

Open for Business

Imagine a capitalist manifesto. It would prescribe free trade, open competition, individual choice, strong property rights and all the other ingredients vital to a healthy market economy.

These attributes can be measured. The Fraser Institute, World Bank, Heritage Foundation, Institute for Strategy and Competitiveness, Transparency International and other think tanks compile consistent, fact-based ratings on the climate for capitalism around the world. Taken together, they provide a broad range of yardsticks for gauging the relative quality of economic policies.

Comparing these measures against A.T. Kearney's globalization rankings reveals a marked correlation between more open borders and policies that bolster economic performance.

The two forces are complementary—so strict causality is elusive. Globalization clearly gives governments incentives to enact policies to attract and retain mobile factors. At the same time, countries with solid policies will be more successful in the global economy, encouraging further opening and deeper cross-border connections. The chicken-and-egg debate shouldn't detract from the fundamental truth that globalization and good policies go together.

Let's run through a dozen policy measures to see how they correlate with globalization. (*See Exhibit 3 on page 10.*)

Trade policies make a good starting point. Since 1990, nations have peeled away restrictions on goods and services, signing nearly 180 regional trade pacts, including the North American Free Trade Agreement in

1992. The creation of the 149-nation World Trade Organization (WTO) in 1995 delivered a jolt of liberalization in such areas as global financial services, telecommunications and other high-value-added sectors. The WTO also established a forum for further market opening, and its members are now aiming for breakthroughs on such tough issues as farm-trade restrictions and subsidies.

The flurry of trade deals has opened markets. Since 1980, negotiations have slashed the average tariff from 27.6 percent to 11.3 percent for developing nations and from 9.8 percent to 4 percent for industrial countries.

Trade policies are integral to globalization, so it's no surprise that nations scoring high on Fraser's measure of freedom to trade cluster toward the top of the A.T. Kearney index.

Investment policies that free capital to seek its best uses give countries more resources to expand production. Many of the treaties that sweep away restraints on trade also knock down international barriers to investment. Since signing NAFTA, for example, Mexico has welcomed foreign capital, reducing red tape and opening sectors once reserved for nationals. Mexico's payoff has been \$145 billion in direct investment from abroad over the past decade.

Countries well connected to the world economy post the highest scores on Fraser's measure of capital market openness. Despite the benefits of open capital markets, less globalized nations persist in hindering money flows because they either want to keep capital at home or limit foreign involvement in their economies.

Regulatory policies may be largely domestic, but they play a

significant role in international competitiveness. More-globalized economies rank higher on Fraser's measure of the lack of regulatory burden and the World Bank's barometer of regulatory quality.

In more open economies, governments are less likely to impose price controls and other burdens on business. Effective regulation isn't just about what government ought not do. It also covers policies important to the smooth functioning of market economies, such as adequate supervision of banks.

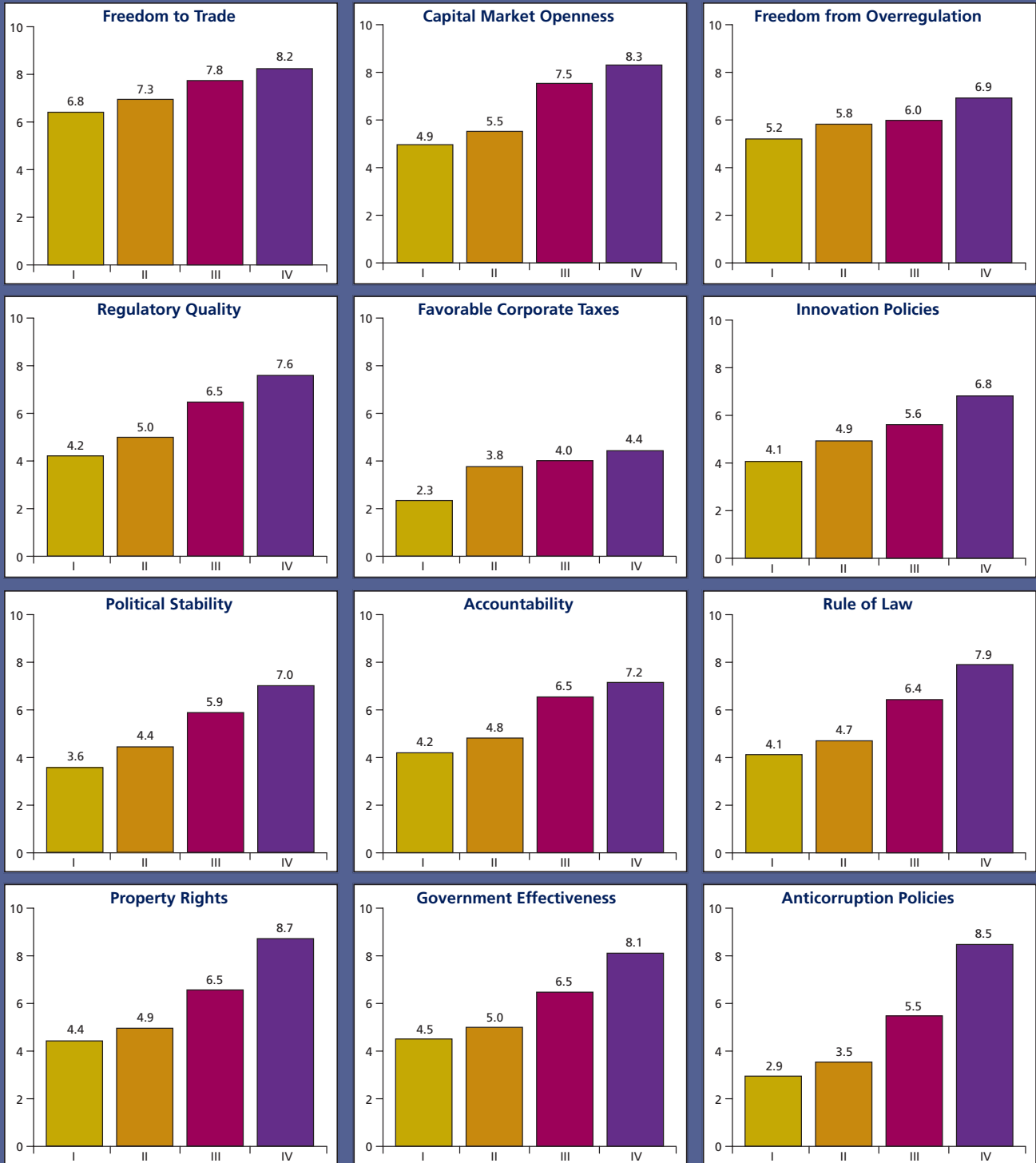
Favorable tax policies are an important asset in an era when multinational operations and mobile capital enable companies to invest and produce anywhere in the world. In the past two decades, nations responded to globalization by reducing tax burdens—as shown by the Heritage Foundation's measure of favorable corporate taxation.

High taxes discourage work and investment, and dozens of countries lowered top income tax rates for individuals between 1980 and 2000, some significantly. Including national and provincial taxes, South Korea lopped off 45 percentage points; Portugal, 44; and Britain, 43. More than a dozen developed countries have lowered top corporate rates by at least 10 percentage points from 1986 to 2000, led by Ireland's 26 points and Sweden's 24. Among the 30 members of the Organization for Economic Cooperation and Development, the average top corporate tax rate at the national level fell from 33 percent in 1998 to 27.7 percent in 2004.

Lower levies helped Ireland halt its brain drain, attract foreign businesses and launch an economic

EXHIBIT 3 Raising the Bar

As countries open themselves to international competition, they tend to pursue policies that promote success in the world marketplace. From freer trade to low levels of corruption, the more-globalized countries fare better on various research groups' measures of sound policies. Countries become more globalized moving from quartile I to quartile IV. Policies improve from 0 to 10.



INDICATOR	MEASURE	INDICATOR	MEASURE
Freedom to trade (Fraser Institute)	Barriers to goods and services	Political stability (World Bank)	Likelihood of unfavorable events
Capital market openness (Fraser)	Restrictions on capital flows	Accountability (World Bank)	Responsiveness to citizens
Freedom from overregulation (Fraser)	Extent of government intrusion on business	Rule of law (World Bank)	Strength of legal system
Regulatory quality (World Bank)	Effectiveness of civil service	Property rights (Fraser)	Protection from arbitrary losses
Favorable corporate taxes (Heritage Foundation)	Burden on company profits	Government effectiveness (World Bank)	Competent administration
Innovation policies (Harvard University)	Support for technology	Anticorruption policies (Transparency International)	Honesty in the public sector

revival. Free of communism, new EU members Latvia, Lithuania, Estonia and Slovakia bucked the continent's progressive tradition by instituting flat taxes.

Innovation policies help foster new business formation and expand opportunities for established companies. Harvard's Institute for Strategy and Competitiveness ranks nations on their commitment to technology, shown by such measures as protection for intellectual property, size of R&D tax credits, and attractiveness to scientists and engineers.

Open economies exhibit a greater willingness to nurture new technologies. Many of the Harvard study's most innovation-friendly nations are among A.T. Kearney's most globalized.

Political stability matters to economies because confusion, uncertainty and violence wreak havoc on markets. Businesses and individuals will be wary of entering into contracts and other long-term arrangements unless they're fairly certain society's basic structure will endure. When administering public policies, stable regimes are more effective and consistent.

The World Bank finds the most stability among long-standing democracies of Western Europe, North America and Australia. Many of these nations score well on the A.T. Kearney globalization rankings.

Accountability emerges as a key aspect of political stability. The potential for chaos recedes in societies with civil liberties, political and human rights, and opportunities for citizens to select and influence their governments.

The World Bank's readings on accountability, like those on stability, favor democratic nations with a strong tradition of individual rights. These countries tend to have free enterprise economies that are engaged in the world economy.

Rule of law narrows the focus to the justice system. Society's norms receive greater respect in countries with lower crime, effective courts and dependable enforcement of contracts. An abiding respect for the rule of law enhances the predictability businesses require for forward-looking decisions based on the sanctity of contracts.

Countries seeking to establish themselves as good places to do business will maintain fair and functional legal systems. The most open economies already do, while the least globalized struggle to deliver adequate law enforcement.

Property rights are a specific aspect of the rule of law. When caprice or government actions call into question the ownership or value of property, economic activity becomes risky and may grind to a halt. Strong protection of property rights makes market economies function more smoothly by enabling buyers and sellers to conduct transactions with a higher degree of trust.

The most globalized nations guarantee property rights; the least globalized offer less protection. The ranking relies on Fraser's measure of the effectiveness of nations' legal systems and their protections for property rights. Countries earn high scores if their citizens have legal recourse to prevent theft, fraud and government actions that jeopardize their homes and businesses.

Government effectiveness recognizes that good policies don't inspire respect and confidence without competent administration and consistency over time.

The World Bank focuses on the quality of government services, the capabilities of civil servants, the political independence of public agencies and the credibility of the government's commitment to good policies. Highly globalized countries realize they can't succeed without good government at home.

Anticorruption policies take aim at illicit dealings that undermine economies by raising costs, creating uncertainty and thwarting competition. Russia's transition from communism to capitalism, for example, has degenerated into a kleptocracy that can't keep insiders from enriching themselves by rigging the system.

The most globalized countries are less likely to tolerate corruption. They rank significantly higher on Transparency International's index for absence of corruption and the World Bank's measure of the ability to control corruption.

Globalization's influence does not end with the policies and attributes studied by the think tanks. Honing labor's skills, for instance, creates an edge in our high-tech age, and businesses are likely to flow toward nations that better educate workers. The forces of an increasingly global economy are also likely to play a role in immigration, education and energy policies. Indeed, as nations grow even more interconnected, globalization may impact realms of public policy that today seem far removed from the world economy.