Open Door Policy
March 24, 2006

From the panic over the Dubai ports deal in America to Europe's bout of merger anxiety, ambitious politicians on both sides of the Atlantic are baring their protectionist teeth. Now would seem a good time to recall how well their countries and others have done by flinging doors open to trade, capital, services and people.

The emergence of China and, a bit later, India as global giants-in-the-making dates directly from their decisions to liberalize. America's expansion is powered in part by welcoming capital from abroad. The Asian Tigers grew off trade. The singular achievement of the European Union was to create the biggest zone for the free exchange of goods, capital and people on the planet.

In the last four decades, open economies (mostly in Europe, East Asia, North America) have fared far better than closed ones (Africa, Latin America, parts of Eastern Europe). Researchers Jeffrey Sachs and Andrew Warner found that average annual growth in open developed economies was 2.3%, compared with 0.7% in the closed. In developing countries, those numbers were 4.5% and 0.7%, respectively, over a 20 year period.

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As is so often the case with the dismal science, not to mention the dismal profession of politics, the superior performances notched up by open economies haven't settled the intellectual argument. So New York Senator Chuck Schumer and Dominique de Villepin can make their case for "economic patriotism," to use the Frenchman's phrase, with a straight face. European leaders at their summit in Brussels today will spar over the hurdles erected in recent weeks by France, Spain and Poland to investors from other EU countries which in theory belong to a common market. The protectionists are favored to carry the day.

But Europe is a good laboratory to test the link between market access and prosperity. Forget about old and new, south and north, the real divide in the EU is between open and less open economies.

In the former category are not only the "Anglo-Saxon" success stories of the last decade, Britain and Ireland, though they are instructive. Starting with the Thatcher era, the U.K. put a "For Sale" sign out. A swath of British industry, including all its car makers, is now in foreign hands. But -- Mr. de Villepin, take note -- the world didn't end. Britain focused its attention on building a strong service economy. London grew into a global financial center. Britain's rate of growth and employment over the past decade is the envy of Europe.

The real star pupil is Ireland, which went from the bottom of the EU league tables in GDP per capita to the top in a generation by slashing taxes and barriers to investment. Of the OECD countries, Ireland has the highest share of foreign-controlled affiliates in terms

of employment -- nearly 50% -- and turnover -- 78%. In Portugal, which puts up higher obstacles to foreign investment, it's 15% and 8%, respectively. Portugal, on par with Ireland in the 1970s, is today the poorest country in Western Europe.

Less well-known is the Austrian case. Having emerged from the Cold War with a state-dominated corporatist system, Austria turned its fortunes with the opening of and to the east while liberalizing its own economy. Barriers to foreign direct investment went from above to below the OECD average, according to the Paris-based group's index. In 1998 Austria had the most legal barriers to investment in industry; by 2003 Vienna had the least after New Zealand, another socialist backwater that liberalized its economy across the board starting in the 1980s.

An open door policy may be the only proven way that EU countries will be able to salvage their beloved "social model." Consider the experience of the Nordic states. French, German and Italian leaders envy their high economic growth and expansive welfare states, but don't want to see what makes it possible. These countries have deregulated product and service markets, and are open to foreign investment. Volvo and Saab aren't owned by "Swedes" anymore. The human capital in those countries, often cited as one reason for its highly competitive economies, didn't spare them a serious downturn in the 1990s. That's when Sweden, Denmark and Finland embraced the sort of market reforms that former communist countries used to become the most dynamic economies in Europe. Call it "a second-generation Nordic Model," socialist mainly in the welfare sphere.

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Foreign capital and free trade have kept the more protectionist EU states afloat, as well. No Western European country has more barriers to foreign investment than France, according to the OECD. (The U.K. has the least.) But investors have nonetheless moved into France, drawn by its highly-educated workforce. By one measure, the stock of foreign direct investment as a share of GDP, France (41.8%) is ahead of Britain (36%) and Germany (21.3%), according to Eric Chaney of Morgan Stanley. French multinationals are, in the meantime, flourishing abroad and notching up record profits. With the state eating up half the GDP, the strong private sector drives the little growth -- a paltry 1.4% last year -- that France has.

Imagine what a freer market for capital and services could do for France. But the government's nationalist turn of recent years is proving costly. Outside investment is dropping, amounting to half of 2003's level each of the last two years. After the Villepin government's highly-publicized recent moves to stop foreign takeover attempts in the energy and dairy sectors, French investors abroad may in turn soon find themselves unwelcome in other countries. When the French political class vilified Indian-born steel baron Lakshmi Mittal and his hostile bid for Arcelor, the Indian finance minister warned that the French may not be so welcome in his booming economy. Jacques Chirac quickly went to Delhi to try to patch things up.

Globalization is a two-way street. Nations can't take advantage of it abroad and try to protect themselves from it at home. Maybe one day this message will sink in at a gathering of EU leaders or in the halls of Congress. The world's prosperity depends on it.