The Invisible Hand that Vanished

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Adam Smith, the Scottish moral philosopher, wrote a pioneering work in 1776 whose title was 'The Wealth of Nations'. He visualised economic activity as a free exchange between producers and consumers. He assumed that they would have the knowledge to make the best choices. This knowledge and thought process was labelled as the 'Invisible Hand' that smoothens irregularities and yields the best results possible.

David Ricardo, a political economist who succeeded Adam Smith, embellished his theory with the study of what he termed 'Comparative Advantage'. Instead of the Micro approach of Adam Smith, which concentrated on individual choices, Ricardo carried the argument to competition between countries and their specialisation in what fits their resources, whether natural or human. Like Adam Smith's classical notion of rational choices, the theory of 'Comparative Advantage' persists in economic treaties.

John Stuart Mill, an English philosopher and political economist elaborated the thoughts of Adam Smith and Ricardo. He lived in the 19th century when the industrial revolution was in full swing and the teachings of Smith, Ricardo and Mill represented classical economics as viewed by the students of economics and political economy until the discourse of Karl Marx toppled the notion of the Invisible Hand and introduced the notion that Central Planning would improve economic performance and general welfare. The strength of Karl Marx thinking was bolstered by the Russian revolution.

The thoughts of Karl Marx were put into print before the death of John Stuart Mill came about in 1873. Their resonance, however, was not heard until 1914-1917. In fact, Marxist principles were not endorsed by the new governors of Russia until 1928. The symptoms of the great depression started showing and the masses were ready to endorse these thoughts as an alternative to classical principles of economics, which seemed to push the world into economic crisis twice within three decades.

Already, a serious economic crisis had erupted in the U.S. in1907 with consequent deflation of values of shares and real estate. The concept of a free economy, not burdened by Central Planning was shaken to its core.

This was the case although two notable economists had outlined different approaches to full employment and financial stability. A prominent economist at Cambridge University Joan Robinson wrote a book that demonstrated the bad consequences of monopolistic power, whether due to the size of corporations or technological breakthroughs. She favoured a form of socialism different from Centralised Marxism, which was married to autocratic rule as of 1928. England then continued to function as a Constitutional Monarchy.

John Maynard Keynes changed everything with the publication of his ‘General Theory’ in 1936. Keynes’ writing in the aftermath of World War 1, and the great depression asserted that full employment and stability can only be achieved if the state undertook to realise infrastructural works and the provision of health guarantees, which could be achieved with full employment.

Both these economists’ opinions were neglected. Both were advocating economic principles that went beyond Classical Thought, which relied on the Invisible Hand. In fact, Keynes was invited to participate in drafting the Bretton Woods Agreements, but his paper was neglected in favour of ideas and plans laid out by George Marshall, an American economist.

In 1943, and in anticipation of the success of the Allies in ending the war with Germany, the Bretton Woods Agreements were drafted in the U.S. with the aim of reorganising the international financial market, which had as of that time the dollar as the fulcrum of international finance. A return to classical economics seemed inevitable because the U.S. held on to free enterprise more so than most other European countries.

After World War 11, the devastated economies of Western Europe, particularly of Germany, France, Italy and the economy of Japan were renovated by the American AID programmes. The Marshall Plan – after George Marshall, the general who commanded Allied Troops on the Western Front in the last years of World War 11, and the General McCarthy Plan for Japan gave sway to American ways of doing business. This was due to the strength of the dollar, America's rich endowment of oil that was supplied to Western Europe and Japan, and the dollar became the currency of reference. The gold standard had dropped out of use, and was substituted by the Gold Exchange Standard, which pledged that countries with excess dollars could exchange every $35 for one ounce of gold. This standard was finally eliminated in 1973 by Richard Nixon.

The Russians, who had suffered the greatest human losses during World War 11 were denied any help and because of the lack of American help, Stalin became very cautious in his dealings with the Americans. Also, he was fearful that the British and Americans could attack Russians forces. His fear stemmed from the use of nuclear bombs to devastate Hiroshima and Nagasaki in Japan.

Russian defense was based on its control of most East European countries, including the Ukraine, Poland, Czechoslovakia, Yugoslavia, Romania, Hungary, Bulgaria, the Baltic states and for a time Austria, and until 1989, East Germany.

The Soviet Union became a vast conglomeration of countries and ethnicities. It had oil resources in Azerbaijan, Romania and Russia. It was a stretch far bigger than Western Europe, and Stalin started intensive and cruel programs for increasing agricultural and industrial production.

He remained afraid of confrontation with the U.S. until Russia produced its Atomic Bomb in 1951 and the Hydrogen Bomb in 1952.After achieving what he considered a nuclear balance, Stalin felt that he could relax from the fear of American and British aggression.

The Cold War had set in. And Europe was not rid of American hegemony until the drafting of the Treaty of Rome that heralded the formation of the Common Market. Only then could the Europeans feel that they can have a market that can compete with the American market in size and diversity. France, under President Charles de Gaulle worked on its nuclear potential and did not join NATO. Although the Force de Frappe was ridiculed by the British and Americans, France became a first rate nuclear power and excelled in the construction of electric nuclear stations.

In 1949, China had been overtaken by the revolution of its peasants. Mao Tse Tung had overpowered Chan Kai Check, who fled to Taiwan.

By 1950, the Communist world was numerically far more than Western Europe and Japan. It was not a homogeneous world. Communist China was even stricter in its adoption of communist teachings than the Russians, and soon after Mao Tse Tung and his team took over power, war in Korea started and the country split into North Korea – ruled by Communist dictators and South Korea, which became a republic. North Korea languished economically, whereas South Korea became prosperous as of the nineties. East Germany and North Korea failed to keep step with their counterparts, West Germany and South Korea.

In the decade of the eighties, the U.K. and the U.S. enshrined free competition and anti-union policies and achieved growth, which overshadowed Russian successes in space. China had just rid itself of the shackles of Mao's rule and started experimenting with gradual liberation of economic regulations and strict use of power was loosened.

Free enterprise seemed to be gaining over regulated and autocratic societies. The information technology revolution was fast developing, and markets were freed of exchange controls. Capital flows were no longer regulated and the world at large seemed to be an extended free market except for the Soviet Union and China. The former conglomeration, together with China accounted for 40% of the total world population. Free enterprise received from American policies and the U.K. a strong doze of pro-free enterprise policies.

Japan, which had become a major economic player, whether in shipbuilding, steel, automobiles or electronics products, was anything but a free market. Japanese enterprises were guided and supervised by MITT, the powerful Ministry of International Trade and Industry. Free enterprise was exercised in smaller industries and services centres. The government played an important role in encouraging exports and supervising foreign investments, whether in Japan by foreign capital or by Japanese enterprises elsewhere.

Free zone trade areas were late in mushrooming in the Pacific or North America. These had to await the nineties and broader agreements within the WTO (World Trade Organisation), which substituted GATT (General Agreement on Tariffs and Trade) drafted in 1947 with little effect.

Before the end of the 20th Century, two major developments had impacted the world economic and financial scene. The Soviet Union disintegrated after the Berlin Wall was torn down, and East Germany was united with West Germany. This development seemed to indicate that finally free enterprise and democracy would reign. This impression was further strengthened by the incredible growth of services in advanced economies. It is sufficient to say that Microsoft and Google became the largest companies in the world by their market evaluation.

Then we had the 2007-2008 the international financial and economic crisis. This crisis continues and has brought about consequences close to depression in countries such as Spain and Greece where unemployment for their youth reached 40-50% levels.

Lebanon was holding on to the notion that it has a free enterprise system. Ever since the Lebanese currency became freely exchangeable money in the early fifties, and Raymond Edde’s banking secrecy law was approved in 1956, the free economy image characterised Lebanon. We benefited from this impression until 1975. I believe that the Invisible Hand of free enterprise has evaporated in Lebanon.

As of 1973 however, Tripoli refinery was nationalised and taken over by the government. Soon after the owners of Zahrani refinery pulled out of Lebanon and surrendered the refinery to the government.

Without dwelling on the war, which lasted for 16 years, we have seen private or semi-private enterprises fall into government hands These included Intra Bank, which was transformed into an investment company with the Ministry of Finance holding 35% of its shares and the Central Bank 10%, and in consequence the public sector controls 52% of the Casino du Liban, and 100% of Middle East Airlines. The Electricite du Liban, which was run on private grounds successfully until 1975, gradually became a burden on the shoulder of the public sector.

As of 1991 and the start of implementation of the Taef agreement, senior posts in government controlled institutions were allotted on sectarian basis. Even Telecommunications of cellular operators, which started as private companies, were taken over as of 2005 by the public sector against payment of substantial compensation figures. The result was a charade of public ownership contracted to private companies, and thus we have the most expensive and inadequate service of all Middle Eastern countries.

We are told, and that is true, that after the introduction of VAT, our budget, which suffers from a deficit that equals 10-12% of GDP, has come to account for 26% of the GDP. But this is not the end of the story.

I contend that the public sector and its peripheral attachments accounts for more than 50% of the GDP, and this is not consistent with a free economy, particularly because the government administration is too large, too inefficient, with a high degree of corruption.

Let us be frank and enumerate some of the institutions that are controlled or serve public objectives, but their revenues are not included in the budget.

- Bank of Lebanon – which is actually today the largest Commercial Bank in Lebanon.
- Intra Investment Company.
- Middle East Airlines
- The Casino Company.
- Finance Bank
- The Beirut Stock Exchange.
- Authority of Financial Markets.
- National Institution of Deposits Guarantees.
- The Municipality of Beirut
- The Tobacco Regie
- The National Social Security Council.
- Electricite du Liban.
- Practically all the Water Authorities.
- Both refineries, which now serve as depots for imported products.

In fact, if we add the turnover of all these organisations and others that I cannot enumerate in full, the Public Sector accounts for more than 50% of the GDP.

The only free aspect of the Lebanese economy is represented by the free exchange of the Lebanese pound.

And

The unique free enterprise continues only thanks to transfers of Lebanese people working abroad, which were in the order of $9 billion in 2013 and $7.8 billion in 2014.

Will we survive for long under these circumstances, when transfers are expected to fall because of lower oil prices and tighter budgets in Arab oil producing countries and Nigeria – I doubt.