

Introduction

Description:

The unobservable market force that helps the demand and supply of goods in a free market to reach equilibrium automatically is the invisible hand.

: The phrase invisible hand was introduced by Adam Smith in his book 'The Wealth of Nations'. He assumed that an economy can work well in a free market scenario where everyone will work for his/her own interest.

He explained that an economy will comparatively work and function well if the government will leave people alone to buy and sell freely among themselves. He suggested that if people were allowed to trade freely, self interested traders present in the market would compete with each other, leading markets towards the positive output with the help of an invisible hand.

In a free market scenario where there are no regulations or restrictions imposed by the government, if someone charges less, the customer will buy from him. Therefore, you have to lower your price or offer something better than your competitor. Whenever enough people demand something, it will be supplied by the market and everyone will be happy. The seller end up getting the price and the buyer will get better goods at the desired price.

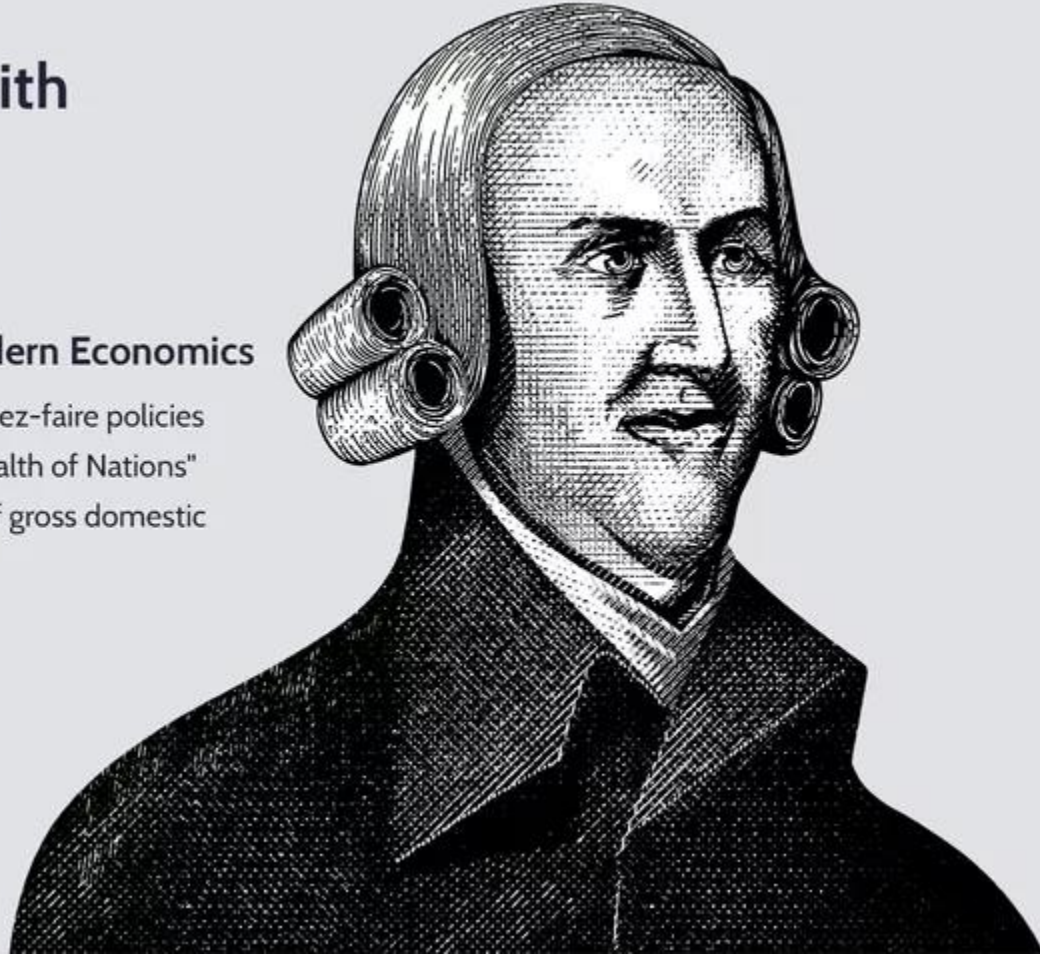
Adam Smith

Born: 1723

Died: July 17, 1790

Founder of Modern Economics

- Advocated for laissez-faire policies
- Author of "The Wealth of Nations"
- Created concept of gross domestic product (GDP)



What Is the Invisible Hand?

The term "invisible hand" first appeared in Adam Smith's famous work, *The Wealth of Nations*, to describe how free markets can incentivize individuals, acting in their own self-interest, to produce what is societally necessary.

The invisible hand is a **metaphor for how, in a free market economy, self-interested individuals operate through a system of mutual interdependence**. This interdependence incentivizes producers to make what is socially necessary, even though they may care only about their own well-being.

How the Invisible Hand Works

The invisible hand is part of laissez-faire, meaning the "let do/let go," approach to the market. In other words, the approach holds that the market will find equilibrium without government or other interventions forcing it into unnatural patterns.

The Invisible Hand and Market Economies

- Adam Smith wrote about an invisible hand in his writings during the 1700s, noting that the mechanism of an invisible hand benefits the economy and society thanks to self-interested individuals. Smith mentions "an" invisible hand, which is the automatic pricing and distribution mechanisms in the economy that interact directly and indirectly with centralized, top-down planning authorities.
- Business productivity and profitability are improved when profits and losses accurately reflect what investors and consumers want. This concept is well-demonstrated through a famous example in Richard Cantillon's *An Essay on Economic Theory* (1755), the book from which Smith developed his invisible hand concept.
- the business climate of the U.S. developed with a general understanding that voluntary private markets are more productive than government-run economies. Even government rules sometimes try to incorporate the invisible hand.

Examples about invisible hand

- Consider an example of a small business facing stiff competition. To best position itself in the market, the small business decides it will invest in higher quality materials for its manufacturing process as well as reduce its prices. though the small business may be doing so out of the best interest of its company (i.e. to drive sales and steal market share), the invisible hand is at work as the market now has access to more affordable yet higher quality goods.
- Another example of the invisible hand is the ripple effect a retail company can have when attempting to meet consumer demand. Consider a hardware store that anticipates demand for yard maintenance tools. The hardware store will coordinate with a manufacturer to secure the appropriate goods. Meanwhile, the manufacturer will communicate with a raw materials distributor to ensure it has the items it needs.