

## COMMENT &amp; ANALYSIS

Personal View • Jeffrey Garten

# The challenges of an emerging world

Huge changes in developing countries pose threats as well as opportunities



Several big emerging markets hold enormous promise for the expansion of business and democracy around the world. But business executives, trade officials and foreign ministries are not sufficiently sober about the tumultuous transition that is occurring from Brasilia to Beijing and the many crises that loom in the emerging world.

Too many governments, companies and investors are have bought the line that Adam Smith and John Locke have completely won the day: they are making straight-line projections that the substantial economic and political progress which has occurred in east Asia, Latin America and central Europe will continue at the pace of the last several years. This is a dangerous miscalculation.

Some of the problems on the horizon are familiar. A significant rise in US interest rates, for example, could have a devastating impact in Latin America, which is so heavily reliant on capital inflows in stocks and bonds, much of which could migrate north in search of higher returns. In Asia, multinational companies are so bullish that we are seeing the spectre of overcapacity in electronics, petrochemicals and autos. Such gluts have historically played havoc in the world economy.

Then there is the sheer difficulty of implementing the next generation of economic and social reforms. From Mexico City to Seoul, progress in such areas as labour reform and education is nowhere near adequate to meet the requirements of minimum decent living standards, let alone the need for

societies to compete globally. Slow progress in developing modern banking systems is an Achilles heel that portends real problems.

It would be dangerous, too, to count on a continuous upward trajectory for trade expansion. Over the next decade, some 1.5bn young workers from emerging markets will enter the global workforce. They will be earning \$5-\$10 a day, against \$100 in the US, Europe, or Japan but – with access to western management, technology and capital – they will be almost as efficient. We can expect rising imports and severe downward pressure on wages in the industrial world. Enormous protectionist tension is a real possibility.

These problems pale next to the difficulties that are arising as capitalism confronts weak or non-existent democracies. Free markets are emerging without the required political preconditions – without adequate regulatory structures, minimal safety nets, or fair and impartial institutions for enforcing the laws. The scenarios are frightening: Mafia dominated economies like Russia; breakdown of law and order in Brazil or Taiwan; seething pressures that could burst out in the open in Mexico or Indonesia.

This collision between economic and political forces is no small matter. It could put a monkey wrench in the wheels of economic reform, and lead to political chaos and instability. In the eyes of local populations, it could discredit the great transition to democratic capitalism, leading to a return of authoritarianism and futile, but disruptive, attempts at more centralised controls. If this happened, the economies of the US, Europe and Japan, which are increasingly dependent on trade with emerging markets, could be badly damaged. There would also be intractable foreign policy problems.

None of these potential crises ought to be an excuse for

countries such as the US, the UK or Japan – or for their companies – to turn away from the emerging world. On the contrary, they must redouble efforts to engage the big emerging markets with trade and closer political ties.

Such engagement would have several dimensions starting with intense efforts to build a global network of institutions, such as the World Trade Organisation, which help these countries make their difficult transitions. Engagement should extend to serious technical assistance, bilateral and multilateral, to implement the second generation of micro-reforms from financial regulation to flexible labour laws. Efforts to bring China into the WTO should be accelerated. The US Securities and Exchange Commission, together with its counterparts in Europe, should expand efforts to strengthen stock markets. Foundations, helped by legal societies in the west, should focus more on establishing the rule of law in emerging markets.

Global companies have a big role to play, too, for business has become the most powerful force shaping the world. Chief executives need to brace for the longer term in emerging markets. Part of that strategy should encompass investment and technical assistance in such fields as education, workforce training, and healthcare delivery. This is all the more necessary as the resources of western governments come under increasing pressure.

The big emerging markets are reshaping the world as we know it. We need a proportional and complex response. Blind optimism is not enough.

*The author, under-secretary of commerce in the Clinton administration from 1993-95, is dean of the Yale School of Management. He is author of The Big Ten: The Big Emerging Markets and How They Will Change Our Lives (Basic Books)*