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Globalizing Good Government

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The protests in France over job security for young workers have exposed the fault lines between globalization and public policy. On the one hand, the French government has recognized that the country's labor laws are uncompetitive and a drain on the economy. The public reaction, however, shows the depth of popular misunderstanding regarding the realities of our globalizing economy.

Nations can no longer sit within their borders and pursue policies incompatible with an increasingly integrated world economy. The types of services, manufacturing and entrepreneurship that generate national wealth are more mobile than ever, and they will forsake countries that shackle business and labor with unnecessary burdens.

With this in mind, the Federal Reserve Bank of Dallas set out to document the connection between globalization and public policy. We found that the more globalized nations tend to pursue policies that achieve faster economic growth, lower inflation, higher incomes and greater economic freedom. The least globalized countries are prone to policies that interfere with markets and lead to stagnation, inflation and diminished competitiveness.

For our study, we began with research by Foreign Policy magazine and AT Kearney, a management consultancy firm, which ranked 60 countries by degree of globalization. Singapore, Ireland, the United States and other countries at the top of the rankings are far more integrated into the world economy than the insulated nations at the bottom like Iran, Egypt and Bangladesh. As the accompanying charts show, we divided the countries into four groups and looked at how each faction performed on policies that shape economic performance.

Take inflation. In a world where investment capital can flit anywhere in the world with the click of a computer mouse, nations should see the virtue of price stability and preserving the value of money. And they do: the more globalized countries we studied had an average inflation rate of 2.3 percent from 2001 to 2003, compared with 10 percent for the nations in the least globalized quarter.

This pattern is repeated in more than a dozen aspects of effective public policy, as measured by the World Bank, Harvard University, the Heritage Foundation, Transparency International and the Fraser Institute, a Canadian public policy group. (Although these groups used various ranking systems to portray their data, we took the liberty of converting each to a 1-to-10 scale, with 10 being the most successful, for the accompanying graphs.)

The gist is clear: as nations become more integrated into the world economy, they tend to maintain fewer barriers to trade and the movement of money. They are less likely to impose punishing corporate taxes and onerous regulations. Their technology policies are more favorable to innovation. Nations more open to the world economy score above the less globalized countries in respect for the rule of law and protection of property rights. More globalized countries also offer greater political stability. Not all policies fit neatly into this framework. We found that more globalized countries do no better in limiting the size of government, which we consider vital to economic prosperity. They are worse than the less globalized in containing public entitlements and subsidies, which must be paid for by higher individual income taxes. Perhaps it is

because they are richer and have the means to spread those riches through their societies.

The French *contretemps* illustrates why labor policies are less sensitive to globalization than factors like taxation and trade barriers. As long as workers refuse to acknowledge that they are competing in a world economy, they will petition a wealthy government to protect their jobs. This in turn slows job growth and raises unemployment, creating a greater demand for expensive and expansive safety nets for idle workers.

Still, globalization may yet alter labor policies. France, Germany and other countries are beginning to recognize that their labor rules are uncompetitive, and the timing of change is a political question, not an economic one.

So, do our statistics show that globalization is necessarily the cause of good policies? That would be overstating it - our data simply show the two trends are complementary. But it is clear that countries with solid policies will be more successful in the global economy, encouraging further openness and deeper cross-border connections. The chicken-and-egg debate shouldn't detract from the fundamental fact that globalization and good policies go together.

Globalization's critics argue that a more open world economy sets off a race to the bottom by encouraging countries to jettison protections for consumers, workers and the environment. In reality, the opposite is true. If our data demonstrate anything, it is that globalization prompts a race to the top by pushing countries to abandon policies that burden their economies in favor of those that fuel growth and economic opportunity.

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