in the 1940s. He featured in early game theory and in the Savage axioms of rationality, laid down in the 1950s. Duncan Black defined the self-seeking rational voter, and laid the foundation for Anthony Downs's *Economic Theory of Democracy* in the 1950s. In the 1960s, Mancur Olson argued the futility of collective action. By the 1970s, methodological individualism and rational choice had become the standard assumptions in economics and political science. These doctrines are so pervasive now that it is easy to overlook how radical they were initially. This 'selfish turn' may neutrally be described as sociopathic, i.e. inimical to social co-operation. In social science discourse, the criterion of common good was simply set aside. Rational choice theory does not even need to be blessed by the invisible hand.⁴⁷ The 'hand' is bolted on as an afterthought.

There is a puzzle as to why, from the 1950s onwards, such an extreme form of self-regard should have beguiled academics in economics, political science, and philosophy, as being so manifestly self-evident. In evolutionary biology as well, the tide flowed from group to individual selection. Even John Rawls's *Theory of Justice*, the dominant work in moral and political philosophy, took individual self-interest, 'behind the veil of ignorance', as its point of departure. It is not generally known that Rawls was briefly a member of the Mont Pélérin Society. Rawls was put forward by Milton Friedman in 1968, and withdrew from the Society three years later, before the publication of the *Theory* in 1971.⁴⁸ In keeping with the Society's orientation, Rawls privileges 'freedom' as the highest good. Many other philosophers and political

⁴⁷ Elster, 'The Nature and Scope of Rational-Choice Explanations'.

⁴⁸ Mont Pélérin Society, Proposals for Membership, September 1968, Mont Pélérin Society Papers 44/1, Hoover Institution Archives; Mont Pélérin Society, 'List of Members' [1970], Friedman Papers 87/5, Hoover Institution Archives; Mont Pélérin Society, list of lapsed members, 1972, Friedman Papers 87/2;

scientists have followed his lead. But other social sciences, notably sociology, anthropology, and psychology, maintained a sceptical distance, and earned the disdain of ‘tough-minded’ rational choice colleagues.

Maybe this posture of ‘toughness’ is a clue. Decisiveness can be attractive, and it is only a short step to extol the rough virtues of manliness. In American culture in particular, ‘toughness’ is held out as a virtue. A robust Social Darwinism coexisted in nineteenth-century America with an intense religiosity – indeed the two were regarded as complementary. Success was Godly, failure deserved.⁴⁹ The British gentlemanly ideal was the opposite: self-control rather than self-assertion, ‘gentility’ rather than hardness.⁵⁰

Toughness is worthy of admiration when it signifies the ability to *endure* pain. But in the social and political rhetoric since the 1970s, toughness has mutated into a willingness to *inflict* pain: the rhetoric is ‘hard choices’ (hard for me to hurt you), ‘cruel to be kind’ or more directly ‘if it ain’t hurting, it ain’t working’. When combined with a license for self-seeking, such ‘toughness’ might well inspire wariness rather than admiration.

The ideal of ‘Freedom’ is associated with toughness, to the extent that it means a ‘rugged’ independence, ‘standing on one’s own feet’. Freedom has an exalted lineage in the historical struggle against religious oppression and in resistance to external and domestic tyranny. The historical quest for freedom is replete with martyrdom. In the European tradition of Rousseau and Kant, ‘freedom’ is also about the scope for moral or personal autonomy. In the Anglo-Saxon tradition, however, it stands primarily for the security of property rights, although both other meanings are implied as well.⁵¹ In

⁴⁹ Hofstadter, *Social Darwinism in American Thought*, especially chapter 3 on William Graham Sumner.

⁵⁰ Girouard, *Camelot*; Mason, *The English Gentleman*.

⁵¹ MacPherson, *Possessive Individualism*; McGilvray, *Invention of Market Freedom*.

the American and British traditions, ‘freedom’ was compatible with the ownership of slaves: indeed, it dignified the ownership of slaves.⁵² Chicago economist Robert Fogel won the Nobel Prize in part for a book that argued that slavery was ‘efficient’.⁵³ No Pareto efficiency veto for the slaves; no more than was for the subjects of the Pinochet dictatorship, lauded for its market liberalism and advised by Milton Friedman and James Buchanan. For market liberals, freedom does not extend to speech: both the Mont Pélérin Society and the Chicago Department of Economics, the sectarian incubators of market liberal thought, have restricted access to those with like-minded opinions and have not gone out on their way to debate with their critics. Protection of property is commonly conflated with individual autonomy and discretion, although possession of property and freedom for some, as Bentham once recognised, limits the freedom of others. In the market discourse of the 20th century, ‘freedom’ has become just another term for self-interest, ubiquitous on right-wing mastheads. As in the case of ‘toughness’, personal virtue has transformed into social license: freedom from tyranny has mutated into freedom from obligation. In its more extreme form, as among the followers of Ayn Rand, it is a kind of juvenile revulsion from parental tutelage – indeed, ‘paternalism’ is one of the freedom advocates’ greatest evils.

For all its rhetoric of freedom, neoclassical economics, at both micro and macro level, is not comfortable with actual choice. In microeconomic consumer theory, the agent has a set of innate preferences. He or she is presented by reality with a complete set of opportunities, prices and their probabilities. Given their immutable preferences and the information they have, consumers can only make one choice, the one that maximises their preferences. They have no more discretion than a piece of clockwork. This rigid determinism leaves no room for ethical choice, and justifies any outcome as

⁵² Brown, ‘Free Enterprise and Economics of Slavery’; ‘Adam Smith’ s view of Slaves As Property’.

⁵³ Fogel and Engerman, *Time on the Cross*.

being inevitable. Likewise, at the macro level, policy-making is delegated to so-called ‘independent’ central banks with a rigid and narrow mandate, to achieve a given rate of inflation. Even that discretion is a concession designed to hold down the unruly pressure of wage demands. When it comes to asset prices, no intervention is warranted at all. In other words, one rule for labour, another for capital.

In reality choice is never so easy. In contrast with the premises of deterministic economic modelling, a good deal of the future is unknowable, and time- inconsistent discounting means that choice is often genuinely intractable, with no optimising algorithm available.⁵⁴ In the face of such imponderables, choices still have to be made.⁵⁵ This indeterminacy opens up room for genuine discretion, including an ethical choice, for ‘doing the right thing’. In the absence of clockwork procedures, people fall back on established commitment devices, which allow them to place a larger conception of welfare above what might seem to be their own immediate interests. These commitment devices are established social conventions and strategies which often embody ethical norms, and which make it possible to overcome myopic preferences. Examples of this at a personal level are marriage, education, insurance, prudence, and patriotism; at the social level, constitutions, law, religion, money, calendars and clocks, government, and taxes. Before the relativism of Robbins and his amoral successors, the utilitarian doctrines of Victorian economists were also commitment devices of this kind.

Many of these commitment devices can be thought of as ‘ethical capital’. They form a reliable inventory of expectations about how people are likely to act. They underpin trust and facilitate exchange. They economise on monitoring and

⁵⁴ Offer, *Challenge of Affluence*, ch. 3.

⁵⁵ Bidhe, *A Call for Judgment*.

enforcement. Ethical capital takes us back to Adam Smith, the impartial spectator, and the assumption of innate virtue.

Seen this way, the ‘selfish turn’ of the 1960s and 1970, the rise and acceptance of rational choice doctrines, constituted a wholesale destruction of ethical capital, an episode of normative demolition. ‘Freedom’ has a transcendental appeal in American culture and politics. But for a self-regarding rational individualist, it comes down to calculation: how much self-seeking is it useful to allow, if the same license is available to others. The choice depends on socio-economic standing: freedom from obligation is more valuable to the rich and powerful than to others, because there is more for them to lose.

References

- Ackerman, F. (2004). *The Flawed Foundations of General Equilibrium : Critical Essays on Economic Theory*. London ; New York, Routledge.
- Arrow, K. J. (1987). Economic Theory and the Hypothesis of Rationality. *The New Palgrave Dictionary of Economics*. Ed. J. Eatwell and M. Milgate. London, MacMillan: 70-74.
- Arrow, K. J. and F. Hahn (1971). *General Competitive Analysis*. Amsterdam ; Oxford, North-Holland.
- Becker, G. S. (1976). *The Economic Approach to Human Behavior*. Chicago ; London, University of Chicago Press.
- Bentham, J. (1838). Principles of the Civic Code. *The Works of Jeremy Bentham*. Ed. J. Bowring. Edinburgh: 11 vols., i.
- Bhide, A. (2010). *A Call for Judgment : Sensible Finance for a Dynamic Economy*. Oxford, Oxford University Press.

- Bromley, D. W. (1990). "The Ideology of Efficiency: Searching for a Theory of Policy Analysis." *Journal of Environmental Economics and Management* **19**(1): 86-107.
- Brown, M. (2010). "Adam Smith's View of Slaves as Property." *Real-World Economics Review*(54).
- Brown, M. (2010). "Free Enterprise and Economics of Slavery." *Real-world Economics Review*(52).
- Camerer, C. (1988). "Gifts as Economic Signals and Social Symbols." *American Journal of Sociology*, **94**, S180-214.
- Camerer, C. and E. Fehr (2004). Measuring Social Norms and Preferences Using Experimental Games: A Guide for Social Scientists. *Foundations of Human Sociality: Economic Experiments and Ethnographic Evidence from Fifteen Small Scale Societies*. Ed. J. E. A. E. Henrich. New York, Oxford University Press: 55-95.
- Coase, R. (1976). Adam Smith's View of Man. *Hayek Papers*. Hoover Institution, Stanford University.
- DeMartino, G. F. (2010). *The Economist's Oath on the Need for and Content of Professional Economic Ethics*. New York, Oxford University Press.
- Edgeworth, F. Y. and P. Mirowski (1994). *Edgeworth on Chance, Economic Hazard, and Statistics*. Lanham, Md., Rowman & Littlefield.
- Elster, J. (2001). The Nature and Scope of Rational Choice Explanation. *Readings in the Philosophy of Social Science*. Ed. M. Martin and L. C. McIntyre. Cambridge, MA, MIT Press: 311-322.

- Fogel, R. W. and S. L. Engerman (1974). *Time on the Cross : The Economics of American Negro Slavery*. London, Wildwood House.
- Friedman, M. Papers. *Milton Friedman Papers*. Hoover Institution Archives, Stanford University.
- Friedman, M. (1976). Adam Smith's Relevance for 1976. *Hayek Papers*. Hoover Institution, Stanford University.
- Friedman, M. and R. D. Friedman (1962). *Capitalism and Freedom*. Chicago, University of Chicago Press.
- Girouard, M. (1981). *The Return to Camelot : Chivalry and the English Gentleman*. London ; New Haven, Yale University Press.
- Grampp, W. D. (2000). "What Did Smith Mean by the Invisible Hand?" *Journal of Political Economy* **108**(3): 441-465.
- Hahn, F. (1984). Reflections on the Invisible Hand. *Equilibrium and Macroeconomics*. Ed. F. Hahn. Oxford, Blackwell: 111-132.
- Hartwell, R. M. (1995). *A History of the Mont Pelerin Society*. Indianapolis, Liberty Fund.
- Hofstadter, R. (1955). *Social Darwinism in American Thought*. Boston, Beacon Press.
- Lipsey, R. G. and K. Lancaster (1956). "The General Theory of Second Best." *Review of Economic Studies* **24**: 11-32.
- MacGilvray, E. (2011). *The Invention of Market Freedom*. Cambridge ; New York, Cambridge University Press.
- Macpherson, C. B. (1962). *The Political Theory of Possessive Individualism : Hobbes to Locke*. Oxford, Clarendon Press.
- Mandeville, B. (1714, 1988). *The Fable of the Bees, or, Private Vices, Publick Benefits*. Indianapolis, Liberty Classics.

- Mason, P. (1982). *The English Gentleman : The Rise and Fall of an Ideal*. London, André Deutsch.
- Mirowski, P. (1994). Introduction. *Edgeworth on Chance, Economic Hazard, and Statistics*. Ed. P. Mirowski. Lanham, Md., Rowman & Littlefield: vii, 462.
- Mirowski, P. and D. Plehwe (2009). *The Road from Mont Pèlerin : The Making of the Neoliberal Thought Collective*. Cambridge, Mass. ; London, Harvard University Press.
- Montes, L. (2003). "Das Adam Smith Problem: Its Origins, the Stages of the Current Debate, and One Implication for Our Understanding of Sympathy." *Journal of the History of Economic Thought* **25**(1): 63-90.
- Nieli, R. (1986). "Spheres of Intimacy and the Adam Smith Problem." *Journal of the History of Ideas* **47**(4): 611-624.
- Offer, A. (1997). "Between the Gift and the Market: The Economy of Regard." *Economic History Review* **50**(3): 450-476.
- Offer, A. (2006). *The Challenge of Affluence : Self-Control and Well-Being in the United States and Britain since 1950*. Oxford, Oxford University Press.
- Robbins, L. R. (1932). *An Essay on the Nature & Significance of Economic Science*. London, Macmillan.
- Robertson, D. H. (1956). What Do Economists Economize On? *Economic Commentaries*. Ed. London, Staples Press: 147-154.
- Rothschild, E. (2001). *Economic Sentiments : Adam Smith, Condorcet and the Enlightenment*. Cambridge, MA, Harvard University Press.
- Samuels, W. J., M. F. Johnson, et al. (2011). *Erasing the Invisible Hand :B Essays on an Elusive and Misused Concept in Economics C Warren J. Samuels ; with the*

Assistance of Marianne F. Johnson and William H. Perry. Cambridge ; New York, Cambridge University Press.

Smith, A., R. H. Campbell, et al. (1776, 1976). *An Inquiry into the Nature and Causes of the Wealth of Nations.* Oxford, Clarendon Press.

Smith, A., A. L. Macfie, et al. (1759, 1976). *The Theory of Moral Sentiments.* Oxford, Clarendon Press.

Society, M. P. *Papers.* Hoover Institution Archives, Stanford University.

Sugden, R. (2009). "Can Economics Be Founded on 'Indisputable Facts of Experience'?" Lionel Robbins and the Pioneers of Neoclassical Economics." *Economica* **76**(304): 857-72.

Thompson, E. P. (1971). "The Moral Economy of the English Crowd in the Eighteenth Century." *Past and Present*(50): 76-136.

Viner, J. (1972). *The Role of Providence in the Social Order : An Essay in Intellectual History.* Philadelphia, American Philosophical Society.

Walpen, B. (2004). *Die Offenen Feinde Und Ihre Gesellschaft : Eine Hegemoniethoretische Studie Zur Mont P©·Lerin Society.* Hamburg, VSA-Verlag.

Williamson, J. (2008). A Short History of the Washington Consensus. *The Washington Consensus Reconsidered: Towards a New Global Governance.* Ed. N. Serra and J. Stiglitz. Oxford, Oxford University Press.

University of Oxford Discussion Papers in Economic and Social History: Recent publications

85 S. Ryan Johansson, *Medics, Monarchs and Mortality, 1600-1800: Origins of the Knowledge-Driven Health Transition in Europe* (October, 2010)

86 Luke Samy, *'The Paradox of Success': The Effect of Growth, Competition and Managerial Self-Interest on Building Society Risk-taking and Market Structure, c.1880-1939* (January, 2011)

87 Paul Minoletti, *The Importance of Ideology: The Shift to Factory Production and its Effect on Women's Employment Opportunities in the English Textile Industries* (February, 2011)

88 Emanuele Felice, *The determinants of Italy's regional imbalances over the long run: exploring the contributions of human and social capital* (March, 2011)

89 Rui P. Esteves, *The Political Economy of Global Financial Liberalization in Historical Perspective* (June, 2011)

90 Eric B. Schneider, *Evaluating the Effectiveness of Yield-Raising Strategies in Medieval England: An Econometric Approach* (July, 2011)

91 Jane Humphries, *The Lure of Aggregates and the Pitfalls of the Patriarchal Perspective: A Critique of the High Wage Economy Interpretation of the British Industrial Revolution* (July, 2011)

92 Douglas A. Irwin and Kevin O'Rourke, *Coping with Shocks and Shifts: The Multilateral Trading System in Historical Perspective* (November, 2011)

93 Simon C. Holmes and Florian Ploeckl, *Bank on Steel? Joint-Stock Banks and the Rationalisation of the British Interwar Steel Industry* (January 2012)

94 Harold James and Kevin O'Rourke, *Italy and the First Age of Globalization, 1861 - 1940* (February 2012)

95 Alan de Bromhead, Barry Eichengreen and Kevin O'Rourke, *Right Wing Political Extremism in the Great Depression* (February 2012)

96 Gregg Huff, *Gateway Cities and Urbanisation in Southeast Asia before World War II* (February 2012)

97 Eric Schneider, *Prices and Production: Agricultural Supply Response in Fourteenth Century England* (February, 2012)

98 Harold Carter, *From Slums to Slums in three Generations; Housing Policy and the Political Economy of the Welfare State, 1945-2005* (May, 2012)

99 Eric Schneider, *Real Wages and the Family: Adjusting Real Wages to Changing Demography in Pre-Modern England* (May, 2012)

101 Avner Offer, *Self-interest, Sympathy and the Invisible Hand: From Adam Smith to Market Liberalism* (August, 2012).

UNIVERSITY OF OXFORD DISCUSSION PAPERS IN ECONOMIC AND SOCIAL HISTORY

are edited by

Rui Esteves (Brasenose College, Oxford, OX1 4AJ) Florian Ploeckl (Nuffield College,
Oxford, OX1 1NF)

Papers may be downloaded from
<http://www.nuff.ox.ac.uk/Economics/History>