Do as the US Says, Not as it Does
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America preaches free markets, but at home it's a different story.

Today, many emerging markets, from Indonesia to Mexico, are told that there is a certain code of conduct to which they must conform if they are to be successful. The message is clear: here is what advanced industrial countries do, and have done. To join the club, you must do the same. The reforms will be painful, vested interests will resist, but with enough political will, you will reap the benefits.

Each country draws up a list of what's to be done, and each government is held accountable in terms of its performance. Balancing the budget and controlling inflation are high on the list, but so are structural reforms. In the case of Mexico, opening up the electricity industry, which Mexico's constitution reserves to the government, has become the structural reform of the day demanded by the west. So analysts praise Mexico for its progress in controlling its budget and inflation, but criticise it for lack of progress in electricity reform.

As someone who was intimately involved in economic policy making in the US, I have always been struck by the divergence between the policies that America pushes on developing countries and those practised in the US itself. Nor is America alone: most other successful developing and developed countries pursue "heretical" policies.

For example, both political parties in the US now accept that when a country is in a recession, it is not only permissible, but desirable, to run deficits. Yet developing countries are told that central banks should focus exclusively on price stability. America's central bank, the Federal Reserve Board, has a mandate to balance growth, employment, and inflation - a mandate that brings it popular support.

While free marketeers rail against industrial policy, in the US the government actively supports new technologies, and has done so for a long time. The first telegraph line was built by the US federal government in 1842; the internet was developed by the US military; and much of modern American technological progress is based on government-funded research in biotechnology or defence.

Similarly, while many countries are told to privatise social security, America's public social security system is efficient (with transactions costs a fraction of private annuities), and customers are responsive to it. While the US social security system now faces a problem with under-funding, so does a large fraction of America's private pension programmes. And the public pension system has provided the elderly with a kind of security - against inflation and the stock market - that the private market has not. Many aspects of US economic policy contribute significantly to the country's success, but are hardly mentioned in discussions of development strategies. For more than 100 years, America has had strong anti-trust laws, which broke up private monopolies in many areas, such as oil. In some emerging markets, telecom monopolies are stifling development of the internet, and hence economic growth. In others, monopolies in trade deprive countries of the advantages of international competition.

The US government also played an important role in developing the country's financial markets - by providing credit directly or through government-sponsored enterprises, and by partially guaranteeing a quarter or more of all loans. Fannie Mae, the government-created entity responsible for providing mortgages for middle-class Americans, helped lower mortgage costs and played a significant role in making America one of the countries with the largest proportion of private home ownership.

The Small Business Administration provided the capital to help small businesses - some of which, like Federal Express, have grown into major businesses. Today, US federal government student loans are central to ensuring that all Americans have access to a college education, just as in earlier years, government finance helped bring electricity to all Americans.

Occasionally, America has experimented with free-market ideology and deregulation - sometimes with disastrous effects. President Reagan's deregulation of the savings and loan associations led to bank failures that contributed to the recession of 1991.

Those in Mexico, Brazil, India and other emerging markets should be told a different message: do not strive for a mythical free-market economy, which has never existed. Do not follow the encomiums of US special interests because, although they preach free markets, back home they rely on the government to advance their aims.

Instead, developing economies should look carefully, not at what the US says, but at what it did in the years when it emerged as an industrial power, and what it does today. There is a remarkable similarity between those policies and the activist measures pursued by the highly successful east Asian economies over the past two decades.