Balanced Growth: The Scope for National Policies in a Global Economy

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Preface

This John Deutsch Institute publications series arises from our CIDA-supported projects with the Thailand Development Research Institute (TDRI) and the Malaysian Institute of Economic Research (MIER). Central to these projects is collaboration by Canadian, Malaysian and Thai researchers. These monographs are intended to make research results available to broader Canadian and international audiences. We are grateful to CIDA for its financial support.

Professor Helliwell was invited to be keynote luncheon speaker at MIER's annual National Outlook Conference in December 1998, and chose to speak on the theme "Balanced Growth: The Scope for National Policies in a Global Economy." This paper, which formed the basis for this address, draws on two strands of Professor Helliwell's recent work: the importance of national borders, and determinants of relative growth performance. Both themes are of great interest and importance to Malaysia in light of the country's policy responses to the economic crisis.

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A. INTRODUCTION

Is there scope or need for national economic and social policies in today's global economy? Many commentators have argued that national economies have disappeared, with their former powers and functions being usurped from the one side by the global economy and from the other side by cities and regions. Thus Kenichi Ohmae (1995) treats regional economies and multinational firms as the chief building blocks of the modern global economy. If this is true, then we would expect to find that national borders no longer mark separations in economic space. This paper assesses the facts of the matter, searches for their implications for national economies, and considers the scope and need for local and national policies that provide a basis for balanced growth. This will be done in two main sections. The first will summarize the evidence and implications leading to the conclusion that there is still great scope and need for national policies. In some ways, increasingly open international markets pace even greater importance on the development of national policies to develop domestic institutions that are

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robust enough to deal with the consequences of international disturbances. The second section will consider some specific domestic policies that can help to support balanced growth. The range considered will be far broader than the usual list of economic policies, because there is increasing evidence that sustainable economic growth depends on a whole range of social and political institutions. The emphasis will be on those institutions that can help to support growth that is socially, politically and environmentally balanced, and thereby sustainable.

B. COMPARING NATIONAL AND GLOBAL ECONOMIC LINKAGES

Evidence[1]

Only in recent years has it been possible to measure the relative strengths of domestic and international economic linkages. Even now, most countries have no systematic measures of internal trade flows, and hence no empirical basis for comparing domestic and international trading intensities. Canada remains the only country with a full set of interprovincial trade data that can be compared with trade flows between Canadian provinces and U.S. states. The first use of these data to compare the strengths of domestic and international trading intensities was by John McCallum (1995), who came to the startling conclusion, based on a gravity model of trade flows, that in 1988 Canadian provinces traded twenty times as intensely with each other as with U.S. states of comparable size and distance.

The gravity model assumes that trade flows increase proportionately with the economic size of the trading partners, and decrease proportionately with the distance separating them. These adjustments are essential if domestic and international trade densities are being compared, because the important effect of distance on trade would lead us to expect greater trade flows within a country just because of the greater distances involved in foreign trade. Over recent decades, the gravity model, always a great empirical success, has gone from being a theoretical orphan to being the favoured child of all main theories of international trade.[2] This makes it a solid tool for the evaluation of border effects, even if it

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[1] Parts of this section, including Figure 1, are drawn from my chapter in *The State of the Federation 1998*.

[2] Despite its use in many early studies of international trade, the equation was considered suspect in that it could not easily be shown to be consistent with the dominant Heckscher-Ohlin model explaining net trade flows in terms of differential factor endowments. Anderson (1979) showed that the gravity model could be derived from expenditure share equations assuming commodities to be distinguished by place of production. Anderson also showed

cannot easily be used to discriminate among competing theories of international trade.

To ensure that McCallum's startling finding is not some mysterious result generated by some feature of the model used for estimation, it is useful to see if it matches the data for specific pairs of provinces and states. For example, Ontario is almost equidistant from British Columbia, Washington State, and California. In 1990 the Californian economy was almost twelve times larger than that of British Columbia, and thus should have provided, without border effects, a market almost twelve times as large. Ontario merchandise shipments to British Columbia were actually almost twice as large as to California, for a total border effect of 21. Washington State GDP was more than one-third larger than that of British Columbia, but Ontario's exports to British Columbia were more than twelve times larger than to Washington, for a total border effect of 21.

In Helliwell (1996) I extended the sample to include data for 1989 and 1990, found an increase of the border effect from 1988 to 1990, and showed that the preference for Canadian over U.S. markets applied as much to Quebec as to the other provinces. Since that time, there has been additional work by Statistics Canada to improve the province-state data to make them match more closely the concepts used in the construction of the interprovincial trade data, and to refine the assignment of trade to its province of origin or destination. In addition, the data have now been extended through 1996, permitting the consequences of the U.S.-Canada Free Trade Agreement (FTA) to be assessed.

Results for 1988 through 1996, including disaggregation by province, by industry, and by direction of trade, are all reported elsewhere (Helliwell 1998, Chapter 2). The best summary measure of the results is for total merchandise trade, along with some more approximate calculations for trade in services. The estimated border effects, shown separately for merchandise and for services, for each year from 1988 through 1996, are pictured in Figure 1. The improvements in the classification of province-state trade flows for 1990 have lowered the estimated border effect for merchandise trade for that year from a previously estimated 21 to about 17. The subsequent sharp drop in the border effect from 1990 to 1993, coupled with its rough constancy since, at a level of about 12,

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that the model, to be fully consistent with the generalized expenditure share model, should include remoteness measures in bilateral share equations, as we do here. Helpman (1984) and Bergstrand (1985) showed that the gravity model can also be derived from models of trade in differentiated products. Such trade must lie at the core of much of manufacturing trade, given the very large two-way flows of trade in even the most finely disaggregated industry data. Finally, Deardorff (1997) showed that a suitable modelling of transport costs produces the gravity equation as an estimation form even for the Heckscher-Ohlin model.

suggests that the major adjustments of trade patterns following the FTA may have been completed.

The estimated border effects for services are in every year much larger than those for merchandise trade, and do not show the same evidence of sharp reduction in the wake of the FTA. The high values of border effects for services are not simply caused by the fact that services are generally less traded than goods, since the border effects being estimated relate only to those services that do enter trade, whether interprovincial or between provinces and states. Intra-provincial consumption of goods and services does not enter these calculations, although it is perhaps worth noting, in the light of all the discussion about interprovincial trade barriers, that attempts to estimate interprovincial border effects show them to be small and insignificant (Helliwell 1998, Chapter 2).

Thus Figure 1 is consistent both with the large increase in north-south trade flows in the 1990s, and with continuing national border effects of about 12 for goods and about twice that for services. Two features of the post-FTA changes in border effects are worth further discussion here. First, the post-1990 increases in north-south trade are more than twice as large as those that were predicted in various studies before the FTA came into effect.[3] Second, the forecast productivity gains have not materialized to any significant degree. This combination poses a puzzle for future research, but in the meantime provides some evidence to support the tentative conclusion of the next section- that the continuing high levels of national economic densities, relative to international ones, may not suggest that there are large productivity gains thereby lost.

The finding of large border effects for Canadian merchandise trade led to attempts to develop data that could lead to replication, or not, of these results in an international setting. Unfortunately, domestic inter-regional trade data are not available for other countries, so that it is necessary to estimate total domestic sales (using data from input-output tables, not available even for all of the OECD countries) and then to use some plausible procedure for guessing what might be the typical internal trade distances. This is no mean feat, since the estimate hinges a great deal of how much internal trade goes on within rather than between the large cities and industrial areas. Wei (1996) assumed that internal trade distances

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[3] Tables 5 and 6 in Helliwell, Lee and Messinger (1998) show the forecast and actual post-FTA changes in Canada-US trade for each of 25 major sectors. Averaging across the sectors, Canadian exports were forecast, by the trade model used to support official pre-FTA estimates, to increase by 33%, relative to GDP, but actually increased by more than 90%. Imports were forecast to increase by 12%, while actual growth, relative to GDP, from 1989 to 1996 was 46%. These are simple averages of the sectoral results, which are larger than the figures for total trade because some of the smallest sectors, such as knitted products, have had the fastest post-FTA growth in two-way trade.

were generally one-quarter those between the capitals of a country and its nearest neighbour. On this basis, the latest estimates of 1992 border effects for merchandise trade within and among the OECD countries is about 10 for countries not sharing a common language or membership in the European Union (Helliwell 1998, 51). Sharing a common language increases trade densities by more than 60%, while EU membership increases trade between member countries by about 40%. This 40% is a significant effect, but it emphasizes once again the surprisingly large size, almost equivalent to the cumulative EU effect, of the trade-increasing effects of lowering or removing the relatively small pre-FTA tariff rates on trade between Canada and the United States.

Comparable estimates of border effects for developing countries show them to be up to 100 or more, with a strikingly tight relation between GDP per capita and the size of the border effect. If a gravity model is fitted to merchandise trade data for the OECD countries plus a sample of other countries for which suitable data are available, the wide variety of border effects is successfully explained by the hypothesis that international differences in border effects are entirely due to international differences in real GDP per capita. These international results, along with further discussion of their trends and implications, are reported in Helliwell (1998, Chapter 3).

Engel and Rogers (1996) reasoned that if trade densities are greater within than between national economies, then it should also be true that inter-city price differentials are larger and more enduring internationally than within the same country, for city pairs of the same distance from one another. Using data for the inter-city co-variability of components of the consumer price index, for a sample of Canadian and U.S. cities, they found that this was indeed the case, and calculated that the implied width of the U.S.-Canada border was more than 2000 miles. Subsequent research using their data (and reported in Helliwell 1998, Chapter 4) has shown the result to be even starker, since there is no evidence of cross-border price arbitrage for city pairs of any distance, making the border of infinite width in terms of their calculations. Of course, there is no doubt a lot of cross-border price competition, but it does not show up in month-to-month changes in the components of the consumer price index. National economies are so much tighter than the international economy that arbitrage of these prices among domestic city pairs does show up even using the short-term data for components of the consumer price index, but not across national borders.

Turning to capital markets, there was an important finding by Feldstein and Horioka (1980) that domestic savings and national investment rates are correlated across countries, leading them to conclude that capital markets are separated rather than integrated. To avoid such correlation entirely would require that markets for goods and capital both be tightly integrated. If provincial markets are tightly integrated, but national ones are not, then the Feldstein-Horioka result

should be less evident, or disappear entirely, using interprovincial data. Helliwell and McKitrick (1998) pooled OECD and provincial data, and confirmed the Feldstein-Horioka result among the OECD countries, with the effect being completely reversed for the provincial data. This is a strong confirmation of the Feldstein-Horioka interpretation, and shows that the interprovincial markets for goods and capital are tightly knitted together, while international ones are not.

Border effects for migration, at least that from states to provinces, are even greater than for goods and services. Interprovincial migration is about 100 times more likely than is migration from a U.S. state to a Canadian province, after taking due account, using the gravity model, of population, distance, and the economic incentives for migration. (Helliwell 1998, Chapter 5).The border effect is much smaller for migration from Canada to the United States, reflecting the greater southbound flows of migrants and the high interprovincial migration flows.

Finally, even though Coe and Helpman (1995) have provided convincing evidence that research and development spending has important productivity-enhancing effects both at home and abroad, the implied border effects are even larger than those for goods, services and population (Helliwell 1998, Chapter 6).

Implications

If the evidence presented above is to be believed, the economic fabric of nation states has a much tighter weave than previously thought. Is this good or bad, and what does it suggest for current and future national policies?

Many studies have shown that among developing countries, and to a lesser extent among OECD countries, those countries that are more internationally open have had higher rates of growth of productivity and of incomes per capita. The basic intuition behind this result is that developing countries gain most by learning from the successes and failures of other countries, and tailoring the best of foreign ideas to suit domestic conditions. This is also consistent with studies of R&D spillovers, which find them to be larger for countries that have higher degrees of openness. If some degree of openness is a good thing for economic development, is much more openness even better? If so, then the fact that economic densities are much higher within than among national economies means that there is more to be gained from further increases in international linkages.

On the other hand, if some degree of openness is sufficient to achieve the major gains from international exchange, specialization, and the acquisition of fresh ideas, then there may be diminishing returns to openness. If so, and if there are some efficiency effects offered by the partial segmentation of global markets into national pools, then there may be some right amount of openness that may not differ much from the levels already achieved among the industrial countries.

What is the available evidence on these issues? First, as already noted, there is evidence than some degree of openness is good for growth. However, if further increases in openness, beyond those already achieved by the richer OECD countries, promised great efficiency gains, then we would expect to find that bigger countries (in terms of GDP, not hectares) would have substantially higher levels of real GDP per capita, since they already have much larger trading networks, given the fact that trade is much denser within than among nation states. However, there is no systematic evidence that larger countries have higher levels or rates of growth of productivity.

If income levels are not significantly higher in larger countries, and yet economic relations are much denser within than between countries, there are two broad types of explanation possible. One possible explanation is that while there are initially large gains from trade, both to exploit comparative advantage and to achieve efficient levels of scale in production, these gains have been largely reaped by the time international linkages have become as tight as they now are among the industrial countries. There may be more scope for increased openness to lead to temporarily higher growth rates in the developing countries, since there is still much for them to learn from elsewhere, but even here it is clear, as is evident from the recent experiences of cascading loan defaults across Asia, that interdependence may have costs as well as benefits.

The second possible reason why the insular nature of national economies may not be costly is that national boundaries may provide fairly efficient means of segmenting impossibly large markets into manageable chunks. It is well known that in a fully informed and frictionless world of a seamless global market place there would be no need for borders, for firms, or for most of the other institutions of the old and new worlds. But the real world has frictions; knowledge is tough to acquire and becomes obsolete; people cannot always be trusted; contracts are not always what they seem to be; one bad apple can spoil the whole bushel; and Murphy's Law may the only one that applies without an expensive legal process. In such a world, which is the only one on offer, not everyone is equally informed, and people are best informed about the events, institutions, and people they know best.

To deal with those you know and trust, under shared and well-understood rules and institutions, can mean lower costs and lower risks for all participants. Those who understand a market better are more able to guess its moods and changes, and to adapt flexibly to new patterns of demand and new technologies. To the extent that national boundaries enclose communities that have common institutions and shared views, local businesses are likely to be able to meet local market needs at lower cost that are their foreign of global competitors. There are limits to this, of course, set on the one hand by economies of scale and on the other by the possibility of exporting tastes and preferences, thus building a global

market from scratch. Even the most successful global products, however, often have national systems of production and distribution, and characteristics specially put in to suit national tastes. What is surprising, in the latest evidence about the strength of national economies, is that the global market is very much the exception, and the national market the rule.

How does this view of tightly woven national economies tie in with the re-discovery of local economies as poles of growth? There is one strong link between the two. The benefits of close interaction, and the bonds of trust that are built up among those who have many repeated dealings underlie the logic of local economies and the strength of the national economy. Distance is costly, and tends to cause economies to cluster. The regional literature focusses on the effects of distance and also on whatever historical events may have led to a city to get started in the first place. The national borders results, on the other hand, show that distance has many more dimensions than simply kilometres or miles. To whatever extent history, politics and geography have spread people around in groups with different institutions, values and networks, their economic relations will follow similar patterns. This may be partly because patterns, once started, are costly to change, but also reflects the cost advantages possessed by those who are nearby, well-informed, and well-trusted. Physical distance is indeed an important separating device, but national boundaries are also important. One of the findings from recent research is that for different markets the effects of national borders can be interpreted in terms of distance, and the implied numbers are strikingly large, often in the order of thousands of miles.

C. NATIONAL INSTITUTIONS TO SUPPORT STABLE GROWTH

Social Capital

What are the most relevant ways of measuring those aspects of the political and social system that might influence the operation of a modern economy? In their pioneering comparative empirical study of post-war democracies, Almond and Verba (1963) "concluded that interpersonal trust is a prerequisite to the formation of secondary associations, which in turn is essential to effective political participation in any large democracy" (Inglehart 1990). Over the forty years since their empirical work in the 1950s, researchers in many countries have probed the extent of interpersonal trust, and examined the extent to which individuals participate in, and contribute their efforts to, voluntary associations. There have also been attempts to establish the extent to which interregional differences in these variables, described sometimes as measures of social capital or of civic culture, are linked with the extent to which citizens in the regions of a country are

satisfied with the efficiency of their regional governments (Putnam 1973), and in turn whether there are subsequent payoffs in terms of conditionally higher growth in those regions with higher levels of social capital. For the regions of Italy, where detailed research had been carried out for more than twenty years, the results were fairly supportive of the notion that there was a causal linkage running from high levels of trust and engagement to higher levels of regional government performance and in turn to higher levels of economic performance, and higher rates of upward convergence towards best practice levels of efficiency (Helliwell and Putnam 1995).

Subsequent attempts to use World Values Survey (Inglehart 1990) measures of trust to explain subsequent differences in growth rates among industrial countries and among Asian economies (Helliwell 1996a) have had mixed results, although Knack and Keefer (1997) have found stronger evidence supporting the view that better social institutions do support higher levels of growth among a sample of countries including both industrial and developing countries. Their use of a larger sample, covering a broader range of institutional quality, was probably an important reason for their finding.

Democracy

Proponents of democracy often argue that it is good for everything, including economic growth, while sceptics have argued that populist electoral pressures within a democracy are likely to destroy economic policy discipline, and then lead to budget deficits, inflation, and ultimately to political and economic instability. The relationship is difficult to unravel, since there is reason to expect that higher levels of income will increase the demand for democracy, thus making it difficult to untangle the reverse influences running from democracy to subsequent economic growth. My best attempts to sort out these two-way relations (Helliwell 1994) indicate that there is indeed a strong linkage running from the level of real per capita GDP to the existence of a democratic regime. As for the reverse line of causation, from democracy to economic growth, it is of uncertain sign, and in any event very weak. Thus it would appear, based on more than twenty years experience from almost 100 countries, that countries tend to become more democratic as they get richer, while the attainment of democratic institutions does not itself either damage or ensure subsequent economic growth.

In the light of this evidence that democracy does not hinder economic growth, how are we to interpret the sharply contrasting experience of Russia and China over the 1990s? In mid-1989, as President Gorbachev arrived in Beijing, to be greeted by students eager to see Glasnost and democracy imported into China, it seemed as though democracy was poised to spread in both countries. In the event, democracy was established in Russia while being suppressed in China.

As shown in Figure 2, the growth experiences of the two countries diverged dramatically over the following decade, with Russian GDP at the end of the century likely to be about half what it was in 1990, while that of China will have more than doubled over the same period. Is this a black mark for democracy?

At the time the transition in Russia and Eastern Europe was just beginning, policy-makers and analysts drawn together for an OECD conference (Marer and Zecchini, eds.1991) were inferring the lessons to be drawn from previous transitions to market economies, including, among others, post-war experience in Germany and Japan, later industrialization in Spain, and the development experience of Korea. Nothing in those earlier experiences hinted at the many years of economic decline in Russia and Ukraine. What went wrong? The studies done in 1990 did raise the difficulties posed by the institutional gaps in the former USSR - the lack of a rule of law, of standards of commercial practice and contracts, and even of basic levels of social and interpersonal trust - but did not begin to predict the full consequences of these institutional gaps. Perhaps it should have been possible to predict that in these circumstances even the most likely of commercial ventures would be mired in corruption and delays, while the most striking growth would be of criminal activities expanding to fill the institutional vacuum. The result was one of the twentieth century's most dramatic displays of the central importance of the institutions of civic society.

Is it reasonable to attribute the tumult and decline to the existence of a democratic system? Surely not, but it is reasonable to ask if it was unrealistic to expect that the institutional, political, social and entrepreneurial vacuums would be filled appropriately by some magical operation of the invisible hand. Russia's continuing lack of success is being blamed on too much reform, too little reform, political instability, criminality, and other plausible and implausible candidates. What is clear is that the institutional needs would have been easier to fill had they been more clearly foreseen, and if the process had been launched earlier and more effectively. If trust levels start low, and then fall sharply lower, the process of recovery is bound to be more difficult. There is some reassurance from polling evidence that electoral support for continuing economic and political reform is more robust among the pro-reform voters in Russia than is the anti-reform support, which has been easier to erase if and when economic times improve. The earlier studies of democracy would suggest that effective support for reforms might erode as per-capita incomes fell. The fact that this has not happened, and that reforms have even tended to survive changes in government in several of the transition economies, suggests that bad memories of the previous regime are still strong enough to provide continuing support for democracy.

In China, by contrast, the process of gradual economic liberalization was continued in the context of a tight political regime and widespread restrictions on freedom of speech and on personal freedoms and mobility. From the earlier

studies linking income with democracy, the continuing high rates of economic growth are likely to have strengthened the effective demand for democracy. However, the experience in Russia, to the extent it is widely known in China, may provide a broader base of public support for continuing official attempts to halt substantial progress towards democratic political institutions. There are increasing international worries, however, that the same lack of transparency that may smooth the operation of the undemocratic political regime may also be leading to increasing difficulties in the management and financing of both domestic and international production and trading ventures. In other words, the difficulties of trying to combine open trade and a closed political system may be growing so as to make the current set of policies unsustainable. To restore balance while maintaining growth would seem to require gradual relaxation of restraints on freedom of speech, and provision of effectively democratic means for translating pubic opinion into public policy. Transparency of economic institutions and regulations, and the absence of corruption, so widely admired, and increasingly required, by investors and traders around the world, both facilitate and demand parallel changes in political life. If economic openness brings in investors, trader and tourists who then get enmeshed in crime and corruption, they are bound to recoil. Such a recoil will be faster and more costly to digest of there are hints of falling dominoes and mysterious contagion.

Education

One common factor that underlies all successful transitions, whether economic, social or political, seems to be broad and better education. There is substantial evidence that economic growth in developing countries proceeds faster where educational attainments are higher, and where literacy is more pervasive. This seems only reasonable, as the greatest part of the productivity growth of the poorer countries relies catching up to the levels of technological and organizational efficiency already in place elsewhere in the world. To search out and learn from the successes and failures of others is likely to be easier and more effective when education levels are higher and widely met.

Social capital, taken to comprise the norms, networks and trust that underpin civil society, has long been found to depend heavily on education. Empirical research consistently shows that education levels are the most important and pervasive determinants of both trust in others and engagement in community activities. The implication of these results is that rising education levels are not only good for the individuals receiving the education, who thereby receive higher incomes and greater satisfaction from their other activities, but also for the societies in which they live.

The latter inference has recently been challenged by Nie, Junn and Stehlik-Barry (1996), who agree that trust levels are generally higher where education levels are higher, but present evidence to support their claim that the effects of education on participation (as measured by the U.S. General Social Survey) apply only to relative education. They argue that those with relatively high levels of education are able to attain positions of leadership, and tend to participate more than those with lesser education. However, they argue, rising general levels of education do not lead to rising general levels of participation. Although the issue is not yet settled, subsequent research has shown that when education levels of one's peer group are appropriately defined the evidence remains strong that social engagement increases strongly with education levels regardless of relative education effects. For some types of activity, eg., reading groups, participation increases with one's own education and with average education levels, while for other types of activity these own-education effects are partly offset by relative education effects. For all total measures of engagement, at least in the U.S. data studied thus far, there remains a strong link from education to both trust and social engagement (Helliwell and Putnam 1998).

Returning to democracy and political engagement, there is also strong evidence that the likelihood of a country supporting democratic rights and freedoms depends positively on education levels as well as on levels of per capita GDP. This should also come as no surprise, as those citizens with higher levels of education are more likely to take an informed interest in what their governments are doing, and to want an active say in the decisions being taken on their behalf.

There is also a further relation, not yet fully analyzed in the literature, linking education and health status, with those who are better educated taking better care of their own health as well as taking effective action to obtain timely medical assistance where necessary. This linkage is likely to be general as well as relative, so that societies with higher average levels of education are likely to have higher average levels of health, which in turn are likely to feed back to provide a more productive economy and society.

All of the above roles of education provide evidence of social returns which augment the already well-documented private returns to education, suggesting a high policy priority for widely accessible high-quality education. There is evidence that the returns are high to both basic literacy and to higher education, and also some indication that equality of educational opportunities is likely to support a more sustainable and balanced growth path.

Inequality and Insecurity

Although inequality and insecurity are obviously not institutions, they do differ systematically among countries and over time. In addition, they have been found to be linked to several of the variables already mentioned. For example, several studies (eg., Persson and Tabellini 1994) have presented evidence that economic growth is higher in countries where income is more equally distributed. There is also a persistent finding from several countries (Wilkinson 1992, Ben-Shlomo *et al.* 1996, Mustard 1998) that several measures of health status are lower in regions or countries where there is greater inequality of income, even after account is taken of the fact that regions and individuals with higher levels of income have better health outcomes. The inequality effect may be partly because there is a diminishing payoff to income as a determinant of health (Gravelle 1998), but there may be more at play than this. Finally, it has been suggested that greater inequality may also have negative effects on measures of social capital such as trust and participation.

Government and Commercial Institutions

The most important growth-supporting institutions provided by governments are those providing the rule of law, including criminal justice, commercial and civil laws, and a civil service that is free of corruption and capable of developing and administering the framework of laws and regulations required to support a modern society. Within such a framework, there is a real possibility that an enterprising civil population, supported by advice and finance from home and abroad, can develop the commercial ventures to employ and feed the people in such a way as to continually expand their options for contributing to an economically secure and environmentally, politically and socially secure future. Behind this broad picture lie many essential elements: a tax system that is fair and efficient, social safety nets that resemble trampolines rather than hammocks, accounting and reporting standards that provide the transparency needed to support intelligent investments, trustworthy monetary and financial institutions, efficient transportation and communication facilities, credible independent and diverse sources of information, and the ability to deliver education and health services efficiently and fairly. Whether individual items on this menu are provided by governments, non-governmental agencies, or private investors matters less than the quality of their provision. As the pre-1989 experience in the USSR shows, a fully state-operated system is not likely to provide individuals with sufficient freedom and opportunities to develop and exploit their talents. One the other hand, post-1990 Russia has shown all too clearly that without some critical combination of social trust and public institutions, individual and commercial

freedoms are of little use, with or without access to foreign expertise and capital. Indeed, in the absence of the required domestic laws and institutions, an open economy may be in more trouble than a closed one, since the absence of order may scare off many legitimate investors leaving a vacuum to be filled by those venturers more willing and able to operate by stealth and corruption.

How Much Openness?

The discussion above suggests that openness to world markets has many dimensions and many complexities. In a world of Good Samaritans, nothing but good could flow from opening the doors to their help and advice. But that is not the world that exists, so that domestic institutions have to be strong enough to attract and be enriched by good ideas from abroad, while not providing an attractive home for environmental, social or economic exploiters of human and natural resources. What is the evidence on this score? An important study by Sachs and Warner (1995) divided the nations of the world into two groups. One group included all countries which reached fairly modest degrees of four different measures of openness[4], with all other countries considered to be closed. Among their group of open economies there was systematic evidence of convergence, with growth rates higher for those countries with initially lower levels of GDP per capita. Among the closed economies, by contrast, there was no such relation. Their conclusion was that developing countries wishing to raise their levels of GDP per capita towards those already achieved in the richer countries had to have sufficiently open economic and political systems to allow the lessons of foreign experience to be absorbed and applied.

Does this mean that national border effects are harmful, that national policies are bad if they deter any foreign investors, and that globalization is inherently beneficial? No, it does not. First, the Sachs and Warner classification of open economies still admits of substantial domestic policies influencing the structure and pattern of openness[5]. More fundamentally, the evidence on national

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[4] These included a black market foreign exchange premium of less than 20%, quotas covering less than 40% of imports, absence of excessively distorting export marketing boards (a measure only applicable African economies) and a non-socialist system. Since the countries of the USSR were not in the sample, the latter measure led to the exclusion of Angola, Benin, China, Congo, Ethiopia, Hungary, Mozambique, Nicaragua, Poland, Somalia, Zaire and Zimbabwe from the group of open economies.

[5] Among the Asian economies, Malaysia is recorded by Sachs and Warner as always open since independence in 1963, Singapore since independence in 1965, Taiwan open since 1963, Korea since 1968, Hong Kong and Thailand always open, and Indonesia since 1970.

border effects presented earlier in this paper offers a test of whether there is much to be gained from further increases in the degree globalization, at least among the industrial countries. The evidence shows that even among the industrial countries, merchandise trade intensities are ten times higher than those among the industrial countries, with border effects for financial and other service trade being even higher.

If raising the degree of international trade intensity to that already existing within national economies would lead to much by way of further productivity increases, then we would expect to find systematic evidence that smaller countries have lower levels of productivity and per capita incomes than do larger countries. However, there is almost no evidence of scale effects of this sort. My conclusion from this evidence is that the degree of openness already existing among the industrial countries is great enough to permit the most advantageous international trading to take place, and to allow sufficiently free access to the best of foreign experiences and ideas. There are many developing countries with much lower degrees of openness, and many of these have no doubt have much to gain from further increases in openness, especially if domestic capacities and institutions are already strong enough to glean the best and resist the worst of what is offered by the global economy.

D. CONCLUSION

The main message of this paper is that there is much more scope and need for national policies than is popularly thought. This is especially true for policies of the sort needed to build institutions capable of supporting balanced and sustainable growth. This requires economic policy-makers to take a broader than usual perspective. The need for such an enlarged perspective, and for the need to take institution-building seriously, is for me the most striking lesson to be drawn from the experience of the 1990s.

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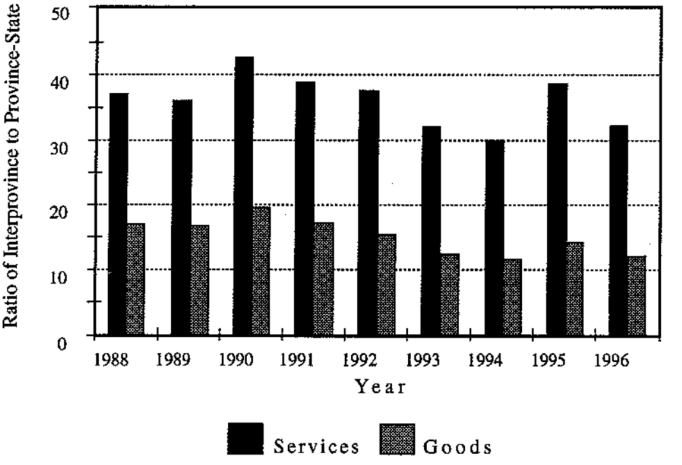
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Figure 1 (added 2026). The text refers to Figure 1, which was not printed in this working paper. It is reproduced here from John F. Helliwell, "Canada's National Economy: There's More to It Than You Thought", in Harvey Lazar and Tom McIntosh, eds., Canada: The State of the Federation 1998/99: How Canadians Connect (Kingston: Institute of Intergovernmental Relations, Queen's University, 1999), p. 93.

Figure 1: Canada-US Border Effects 1988-1996



Source: John F. Helliwell, *How Much Do National Borders Matter?* (Washington, DC: The Brookings Institution, 1998), ch. 2.

Figure 2 (constructed 2026). The text refers to a Figure 2 that was not printed in this working paper; the original has not been found. This figure was drawn in 2026 to show the comparison the text describes, extended to 2010 to show what followed. Like the original, it uses World Bank data, now in their revised form: World Development Indicators, GDP per capita at purchasing-power parity (constant 2021 international dollars, series NY.GDP.PCAP.PP.KD, as revised October 2026). Each country is indexed to its own 1990 level (= 100) and plotted on a log scale, so that a doubling and a halving lie equal distances above and below 100. On these data China's real GDP per capita more than doubled between 1990 and 1998 (index 212) and reached 244 by 2000, while Russia's fell to 58 in 1998 and did not regain its 1990 level until 2006. The dashed vertical lines mark the Tiananmen Square protests (June 1989), the fall of the Berlin Wall (November 1989), and May 1999, ten years after President Gorbachev's Beijing meetings of May 1989, with which the text opens its comparison.

Figure 2: Real GDP per Capita, Russia and China, 1990-2010 (1990 = 100)

