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THE INVISIBLE HAND

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benevolence of the butcher,
the brewer, or the baker
that we expect our dinner,
but from their regard to
their own self-interest.”*

~Adam Smith



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The Invisible Hand

Transcript

JOHAN NORBERG: The progress of the last two hundred and fifty years has been explosive. Year after year, the world and its people have grown more connected and more prosperous. It seems unimaginable.

And yet, a man who lived in a world of sailing ships and horse-drawn carriages, of great wealth and great poverty, imagined our very world. He set pen to paper and recorded the ideas that would revolutionize the world's marketplaces.

He was a Scotsman named Adam Smith – a moral philosopher, a bold voice of the Scottish Enlightenment, and the world's first economist.

He recorded his revolutionary ideas in two remarkable books: *The Theory of Moral Sentiments* and *The Wealth of Nations*.

One of Smith's most well-known concepts is the Invisible Hand, and today, we'll explore what that means.

Adam Smith was born in 1723 in the small seaside town of Kirkcaldy, Scotland, where he learned about morality and economics at the local merchants' market.

He studied at Glasgow University, became its top administrator, and then a pillar of the unlikely intellectual revolution called the Scottish Enlightenment.

He lived, lectured, and socialized in Scotland's capital city of Edinburgh.

And he invented the unique economic concept of an Invisible Hand which helps explain how the world's markets work.

Well, it turns out that the entire global economy boils down to two people: a buyer and a seller. And surprisingly, it works best when the seller has the interests of the buyer at heart.

JAMES OTTESON: What we're doing is looking at each other as potential partners, as peers, not as enemies. You are my opportunity, not my enemy. So Smith saw the market economy as extending the frontiers of opportunity for everyone, including and especially the least among us.

JOHAN: Smith knew that moving products to supply people with what they needed and wanted from around the world is a complicated process, too complicated even for the most powerful government to manage. But he saw it as a natural function of a free market.

EAMONN BUTLER: The essential thing about the free market is that it is voluntary trade between different people, voluntary exchange. You've got something which I want, and I've got something that you want, so we exchange it, and then we're actually both better off.

JOHAN: Have you ever noticed that when it's raining, there's someone there selling umbrellas and when you're at the beach, it's easy to find sunglasses and suntan lotion? Adam Smith told us why.

ADAM SMITH'S WORDS: "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."

JOHAN (03:01): By self-love, Smith means that sellers want to earn a living in order to support their families. To do that, they make the products that they think you and I will want to buy. Not because anyone tells them to, but because it's in their best interests.

OTTESON: So, for Smith, what he saw was not mutual selfishness. What he saw was mutual respect, which is an entirely different moral paradigm.

JOHAN: Here's how it works: the prices we're willing to pay send key signals, and Smith used a baker as an example.

JOHAN TO BAKER: Hi, this all looks delicious. Could I have a cup of coffee?

BAKER: Yeah, of course.

JOHAN: And a scone, please? Thank you.

But let's say we all want scones, and the baker keeps running out. Well, then she can charge a bit more.

Seeing the demand and money to be made, other bakers will start offering scones. All throughout the supply line, people spring into action.

Farmers see that bakers are buying wheat, so they plant their fields and up production. Truckers see money to be made in delivering wheat to bakers, so they buy trucks and hire drivers.

JOHAN TO BAKER: Thank you.

JOHAN: So, we vote with our wallets, and all around the world, people spring into action to satisfy our demands. No one orders them to do this, but every purchase sends a message.

As the supply increases, competition forces prices down. Fewer bakers bake scones, and things stabilize as supply meets demand dynamically and automatically.

This all happens without government intervention, without any trade commissar dictating quotas. This is Smith's invisible hand at work; it guides large businesses and even a small baker.

ADAM SMITH'S WORDS: "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."

JOHAN: The invisible hand leads people to promote an end that was no part of their intention.

When the baker sees that we want to buy bread, she makes the bread so she can make a living, and the other side of the coin is that we get bread.

And it's a beautiful place, welcoming, friendly. There's more to competition than price alone.

BUTLER: One of Smith's great contributions to humanity is his realization that things didn't have to be planned in order to be orderly.

JOHAN: He believed that many complex systems can be generated by local behavior. They don't have to be and actually can't be created from the top down.

BUTLER: Many of the institutions that we have: language, markets—you name it—these are indeed the results of human action, but they're not the results of human design. We never planned these things.

OTTESON: So, note that phrasing: individual human action, but not individual human design.

JOHAN: Smith thought that those people who believed they knew what was best for others were represented by a figure he called the man of system.

RYAN HANLEY (06L05): The man of system is the man who is entranced, enthralled by his own idea of the ideal, tries to make that ideal a reality.

OTTESON: And decides that he's going to impose it from the top down, whether people want it or not. And as Smith said, the man of system makes the mistake of thinking that

he can move people around the way a hand moves chess pieces around on a chess board.

HANLEY: And Smith thinks that this is dangerous for two reasons. First, he thinks he knows more than he can actually know. He thinks he knows what's good for all individuals and then tries to force them into his particular boxes.

OTTESON: But, of course, the mistake, Smith says, is that human beings are not like chess pieces. They have principles of motion all their own. They have their own ideas about what they'd like to do in life. They have free will.

HANLEY: Far better for the well-being of the economy as a whole, far better for actual individuals to be free to pursue their own self-interests as they see fit.

JOHAN: Smith thought that entrepreneurs and businesses create wealth, but don't get the idea that he was an apologist for all business. On the contrary, he saw how many businessmen were drawn to create monopolies and deceive the public interest for their own benefit, and that is precisely why he argued for free competition and free trade.

Greedy businessmen who try to rob consumers by raising prices or lowering quality would be ruined if the consumers were allowed to turn to another competitor. And that is why Smith thought that the government shouldn't be pro-business, it should be pro-market.

But is it possible to have markets that operate in the interests of sellers and buyers without a lot of government regulation? The answer might be yes if they embody Adam Smith's ideas.

It used to be that when you wanted to go someplace in a city, you had to wait for a taxi or rent a car. But now, with apps like Uber and Lyft, that's all changed.

JOHAN TO DRIVER: Lyft?

DRIVER: Yes.

JOHAN: Hi, are you David?

DRIVER: Yes.

JOHAN: People today ride with strangers in their cars, and with sites like Airbnb, they sleep in strangers' homes. It's just a tiny part of a much larger and much more important social trend: an explosion of trust enabled by the internet. And the granddaddy of them all is eBay.

DEVIN WENIG: Almost every country in the world has buyers and sellers who work inside the eBay marketplace.

JOHAN: Devin Wenig is CEO of eBay Marketplaces.

WENIG: eBay is founded on this principle of economic democracy; that individuals around the world who don't know each other and have never met can work in a system to be able to conduct economic transactions fairly and securely and have confidence in that.

JOHAN (09:02): eBay was founded in 1995 by Pierre Omidyar.

WENIG: Pierre thought very strongly about the notion of the free market. He believed in Adam Smith's principles. He believed that an economic democracy would not only be a great business but it had the potential to do immense amounts of good around the world.

JOHAN: eBay has hundreds of thousands of small sellers around the world that are now doing more than half their business outside of their national borders. One retailer that is profiting in this new era is Gelb Music.

MIKE CRAIG: Gelb was started in 1939, about 75 years ago. Located right here in Redwood City, California, it's been here ever since. And about, carry about a little over 50,000 products here.

JOHAN: Mike Craig is Gelb's e-commerce/marketing manager.

CRAIG: We have a complete line of drums, bass guitars, recording equipment.

We were waiting for our own website to be built. We took about 200 products, mostly snare drums, did about \$200,000. The test definitely worked. The following year, we put up about a thousand products, maybe a little bit over and we did about \$750,000 in sales.

WENIG: We now have about 160 million active consumers who buy and sell in our marketplace every day. We now sell a little less than \$90 billion of goods every year. And consumers access us from over 190 countries.

CRAIG: Well, eBay has saved the store number one. But has also opened our eyes to markets that we didn't think were obtainable.

JOHAN: One of the great things about marketplaces is that they act as an incredible price discovery mechanism.

WENIG: Because if you're looking at a collectible or a coin, or a comic book or a rare automobile, the likelihood is that there were more sales in eBay for that particular item than in any other marketplace in the world.

JOHAN: Adam Smith would have said that an invisible hand guides eBay sellers around the world. As prices are on the rise- because buyers want a particular item- sellers stream into the market to satisfy that demand. And when demand drops, prices go down.

WENIG: Imagine a world where there're screens everywhere. Those screens are connected to a global marketplace, that global marketplace has all the worlds' inventory, priced fairly because it's an open marketplace. And you're one click away from buying anything you want at any time for a fair price.

JOHAN: There are millions of exchanges each minute, all of them without regulation: among strangers, across borders and oceans. It's an enormous amount of business based solely on trust.

WENIG: Let the buyers and sellers in the marketplace determine who the best buyers and sellers are. So, the eBay feedback system was born.

CRAIG: The way ratings work is that when you sell a product, the customer can go back and rate you: was it a good experience; was it a bad experience? And that goes onto your record where everyone sees it.

ADAM SMITH'S WORDS (11:59): "Public services are never better performed than when their reward comes in consequence of their being performed, and is proportioned to the diligence employed in performing them."

CRAIG: I think being judged by your customers is a wonderful idea. I think that keeps us as sellers on our toes. You have to deliver on what you promise, and if you do that, you're rewarded by more customers, and you'll grow.

BUTLER: The free market isn't about robbing people or cheating them—stealing from them; it is about cooperating with them. If people trust you, if you're giving them a good service, they will do business with you. If you're trying to cheat them, they might deal with you once, but once they've been cheated, you'll never see them again.

WENIG: Part one of the promise is a fair, open, fast, trusted marketplace that's enabled by technology.

JOHAN: Coordinating a global marketplace like this takes one of the largest site operation centers in the world.

WENIG: We do about 300 million searches a day on the eBay marketplace. There are computers and people, and systems and processes that all have to work in sync to make sure that that's working 24/7.

CRAIG: When we look at forecasting, and eBay's going to make up anywhere from 50 to 80% of our sales that's a huge number.

WENIG: There is a concept of a micro-multinational, which I think is fascinating. And there are hundreds of thousands of them alive inside the eBay marketplace.

CRAIG: It's that family-owned, independent, just homegrown kind of store. We're just being able to sell around the world now.

WENIG: So, without either a strong corporate intervention in the sense of eBay or a strong governmental regulatory intervention, this is a community that has grown enormously because, in essence, it's self-regulated.

A free market is one of the most powerful forces on earth. And we've seen that with our business.

JOHAN: The whole world economy, with its trillions of dollars of activity, all boils down to two people: a buyer who is looking for something and a seller who constantly has the needs and wants of her customers in mind.

But it all starts with a cup of coffee and a scone.

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