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## **DEMOCRACY AND MARKETS**

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Taiwan evolved gradually into a democracy, but China did not. South Korea is a democracy, but North Korea is still a totalitarian country. West Germany was a democracy well before unification, but East Germany was led by a dictatorial regime. The different outcomes in these three cases cannot be attributed to historical cultural conditioning, but rather to more recent political circumstances. In each case, the transition to democracy took place in a market economy while the durability of dictatorship occurred in countries in which the state made the major economic decisions.

The foregoing three examples demonstrate a simple reality: totalitarian regimes that adopt market economics can alter the nature of their governance for the better. Democracy in each of these cases involves open elections, the alternation of political parties in power, a free press, and free speech-critical aspects of society still absent (or which were absent in East Germany) in the three sister states.

A more complex example of transformation to democracy can take the analysis further. Mexicans, on July 2 of this year, elected a new president, thereby ending 71 years of single-party rule, which will become effective when Vicente Fox is sworn in on December 1. Mexico has been a faux democracy, with all the paraphernalia of elections, but whose outcomes were known in advance, until recently. Mexico had considerable individual free speech, but the media were controlled by the government through various devices. The role of the state in the economy was large, and key competitive features of the market were limited. In its way, the market structure was much like the political system, a façade that was as much fraud as reality.

Market competition began slowly in the early 1980s when import restrictions were eased, then gained steam when Mexico joined the General Agreement on Tariffs and Trade in 1986, and reached an apex when free trade with the United States came into force under NAFTA in 1994. Carlos Salinas de Gortari, the president responsible for Mexico's entry into NAFTA, did not hide his priority of opening the economy before allowing the political system to become truly competitive. Ernesto Zedillo, Salinas' successor, gave his final *informe*, in effect his farewell address, on September 1, in which his clear message was that the liberal economic policy Mexico has been following contributed importantly to Mexico's democratic transition.

One additional group of examples can be offered. The Czech Republic and Poland moved rapidly to adopt a competitive market system after Soviet dominance. Indeed, there was much criticism at the time that shock therapy for the two economies would lead to serious hardships. Romania, the Ukraine, and other former Soviet republics were slow to adopt competitive markets. Democracy is considerably more robust in the first two countries than in the others. This can be attributed in part in the Czech case to its earlier democratic history, but there can be little doubt that the Czech story would have been different absent its return to a competitive market structure.

Many analysts have pointed out that while all democracies have competitive market structures, not all countries with market economies are democratic. It is also true that not all democracies retain their competitive political systems. Russia elected its current president, but it is evident that the media are not completely free; nor are markets competitive, as the use of the word "oligarch" to describe those who have been able to manipulate the economic system attests. President Alberto Fujimori was first elected in a democratic election, but democracy in

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Peru has since retrogressed. So too was President Hugo Chávez elected democratically, but the future of democracy in Venezuela is uncertain. Chávez was able to exploit the populist sentiment in his country because the economy was far from being competitive and roughly 80 percent of the population lives in poverty.

President Zedillo used the word "liberal" to describe his economic policy, by which he had in mind a competitive structure and minimum government involvement in the operation of Mexico's economy, other than to set the macroeconomic framework and establish important social safeguards. The critics of this policy use the term "neoliberal" in order to imply a kind of capitalism that tolerates great income inequality and excessive poverty. Most of the demonstrators who show up to protest at international economic meetings around the world—from Seattle (the World Trade Organization), Washington, D.C. (the World Bank and the International Monetary Fund), Melbourne as this is written (an Asian economic gathering), and no doubt in Prague later this month (when the annual meetings of the World Bank and IMF convene)—take an exploitative view of markets.

Are the critics correct? They are if competitive market capitalism is equated with Darwinian economic survival—that is, with capitalism that has no social dimensions. They are correct if the authorities are unwilling to deal with corporate stifling of competition. They are correct when governments systematically favor special over national interests or tolerate crony capitalism. However, all modern industrial countries have programs to deal with the suppression of competition, that is, with interference with the workings of markets. All have safety nets, some more inclusive than others. It is hard to understand why the demonstrators in Seattle, who claim to be supporters of democracy, favored protection against competitive imports. They are working at cross purposes with themselves.

There is no assurance that the operation of markets, coupled with techniques to promote competition (both internally and from imports), and governmental mechanisms to assure social justice, will lead to the establishment of democratic institutions. On the other hand, we do know that the lack of markets—the existence of government monopolies or near monopolies over a country's economy—will not lead to democracy. The reasons for this are reasonably straightforward. Markets promote decentralized decisionmaking and the greater the competitive pressures, the more variegated this decisionmaking is.

A key argument of those who favor granting permanent normal trade relations to China follows precisely this logic—that this will decentralize economic decisionmaking in China. The reasoning is that, over time, China may follow a path similar to that of Taiwan and South Korea and result in the progressive opening of the political system alongside the economic structure. The alternative policy, that of restricting the development of China's market structure by rejecting normal trade relations with the United States, offers little hope for China's democratic development.

These are not sure things. Developing a competitive market does not necessarily lead to the establishment of a democratic society, but there is a positive probability that it will. This, I submit, is a chance worth taking in China and elsewhere, if we value the positive evolution of societies currently closed to outside political influences.