Reviving the Invisible Hand: The Case for Classical Liberalism in the Twenty-First Century
Deepak Lal
Princeton, N.J.: Princeton University Press, 2006, 320 pp.

"Classical liberalism" may be an awkward and arcane term to modern ears but it remains a robust concept. More than two centuries after Adam Smith brilliantly articulated a systematic case for free markets under limited government, classical liberalism continues to reshape the world for the better.

The term itself has fallen out of favor, however, buried under discussions of neoliberalism, market socialism, the Washington Consensus, and a host of "Third Way" variants, but in China, India, and other corners of the world, it is classical liberalism that is gaining ground. In his new book, development economist Deepak Lal explains the global economy through the penetrating light of a philosophy grounded in centuries of Western thought and experience.

Lal is superbly qualified for the task. A professor of international development studies at the University of California, Los Angeles, he is the author of such highly regarded books as *The Poverty of Development Economics, Unintended Consequences,* and the provocative *In Praise of Empires.* He is an erudite scholar with wide-ranging interests and opinions, and they run freely in the pages of his new book.

The book begins with a historical tour from ancient China and Rome through the pro-market reforms of Pope Gregory VII in the 11th century to the "intensive" economic growth launched by the ideas of Adam Smith and the policies of the British government in the 19th century. Lal approvingly describes the triumph of the 19th century "liberal international economic order" built on the pillars of free (or at least freer) trade, the gold standard, and the international recognition of property rights.

Lal draws important distinctions between classical liberalism and the more technical approach that dominates the economics profession today. Classical liberalism emphasizes the process of competition in "contestable markets," not the abstract notion of a final market equilibrium through "perfect competition." The greatest threat to market efficiency is not that markets will fail to achieve equilibrium, but that rent-seeking producers will capture the government to stifle competition. He wisely warns that governments do not typically function as "beneficent guardians" of the public welfare, but more as "predatory states."

Current U.S. and EU policies come under deserved criticism. America's deviations from classical liberalism include President Bush's steel tariffs, abuse of antidumping law, high tariffs on textiles and apparel, and farm programs. In the European Union, the deviation has been more systematic, as a common market vision of free trade and competition has given way to a regulatory state run by technocrats more interested in political union than free and open markets.

He rejects calls for "fair trade" as a form of disguised protectionism and even dismisses the common notion that the "losers" from free trade must be compensated:

> On classical liberal principles there is no case of compensation for losses arising in a competitive capitalistic economy. The dynamics of such an economy, as Schumpeter emphasized, involves constant economic change embodied in new products, new technologies, and new sources of supplies. If those who lose in this competitive process were always to be compensated by the winners, it would attenuate the very process of change (p. 85).

Carrying the compensation argument to its logical end, Lal asks whether makers of personal computers should be required to compensate all the manual typewriter producers they put out of business.

Lal blames the East Asian financial crises of the 1990s and the contagion that followed on the failure of various governments to follow classical liberal economic principles. Specifically, he faults pegged exchange rates; the cozy ties between domestic banks, large industries, and the government; and a failure to hedge borrowing against currency movements. He pronounces the Asian model dead and concludes that "only the derisively labeled 'Anglo-Saxon model of capitalism' is viable in the long run" (p. 117).

The European Monetary Union, World Trade Organization provisions on intellectual property, and the proliferation of regional and bilateral trade agreements also fail the classical liberal test in Lal's view, but he saves his most withering criticism for the World Bank and International Monetary Fund. He faults both organizations for misallocating global capital in a way that often rewards bad policies and fails to promote permanently higher growth. Real reforms have been spurred, not by foreign aid or "conditionality" imposed by those multilateral organizations, but by the proven ability of free markets to spur growth and, incidentally, broaden the government's tax base. He concludes unambiguously that the IMF should be shut down.

In two later chapters, "Morality and Capitalism" and "Capitalism with a Human Face," Lal claims the moral high ground for classical liberalism. Faulting World Bank measures of global poverty, he shows that market reforms have in fact lifted hundreds of millions of people out of poverty. He confronts the myth that capitalism has exacerbated inequality in the world. Global incomes for individuals have actually been trending in the direction of more equality since the 1970s, and the world's poorest nations in 1960 have actually been catching up to the richest nations in the decades since then.

My enjoyment of the book was compromised by two problems, neither fatal. One is the author's looseness with certain facts. Early on he dismisses the Protestant reformer John Calvin by comparing his legacy in Geneva to the Ayatollah Khomeini's in Iran, ignoring the fact that classical liberalism flourished first in those societies most influenced by Calvin while those same ideas languished in Catholic and Muslim societies. President Bush imposed Section 201 tariffs on imported steel in March 2002, not 2001, and President Nixon closed the gold window in August 1971—a date that should be seared in the mind of every classical liberal—not in 1974.

My other complaint is organizational. The book would appeal to a wider audience if more terms were defined, including a more detailed description of the very concept of classical liberalism. It is also marked by digressions, interesting though they are to anyone engaged in the broad subject of the book. In more than one place, I wondered how the subject at hand related to the chapter, and in some cases to the theme of the book. In that sense, the book as a whole was less than the sum of its parts.

Those minor caveats aside, *Reviving the Invisible Hand* offers a spirited defense of classical liberalism and principled and informed insight into the broad range of controversies in today's international political economy. If more policymakers shared the vision articulated in this book, a larger share of the world's population would enjoy the fruits of freedom and prosperity.

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