A Pro-Reform Foreign Policy

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When the Soviet Union imploded and the Berlin Wall collapsed, Adam Smith and John Locke triumphed decisively over Karl Marx. Or did they? True, for the last several years, the winds of democratic elections and free markets have reached gale proportions. But developments in critical emerging markets such as India, Russia, Brazil, Mexico and Turkey point to a hurricane that could be petering out.

This is no small issue. U.S. companies export more to emerging markets today than to Europe and Japan combined, a feat made possible by market openings in these countries. Any significant backlash against reforms would become an economic and foreign policy disaster for us.

Around the World

Look at India, the world's largest democracy. Since 1991, the ruling Congress Party has restrained spending, lowered tariffs and encouraged foreign investment. As a result, inflation declined, foreign reserves increased, trade boomed, growth soared, and New Delhi attracted more foreign investment in the 1993-95 period than in the previous 45 years. In recent elections, however, the Congress Party was replaced by a shaky alliance of 13 parties. It is highly unlikely that this new coalition will be able to make the hard decisions on the next and critical stages of reform, from privatizing bloated state-owned companies to tax reform to dismantling ossified labor laws.

Or consider Russia. The second round in free elections will be completed in July. But if President Boris Yeltsin prevails, he will be obligated to make good on his promises to subsidize huge numbers of workers, including soldiers, teachers and doctors, thereby gunning the fiscal engines and reigniting inflation. If the Communists win, the clock would be set back to the command-and-control days.

Brazil is enjoying a vibrant democracy after decades of military rule. Its anti-inflation efforts have lowered annual price increases from more than 2,000% to under 20%, and its trade-opening policies have been a smashing success. But now President Fernando Henrique Cardozo's unruly populist Congress refuses to grant him authority to sell off state companies, the sine quo non for continued reform.

Mexico, despite a severe financial crisis, has continued to liberalize its policies. But as the dominance of the Institutional Revolutionary Party gives way to a more pluralistic system, we are sure to see the rise of powerful groups seeking redistribution of the economic pie at the expense of making it bigger.

Turkey was, until very recently, on course to become a modern industrial European state. Under the former prime minister, Tansu Ciller, Ankara's rulers were preoccupied with economic reform. No longer. With a warring and precarious political coalition in power, freeing up markets has been all but forgotten.

The common element in all these nations is that democracy and economic liberalization don't always move in lockstep. It is true that political systems must change to accommodate economic liberalization, but what we are seeing is a clash between what emerging markets need to grow and prosper over time--even more economic liberalization and reform--and what the political traffic will bear at the moment. Populism, nationalism, fear of competition, disgust with growing corruption and sheer protectionism are all at play.

How to respond? It is not difficult to conjure up three different approaches. The first, likely to be embraced by some conservative pundits and policy makers, is to conclude that most emerging countries are not ready for full fledged political liberalization. They have neither the traditions, the laws nor the educated population that must underpin an effectively functioning democracy, so the argument will go. Better to have the kind of authoritarianism embraced by the East Asian tigers--South Korea, Taiwan, Singapore.

A different line of reasoning would be to go soft on economic reforms. You can hear Washington's foreign policy establishment warning against pushing too hard and too fast for fear of risking political and security ties. The old liberal economic-development crowd is probably constructing some new theory about the need for a softer kind of capitalism. Another group--senators and congressmen--could easily see stalled reforms as a new occasion to bellow the free market gospel and threaten other countries with sanctions if they don't continue to open their markets.

None of these alternatives is right. Fact is, in the sweep of recent history--which has been so favorable to American interests--the political chaos and backlash appearing in emerging markets are but an aberration. In a global economy, the imperative of economic reform is simply overwhelming.

For one thing, we shouldn't forget how much progress has already been made. Just five years ago who would have identified India as a promising trade and investment partner? Who would have predicted Russia would hold free (and unrigged) elections? For another, faxes, TV and computers have made it possible for people everywhere to see how others live--and to demand at least the same or better. Today financial markets will severely punish governments that stray too far from sound policies, and which become uncompetitive vis-a-vis their neighbors.

America's framework for dealing with this interplay of politics and economics abroad should have four elements:

• Continue to press hard for economic reform, but favor private, behind-the-scenes diplomacy rather than the holier-than-thou megaphone approach. As democracy expands, people in emerging markets will be increasingly sensitive--and resistant--to the American proclivity to preach. The message we should deliver--that it's best to face the music now, that economic reform that is bold and swift works best, that smooth relations with Washington depend on making serious economic reform--ought to be clear and direct. But the style is crucial, and should consist of continuous government-to-government dialogue, outside the glare of the media. American business, using its extensive contacts, would help enormously by delivering the same message privately.

• Give added attention to the building of a multilateral framework for trade and finance. The International Monetary Fund, the World Bank, the World Trade Organization and others are in a better position than any one country, even the U.S., to apply carrots and sticks. Washington--the largest shareholder in each case--should make sure that none of these institutions let up on a full court press for more market-oriented policies in emerging markets. Particularly in the WTO, new rules on liberalization of foreign investment regulations in emerging markets should be accelerated. Washington should also press for the expansion of the North American Free Trade Agreement, to give other Latin American countries besides Mexico a bigger stake in the Western system of open markets.

Help for Reforms

• Think creatively about how to provide technical help for reforms. Emerging markets need help in building a modern capitalistic infrastructure--in fashioning regulations for stock markets, in designing enforcement systems for intellectual property rights, in creating solvent pension and health care systems, and in building the political foundation for genuine and sustainable democracy. American firms and universities can help with advanced training and education, both on site and in the U.S. A new version of the highly vaunted Fullbright education exchange program would help.

• Pursue domestic economic policies worthy of a global leader. This means pro-growth policies--low taxes, low inflation, regulatory simplification, markets wide open to imports--which together allow the U.S. to be an engine of global growth, benefiting from trade everywhere.

The trick now is not to lose our nerve but to lead.

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