

themselves from his methodological and substantial limitations in trying to answer it.

### Section 3. Smith: An invisible hand over suppliers and customers

Because he made no progress beyond Quesnay in the matter of circuit closure Adam Smith plays no major role in this book. He is still considered at some length for two reasons. First, unlike most economists today, being a man of great historic and philosophic knowledge, he was able to show what freedom and liberty (or, in our words: owner power) did in the economic realm; insofar he stands in the great natural law tradition of, e.g., Hobbes, Pufendorf, or Montesquieu, which already guarantees his historical longevity. In particular, he described how owners' power transforms into an abstract discipline of economic liberty, which not only keeps the greed of merchants within bearable limits, but also erects a benevolent automatic general motivational and steering system that favors productivity, consumer orientation, economic growth, and prosperity. Second, Smith stood between Quesnay and Ricardo with regards to the problem of circuit closure. Quesnay had seen the problem and he had set up the just introduced model, which is has remained valid for reflecting on it up to today. Ricardo also saw the problem, but used what he falsely called the "Law of Say" to pseudo-solve it.<sup>44</sup> Smith found himself between the two. He either did not see the problem or somehow considered it as solved; at least it played no relevant role in his work. Note that Smith's famous "invisible hand" was *not* meant to be a solution to the problem; the "invisible hand" was only meant to solve another, smaller problem, as we shall see.

Smith, as an economist, supported the physiocrats. Smith spoke of their work with admiration as the "agricultural system".<sup>45</sup> When Quesnay and the physiocrats had been pro-economic liberty, such economic liberty was, to a good deal, a conscient means to play merchants off against other merchants, about whom

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44 We shall give three interpretations of, what we will call "Ricardo's Law of Say" below. Two are false statements while the third one is a valuable reformulation of the question the "law" is supposed to answer.

45 *Smith* (1776) page 1–3. As Smith says, all major European powers had adhered to the mercantile system since at least the colonization of the Americas, while the agricultural system (the physiocrats who called themselves "les économistes") would have "never been adopted by any nation and... exists only in the speculation of a few men of great learning and ingenuity in France." (Book IV chapter IX, volume II page 157). Smith rightly mentions that Egypt, Indostan, and China (and even Greece and Rome) often pursued policies akin to the agricultural system several times (Book IV chapter IX, volume II page 173–181). *Leon Walras* noted that the word "physiocracy" contains the Greek word for rule. It means "gouvernement naturel de la société" (*Walras* (1874) page 3).

physiocrats, like certain policies in ancient China, had always been quite suspicious. Economic liberty enabled competition and competition helped to discipline merchants to remain in the pre-conceived plan of the tableau and not to grow too wealthy or too powerful.<sup>46</sup> Smith embraced the physiocrats preference for economic liberty, but took it out of its narrow context. “Perfect economic liberty”, was to be fully let out of the bottle and invited to take general control over the economy.<sup>47</sup> The economy was, as von Hayek would later say, a “discovery procedure” (Entdeckungsverfahren), a permanent auto-adjustment-process or, in the later wording of *Walras* a (progressive, multi-level, and multi-place) “tâtonnement”.<sup>48</sup> Even the word “plan” or Quesnay’s “ordre”, which could be modeled in an idealized macro-economic blueprint were, thus, improper in a formal sense. Men observe prices and try to maximize utility and profit conscientiously in their elementary exchanges and “markets” turn thousands or millions of such conscientious actions into an automatic play of liberty. When Smith speaks of an “invisible hand”, thus, he not only means “invisible”, but also “thoughtless”, “mind-free”, “automatic”, or “blind” – resembling blindfolded *Justitia*. Nevertheless, the system will move towards a common good. Free markets, Smith believed, give better guidance to production than family, clan, or tribe traditions, religion, morals, philosophical convictions, or even paternalistic mercantilist bureaucrats. Economic liberty and competition bring about the greatest increase of effectivity, efficiency, and wealth, provided that it was simply left alone!

While Smith departed from the suspicion of physiocracy against merchants and from the narrow intent of using competition as a tool to control them, Smith, nevertheless, put great emphasis on the market’s disciplinary power. The old method of disciplining (by state power, morals, and tradition) can be substituted by a new anonymous market discipline. Much less communicative, administrative, or legal state guidance will be required; instead, the (rather brutal) discipline of economic success and failure, purely economic sanctions, will largely take its place. The dark and nasty force behind the discipline of liberty, which definitively goes into men’s Benthamian calculus of pleasure and pain, is the risk of failure. The terror-side of economic liberty, the “hand” if you will, is the threat of falling out of the upper

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46 “Qu’on maintienne l’entière liberté du commerce; car LA POLICE DU COMMERCE INTÉRIEUR ET EXTÉRIEUR, LA PLUS SÛRE, LA PLUS EXACTE, LA PLUS PROFITABLE À LA NATION ET À L’ÉTAT, CONSISTE DANS LA PLAINE LIBERTÉ DE LA CONCURRENCE” (*Quesnay* in: *Carteliero* (2008) page 244).

47 At least in principle. Smith did not deny occasional mercantilist or pro-colonialist restrictive state interference.

48 *Walras* (1874) page 127 (“Il s’agit de fonder sur le fait de cette détermination sans calcul une méthode de résolution par tâtonnement des équations d’égalité de l’offre et de la demande totale.” The term “tâtonnement” was used previously by Turgot. See *Faccarello* in: *Faccarello/ Kurz* (2016) page 80.

society into being disrespected, suffering, hunger, and death, the lower world of losers. In “a civilized society” in which this discipline operates, Smith writes, “men stand at all times in the need of cooperation and assistance of great multitudes”.<sup>49</sup> This awareness of their (abstract) dependency (to great multitudes) very effectively directs each player’s self-interest to contributions that supply necessities, conveniences, and amusements to others. This view culminates in the famous words: “[I]t is not from the benevolence of the butcher, the baker or the brewer 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 about our necessities but of their advantages.”<sup>50</sup>

Smith’s discipline is not limited to villages, small towns, or even cities like Manchester or London, though. It subjugates human behavior in countries, continents, and the world market. Smith has particularly become famous for the aforementioned metaphor of an “invisible hand”. He analyzes: “Every individual is continually exerting himself to find out the most advantageous employment for whatever capital he can command. It is his advantage, indeed, and not that of the society, which he has in view. But the study of his own advantage, naturally, or rather necessarily, leads him to prefer the employment which is most advantageous to the society.”<sup>51</sup> He then writes that “... he intends only his own gain, and he is... led by an invisible hand to promote an end which was no part of his intention”.<sup>52</sup> So much for Smith’s analysis of economic liberty.

Unfortunately, Smith also abandoned the theoretical interest of physiocracy in capitalism’s capacity for macroeconomic circuit closure. Smith wrote twenty years after the physiocrats and had the luck to live through the industrial revolution in the most advanced capitalist country, which dominated the world technologically, politically, militarily, economically and culturally. Britain and the British Commonwealth, it may have appeared to him, would be able not only to secure much-needed imports of cheap raw materials, but also to export the processed goods in the whatever quantities. In this context he expressly speaks of the discovery of America as “opening a new and *inexhaustible* (sic!) market to all the commodities of Europe”.<sup>53</sup> Smith, obviously, did not share Quesnay’s worries concerning sufficient dépenses. If he at all ever thought about them, he might at least have felt that they should not be an issue for advanced and world-dominating Britain.

The problem of circuit closure, accordingly, is not present in Smith’s work. Smith’s famous term “invisible hand” does not prove the opposite. Smith’s “hand” is defini-

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49 Smith (1776) page 12.

50 Smith (1776) page 13.

51 Smith (1776) page 398.

52 Smith (1776) page 400.

53 Smith (1776) page 393.

tively not a forerunner of Ricardo's law of Say and does not secure that there are no non-owners, which cannot be employed. Smith is, of course, aware that supply must be demanded, that produce must be bought, and that only this will engender the employment of workers, but he neither presented this as a limiting factor for employment, nor his "hand" as the assurance that such limits would be overcome. This can be further explained in two ways. We may, first, consider the playing field, to which Smith' theory of social discipline through economic liberty applies, and where the invisible hand operates so benevolently (assigning the highest profits to those suppliers who serve customers best), as being, from the outset, silently limited to the *beati possidentes*. Hence, to those who, as customers, have sufficient money or, as suppliers, are owners of sufficiently valued goods. Would-be-customers and would-be-suppliers, who don't make it to become customers or suppliers, are systematically forgotten. The invisible hand rules markets – but in markets they are not, or they do not matter there. When Smith speaks of markets, and about the direct production of what is "most advantageous to society",<sup>54</sup> he only has in mind those who are at least marginal and occasional customers and suppliers. They certainly get better goods at more places, faster and more cheaply (or low-priced and low-quality-goods at all). Smith also has sellers in mind. They were buyers once, before they sold, and could buy their supplies at more places, faster and more cheaply and at reduced costs of transportation, etc. They can also use their owner power and buyer's competition to sell their goods to high value-ascribers with money at higher prices. The general increase in productivity will render countries of economic liberty richer than others, from which the public, including the poorer classes, will profit – as a spill over. There will be more and better roads and bridges and sidewalks in muddy city streets as well as more and better military barracks, uniforms and rifles for drawn conscripts. There will be nicer administration buildings and more modern prisons (of the Benthamian style?) and, hopefully, even better water and energy supplies to working class neighborhoods, improved public schools, medical treatment and more generous social security. Yet, just because the invisible hand cannot see money coming from the "have nots", it will not direct production to them, e.g., of housing or food to unemployed.

Or, second, we may view the "invisible hand" as also applying to the have nots. If it reacted to the "haves" through the inclusive and luring algorithm of "I give you more profit, the better you adjust to customer needs", what is its algorithm for the "have nots"? What does it tell the underworld of incapables, failures, the continuous inflow of losers, and what does it do with them? Well, if the "invisible hand" at all takes care of them, it applies some sort of "to each his own" (*suum cuique*) to them. They get all the negative and bad stuff. Quite simply, it tells them in an exclusive and

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54 In the above quote.

rejective way: “You are out. Go to hell and stay there!”. There is no point in producing food or clothes (or even in constructing dwellings) for those who cannot pay a profitable price. Nobody will employ an old unskilled worker...The “no haves” get the hard stuff from the invisible hand. They are damned like the *non-electi* in Manichaeism. They seal the fate of whole social strata or even of continents.

Smith’s “invisible hand”, thus, does not state that circuit closure will be achieved, but only describes the – more or less pleasant – mechanism of market discipline. E.g., where he thinks of a “proportion of those who are annually employed in useful labour, and ... of those who are not so employed...”, he observes the “number of useful and productive labourers, it will hereafter appear, is everywhere in proportion to the *quantity of capital stock* which is applied to setting them to work and to the particular way in which it is so employed.”<sup>55</sup> That is all. But he neither states that the capital stock will grow so large nor that it will be activated to such an extent as to generally achieve full employment. Nevertheless, he generally assumes that the produce can be sold by British firms somewhere and insofar Smith’s “invisible hand” operates before a background of primordial inexhaustible sales markets, at least for English firms. He is not seriously interested in how certain benevolent hinterlands render this possible. Where he touches upon the issue, this appears to have happened by chance. Smith makes no attempt at a systematic theoretical investigation in this question,<sup>56</sup> and his few dispersed remarks on it remain superficial.<sup>57</sup>

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55 *Smith* (1776) page 2 (both quotes).

56 A more abstract reflection by Smith reads: “The extent of the home-trade and of the capital which can be employed in it, is necessarily limited by the value of the surplus produce of all those distant places within the country which have occasion to exchange their respective productions with another: that of the foreign trade of consumption, by the value of the surplus produce of the whole country and of what can be purchased with it: that of the carrying trade by the value of the surplus produce of all the different countries in the world. Its possible extent, therefore, is in a manner infinite in comparison of that of the other two, and is capable of absorbing the greatest capitals” (*Smith* (1776) page 334). Apart from a lack of clarity about the notion of “surplus” in the context, the quote does not provide any insight into the dependencies between the production of exchangeable value. Smith discusses the distribution of the annual produce among the three classes in Quesnay’s *tableau économique* in a manner that “each class enjoys its proper share”, even though he considers the possibility of encroachments of “that natural distribution”, but he shows no interest in preoccupying himself more deeply with the interrelations between Quesnay’s system of supply creation and demand creation (*Smith* (1776) page 167).

57 E.g. he says: “The great affair, we always find, is to get money. When that is obtained, there is no difficulty in making any subsequent purchase” (*Smith* (1776) page 375). He also mentions public mournings as increasing demand for black clothes (*Smith* (1776) page 104) and he points to high duties or prohibitions of trade impairing the demand for British produce: “By diminishing the number of sellers, therefore, we necessarily diminish that of buyers, and are thus likely not only to buy foreign goods dearer, but to sell our own cheaper, than if there was a more perfect freedom of trade.” (*Smith* (1776) page 408). He is also aware that there is

After Smith had died in 1790, the economic situation in the UK and in Europe changed significantly. 15 years of Napoleonic wars incited a build-up of production, especially in the UK and France, and when the armament demand discontinued, in the absence of some kind of Marshall plan and of other expansion options, capacities were far too large for peace production. Ricardo, Say, Sismondi, and Malthus, accordingly, voiced unanimous complaints about a great “engorgement” of markets. The impression of these post-war years, a good decade, must have been similarly important for economic thinking of the time as the Great Depression would be 110 years later. It contributed, as in the 20th century, to shape two camps in macroeconomics, one camp, Ricardo and Mill in particular, remained convinced that missing employment-generating spending still did not have to be a systematic concern, and an opposing camp, Proudhon, Sismondi and Malthus in particular, that took the opposite view. The camps developed in parallel and argued against each other. The camp of Proudhon, Sismondi, and Malthus, in essence, aimed to set free the analytical potential of Quesnay’s circuit analysis by giving up the catechism-like numeric preordainment that circuit would close and to consider whether or not circuits would close as a conscient contingent problem. The other camp, Ricardo and Mill, too, could no longer sidestep the question of where sufficient demand would come from, as Smith had. They tackled it by throwing in something for economists and the public to chew on; Ricardo invented the “Law of Say”.

#### Section 4. Proudhon and Sismondi: Producers cannot buy their produce

But we first turn to Proudhon and Sismondi. In the *Grundrisse*, Marx labeled *Pierre Joseph Proudhon* as somebody “who certainly hears the bells ringing but never knows where”. Marx therewith reacted to Proudhon explaining overproduction with the fact “that the worker cannot buy back his product”.<sup>58</sup> We do not pursue Proudhon, Robert Owen, or other early utopian socialists any further, but will instead turn to *Jean Charles L. Simonde de Sismondi* (1773–1842), a man of higher intellectual caliber. Like Adam Smith, he was of deep historic knowledge and developed his economic ideas in a concise and scientific way. The first edition of his *Nouveaux Principes*

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a feedback from investment to demand and that “...a capital employed in home trade...puts into motion a greater quantity of domestic industry, and gives revenue and employment to a greater number of the inhabitants of the country...” (*Smith* (1776) page 399). Marx wrote much to the point about Smith: “Die Widersprüche A. Smith’s haben das Bedeutende, dass sie Probleme enthalten, die er zwar nicht löst, aber dadurch ausspricht, dass er sich widerspricht”. *Marx*, *Theorien über den Mehrwert*, MEW 26.1, page 121. E.g. Smith’s theory of value oscillates between a labor theory of value and something else.

58 *Marx*, *Grundrisse*, MEW 42, page 338.