Virtue or Vice? A Pedagogical History of the Self-Interest Hypothesis

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> *It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from regard to their own interests. We address ourselves, not to their humanity but to their self-love, and never talk of our own necessities but of their advantages.* (Smith, Wealth 27)

The self-interest hypothesis, articulated by Adam Smith in the *Wealth of Nations*, either explicitly or implicitly, has been a key postulate underlying the paradigm of both classical and neoclassical economic models. But there seems to be some dispute, as revealed in principles of economics textbooks, as to what the self-interest hypothesis actually meansCare personal ethics and morals part of the equation or, rather as conveyed by Samuelson=s best selling principles editions (1948 to the present), does the hypothesis imply that we are selfish, material self-driven individuals, unconcerned with how our actions impact others?

Some recent principles texts and research in the field of experimental economics lean in the direction of a more value-laden hypothesis. For example, Ekelund and Tollison (10) delineate the premise of Arational self-interest,@ where *Homo economicus* makes decisions utilizing a cost-benefit analysis that is conditioned by normative constraints (e.g., Apersonal tastes, values, and social philosophy@). Fehr and Schmidt (1) not only support this finding, but return the hypothesis to its normative roots: AIn recent years experimental economists have gathered overwhelming evidence that systematically refutes the self-interest hypothesis [as defined in Paul Samuelson=s principles text] and suggests that many people are strongly motivated by concerns for fairness and reciprocity.@

To examine the manifestation of the self-interest hypothesis requires this paper to first explore Adam Smith=s topic of self-love in *Theory of Moral Sentiments*. We then address the pedagogical treatment of the self-interest hypothesis in the two most influential principles of economics textbooks of the 20th CenturyCAlfred Marshall=s *Principles of Economics* and Paul A. Samuelson=s *Economics*. *Principles of Economics*, first published in 1890, was the dominant economics text of the pre-World War II period. *Economics* was first published in 1948 and is currently in its 17th edition. It is in Samuelson=s editions that one finds a substantial, if not a misleading, departure from the Classical view of the self-interest hypothesis. Based on his earliest editions, it seems obvious that the intellectual and economic trends of the 1930s and 40s heavily affected Samuelson=s treatment of the topic. The final portion of our essay surveys Samuelson=s revisions in subsequent editions, through which he substantially softens his description of the self-interest hypothesis.

The topic of self love and human action

In *Wealth of Nations*, Smith claims that by employing himself and his capital in the most profitable way, a man contributes to the over-all good of society; the Ainvisible hand@ works its magic. The man neither knows that he is promoting the well-being of society, nor does he know how much he is promoting it. However, it would be misleading to claim a thorough understanding of the role that Adam Smith=s self-interest plays in our actions based solely on his depiction of the invisible hand (Smith, *Wealth* 454B456). A full understanding of Smith=s self-interest hypothesis requires a perusal of the moral philosopher=s *The Theory of Moral Sentiments*, where he develops a holistic approach to human action. It is here that Smith specifies the role that self-love plays in shaping our actions.

Smith (*Theory* 83) makes it quite clear that self-love is not the only driving force guiding one=s actions. Indeed, one=s action will also rationally take into account the point of view of impartial observers. So in the economic realm, we do not see a reckless pursuit of wealth with disregard to others rights. It is inappropriate to act out of self-interest when that involves injuring our neighbor. There is an inherent idea of fair play that must override our own interests.

Smith makes it perfectly clear that our passive feelings are indeed devoted purely to our own self-interest. They can even be described as being selfish. But these feelings are not the guiding principle that shapes our actions. When acting, we take very seriously the opinions that an impartial observer would have about those actions. This consideration exerts an incredible power. We find ourselves unable to act on our passive feelings; we choose to act in such a way that others will find our actions acceptable. We will act in a self-interested manner only as long as those actions conform to some notion of fairness.

The idea that *homo economicus* acts purely selfishly is refuted by Smith. Indeed, he recognizes that people will even act generously. He poses the question of why A[w]hen our passive feelings are almost always so sordid and so selfish, how comes it that our active principles should often be so generous and so noble?@ (*Theory* 137). There are generous people who act for others= happiness and not their own. Smith claims that it is not mere benevolence that acts against our self-love, but rather something greaterCthat people have a consciousness to which they conform their actions. This Agreat judge and arbiter of conduct@ corrects the flaws that come with the love of oneself. Justice overrides our selfish desires (Smith, *Theory* 137). There is something greater than our own self-love, it is another type of love. The greatest power in determining the actions of a man is not love of oneself, but a love of what is good. This does not contradict the self-interest hypothesis, but it shows us that it is limited to market interactions that are carried out without the intentional harm of others.

Furthermore, it is important to look into how Smith explains those instances where one does follow his selfish passions. Smith does believe that there are times when self-love improperly rules our actionsCa process of self-deception (*Theory* 156-157). There are times when we allow our passions to keep us from seeing properly how the unbiased spectator will view us. Our passions Adiscolour our view of things@ causing our perception of the situation to be Amagnified and misrepresented by self-love@ (Smith, *Theory* 157). Even after the action, a man will prefer to stay occupied by those passions which originally moved him to commit the act, because

> [i]t is so disagreeable to think ill of ourselves, that we often purposely turn away our view from those circumstances which might render that judgment unfavourableY This self-deceit, this fatal weakness of mankind, is the source of half the disorders of human life. (Smith, *Theory* 158)

Only a person engaged in the self-deceit described above could engage in the type of material selfishness of which some critics believe the self-interest hypothesis explains. Smith describes the process by which our self-love is normally humbled to prevent us from doing ill, and the process by which the excesses of self-love may be corrected (Smith *Theory* 159). The natural state of man is to avoid these excesses, not indulge in them. Actions of selfishness are not the actions of the butcher, brewer, and baker mentioned in *Wealth of Nations*, but rather of the corrupt man. Selfishness is not the necessary result of self-love.

Self-interest: a pedagogical transition

Alfred Marshall

Until the arrival of Samuelson=s Keynesian oriented text, Alfred Marshall=s *Principles of Economics* was the prominent introductory economics textbook. From 1890 until 1920, eight editions of the book were published. From 1922 until 1961, it was reprinted eleven times.

Marshall (14) spends the majority of the second chapter, AThe Substance of Economics,@ discussing issues related to the self-interest hypothesis. Marshall goes to great pains to point out that there are many virtuous and non-monetary reasons people perform their work and utilize their skills (even pointing out that a businessman must not abandon his sense of right and wrong.) The most stable reason, admittedly, is that of monetary rewards, which can be used for moral or immoral ends. Money he (22) states provides an invaluable tool for measuring man=s economic actions, which is independent of the motives behind its acquisition and use. Maximizing one=s profits or earnings is not a form of low-order selfishness, the morality of it is determined by your motives for earning the money. What is fascinating is that Marshall (22) is debunking myths about economics at the turn of the century that are still prevalent today. Economics does not assume a primary motive of a selfish desire for money. Marshall goes on to describe other motives for work, such as Athe pleasure afforded by the work itself and the instinct of power,@ Athe advantages of an occupation other than material gain,@ Aclass sympathies,@ and of course, Afamily affections@ (22B24).

Marshall=s points are congruent with the self-interest hypothesis that Adam Smith envisioned. Material selfishness and economically self-interested actions are not a tautology. The desire for money does not necessarily imply something immoral; the accumulation of money for worthwhile purposes can and should be considered virtuous; and finally, it is incorrect to assume that material wealth is the only motive driving *homo economicus*.

Signs of things to come: Marshall takes on popular sentiment

In his introductory chapter, Marshall (6) attacks the myth that growth in free competitive markets led to an increasingly selfish society. Free competitive markets give us more choices and hence our decisions are made in a more deliberate fashion. This does not make us more selfish, although it does allow us to make more decisions out of self-interest.

Marshall (8) also confronts the myth that Athings@ used to be so much better before money and free trade. While attractive from the view of the poet, such a AGolden Age@ never did exist. There is no past sociological change which we should undo to arrive at a time of less suffering. This is not to say that there were not some changes which brought about suffering to some people. The Industrial Revolution was a substantial change in the lives of many people, and this would explain why they found it necessary to look back to a non-existent AGolden Age.@

Popular and intellectual thought: post-industrial revolution

The Industrial Revolution brought with it changes that were both economic and social. Because these changes affected the thought of economists everywhere, it is important to take a brief intermission to explore why this was the case.

There is no question that the turn of the 19th Century brought with it periods of rapid economic growth. During this time, AGermany and the United States acquired the status of front-rank industrial powersY [F]rom 1880 to 1900, English *real* wages per earner increased by nearly 50 per cent. This created an entirely new standard of life for the masses@ (Schumpeter, 759). This not to say that everything was great for everybody. The growth experienced during the turn of the century was not without pain. More was being produced, but prices were forced down and existing industries were crowded out (Schumpeter 760). This dislocation led to much resentment. This was the sentiment that builds up to what Schumpeter calls AThe Defeat of Liberalism,@ which he describes as the business class=s shaken confidence in the virtues of laissez-faire. Forces hostile to laissez-faire policies were on the rise, leaving economic liberalism as a less tenable position (Schumpeter 761). The Ainvisible hand@ slowly was losing the trust of the masses. Numerous economists of the day abandoned their classical free trade upbringing.

Economists became less and less enchanted with the notion of an invisible hand that causes self-interested behavior to lead to a desirable outcome for all. The Great Depression of the 1930s would give even more reason to think that was the case. And here we have the intellectual atmosphere that Samuelson would have been trained under, and would have written under.

Samuelson=s influence on current thought

It does not take long to find traces of contemporary pro-government-intervention thought in Samuelson=s first edition of *Economics* (1948). He begins by painting a rather negative view of the economic world. The first section of his first chapter is ominously entitled AFor Whom The Bell Tolls.@ In it, Samuelson writes:

> When, and if, the next great depression comes along, any one of us may be completely unemployedCwithout income or prospects. Or if not totally unemployed, only partially

> employed at reduced hours and pay in an uninteresting dead-end job, without hope of advancement or assurance of keeping even what little we have. There is no vaccination or advance immunity from this modern-day plague. It is no respecter of class or rank. Neither a veteran=s preference nor go-getter pep talks nor advanced degrees can guarantee a job when whole factories are shutting down and when every industry is contracting production and employment. (Samuelson, 3)

Samuelson=s negativity shows through several times here. First, he speaks of the Anext great depression@ assuming its inevitability. In fact, his first question at the end of this chapter is AHow do you expect to fare in the next depression?@ (Samuelson, 11). Secondly, his view of a Adead-end job@ sounds as if it could have come from Marx=s *Estranged Labor*. Samuelson=s picture of the economy=s ability to maintain itself is a bleak one.

The next section of this chapter is entitled APoverty Midst Plenty.@ Here, Samuelson makes the point that despite our economy=s ability to produce more goods than ever before, poverty still exists (Samuelson, 4). The market fails and government must work to fix it. Indeed, in reference to the economic problem of maintaining high levels of employment and providing living opportunities, he says, AIt is not too much to say that the widespread creation of dictatorships and the resulting World War II stemmed in no small measure from the world=s failure to meet this basic economic problem adequately@ (Samuelson, 3). It is quite clear from the introductory chapter of his book that he is economically un-liberal.

Samuelson=s self-interest hypothesis, and its many changes

In Chapter 3, Samuelson covers the topic of Adam Smith=s invisible hand. The price system manages to allocate what consumers want and when they want it. Without any central planning, it solves economic problems of amazing complexity. But after singing the market=s praises, Samuelson (36) quickly changes tone.

> Enough of these oh=s and ah=s. We shall have plenty of occasion to analyze further the nature and functioning of a price system. Right here in the beginning it is just as well to slip the antidote to those who, in reacting away from the extreme view of the economic system as chaos, go to the opposite extreme and regard it as perfection itself, the essence of providential harmony.

This paragraph is a jab at the proponents of economic liberalism. Samuelson argues that the market alone cannot manage our economy, and now even goes so far as to insult those who think it can. His next paragraph is where Samuelson presents his explanation of the self-interest hypothesis.

> Even Adam Smith, the canny Scot whose monumental book, >The Wealth of Nations= (1776) Y proclaimed the mystical principle of the >invisible hand=: that each individual in pursuing his own selfish good was led, as if by an invisible hand, to achieve the best good for all, so that any interference by government was almost certain to be injurious. This unguarded conclusion has done almost as much harm as good in the past century and a half, especially since all too often it is all that some of our leading citizens remember, 30 years later, of their college course in economics. (Samuelson, *1/e* 36)

This paragraph is a huge departure from Adam Smith=s self-interest hypothesis as explained above. Several major points should be extracted from this paragraph. First, Adam Smith is discredited as one of those who is in need of the Samuelson Aantidote.@ Secondly, the Ainvisible hand@ is mocked as being a Amystical principle.@ Thirdly, the phrase Apursing his own selfish good@ has extreme negative connotations, connotations not meant by Smith. Selfish necessarily implies material greed. Avarice is clearly defined differently from the self-love of which Smith wrote, leading one to wonder if Samuelson is presenting Smith=s self-interest hypothesis or one of his own. Fourthly, Smith=s conclusions about the role of government are presented as Aunguarded,@ implying that not enough thought was put into them. The benefits of free markets net to zero (i.e., government intervention is necessary to obtain to positive economic gains).

As interesting as what Samuelson says in his first edition, it is more interesting what he does not say in subsequent editions. The entire tone of this section of his book in subsequent additions changes substantially. By the fourth edition, Samuelson has begun opening his third chapter with a quote from Adam Smith=s *Wealth of Nations*. None of the incendiary language involving Aantidotes@ remains. The self-interest hypothesis paragraph is reworded as follows:

> Adam Smith, whose *Wealth of Nations* we noted previously as representing the beginning book of modern economics or political economy, was thrilled by the recognition of an order in the economic system. Smith proclaimed the principle of the Ainvisible hand@; each individual in pursuing only his own selfish good was led, as if by an invisible hand, to achieve the best good of all, so that any interference with free competition by government was almost certain to be injurious. (Smith did recognize its realistic limitations.) (Samuelson, *4/e* 38)

The entire paragraph has been changed, with the exception of the sentence about Apursuing only his own selfish good.@ No longer is the principle of the Ainvisible hand@ mystical. No longer is Smith presented as someone who was oblivious to the limitations of the market. While still maintaining the negative word Aselfish,@ Samuelson seems to have retracted the rest of his commentary.

As we move to the Seventh Edition (1967), there is one major change, the parenthetical comment at the end of the passage above is replaced by

> While Smith did recognize some of the realistic limitations on this doctrine, it was not until later that economists discovered this truth: The virtues claimed for free enterprise are fully

> realized only when the complete checks and balances of Aperfect competition@ are present. (Samuelson, *7/e* 41)

The core phrasing, of which is most relevant to the topic at hand, shows no change. Indeed, we find the Aselfish good@ all the way through the Tenth Edition (1973). By the time we reach the 14th edition (1992), Samuelson has added a coauthor (William D. Nordhaus). In the 14th edition, we find,

> Smith proclaimed the principle of the >invisible hand.= This principle holds that, in selfishly pursuing his or her personal good, every individual is led, as if by an invisible hand, to achieve the best good for all. (Samuelson and Nordhaus, *14/e* 40)

Although perhaps worded slightly less offensively, we still find the negativity of the previous editions.

By the 16th edition (1998), we have a new section on Adam Smith. We read, ASmithY explained the self-regulating natural order by which the oil of self-interest lubricates the economic machinery in an almost miraculous fashion@ (Samuelson and Nordhaus, *16/e* 40). While the negative phrase from the 14th edition remains, there is at least greater depth given for the self-interest hypothesis.

Throughout all its editions, *Economics* has painted a rather negative view of the self-interest hypothesis. However, we see a gradual but steady lightening of the tone, indicating that there was a reason for revision. Unfortunately, at no point does *Economics* present an accurate depiction of how Smith believed that man acted.

Conclusion

Adam Smith was very clear about what he meant when he formulated the self-interest hypothesis. He did not mean to say that man always acted out of self-interest, and he also did not mean to say that self-interested actions are to be considered as resulting from selfishness. Rather, it is a convention to say that people will act rationally, and not act in ways which they know will leave them less well off. Marshall maintains Smith=s meaning in his *Principles of*

Economics. Samuelson, however, presents Smith=s hypothesis in a manner that renders a negative view of capitalism. The softening of Samuelson=s disillusionment with laissez faire economies is no doubt do to the obvious miserable failure of all the socialist economies during the 20th Century and the numerous studies that have revealed a strong positive relationship between free democratic market economies and real per capita growth. Given the importance of Samuelson=s book in training many of the economics students of the 20th century, there is no wonder why confusion still exists about the true meaning of the self-interest hypothesis.

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