“Invisible hand principle”

By Adam Smith
Problems of Industrial Revolution → Time to look for solutions!

• Some believed the market would fix the problems
• Others believed there should be a change in government

→ What is the market?
“Every individual is continually exerting himself to find out the most advantageous employment for whatever capital he can command. It is his own advantage, indeed, and not that of the society which he has in view. He intends only his own gain, and he is in this, and in many other cases, led by an invisible hand to promote an end which was not part of his intention”
Laissez-Faire Economics

Adam Smith
Wrote: *The Wealth of Nations*
British economist Adam Smith promoted “laissez faire” capitalism
• The #1 economic system during the Industrial Revolution

**Capitalism** – economic system in which the means of production are privately owned and operated for profit.

**Laissez Faire** (hands off) – policy allowing businesses to operate with little or no government interference.
Capitalism

- Private Ownership
- Profit Motive
- Free Enterprise
- Market Economy
- Competition
Smith’s Argument:
• Free market forces (supply and demand) would produce more goods at lower prices
• This would encourage capitalists to invest their money in new ideas
• Claimed that the “invisible hand” of capitalism led individuals who worked for their own good to promote the good of the community
• “The Father of Economics”
Invisible Hand

- Adam Smith:
  - The forces of market competition act like an “invisible hand” so that self-interest behavior can work to the benefit of all society
  - The forces of individual self-interest and competition ensure that resources are used in ways that promote economic growth and national prosperity
Trust in the Invisible Hand

[Diagram showing economic principles and characters engaged in market activities, with labels for Self Interest, Public Interest, Gains, Losses, Sellers, Buyers, Importing, Exporting, and an Efficient Economy concept.]
Invisible Hand

- stressed on the principle of *laissez faire*, which means that governments should not intervene in economic activity
- French term = “let you do”
Take a 2 min break
What does this mean?

- An entrepreneur/consumer “intends only his own gain” but he is directed by the “invisible hand” of market prices to “promote an end [economic prosperity] which was not part of his intention”
What does this mean?

- The market, left on its own, will come to a natural agreement regarding the quantity of goods supplied or produced and the price charged for these goods.
- This is because everyone is promoting his/her own self-interest.
- If people are free to pursue their own private interests, they act in a way that aids the economy as a whole.
What does this mean?

- Central authority is not needed to tell business decision makers what to produce or how to produce it.
- Prices will do the job.
What does this mean?

- The market price directs and motivates both producers and resource suppliers to provide those things that others value highly, relative to their costs.
- Prices will reflect information about consumer preferences.
- Seeking personal gain, businesses will naturally produce goods that are profitable and are in demand.
- Natural competition will ensure goods produced are of high quality and are manufactured using cost effective methods.
OBAMACARE?

NO THANKS, I'LL HAVE LAISSEZ FAIRE