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# In search of growth: neoliberal and institutional models for economic growth in an age of globalization

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**In search of growth: neoliberal and institutional models for economic growth in an age of globalization**

by

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A thesis submitted to the graduate faculty  
in partial fulfillment of the requirements for the degree of

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## **ABSTRACT**

The following study is an examination of the effects of globalization, regime type and macroeconomic policy on economic growth. 90 countries are examined between the years 1975-2003. While there are issues with the use of the proxy variable, the general effects can be explored. These effects are found to differ between high-income and low-income countries. The analysis finds that low-income countries should focus on improving inefficient distribution of services. High-income countries are able to choose from a range macroeconomic policies and are not forced to converge around any one policy.

## CHAPTER 1. INTRODUCTION

Globalization is an emerging force that is changing the way that people engage one another in a variety of ways. Socially, culturally, security-wise, politically and economically people are interacting to a degree to which they never have before. The amount of interconnectedness and the scope of the amount of people involved are unprecedented. At the same time, globalization has changed the way that the state can and is expected to act. Capital mobility has limited the economic policy options available to states. Owing to this, there is a question about what varieties of macroeconomic policies generate economic growth in this new climate. This study will attempt to address what conditions are needed for economic growth and development.

Evidence suggests that global integration, or globalism, is closely associated with trade.<sup>1</sup> Globalism is the level of economic exchange and contact between different peoples spanning territorial spaces. In this analysis, globalization is defined as an increase in the scope of globalism. Liberal policies have played a fundamental theoretical role in the process to reduce trade costs and increase global interaction. In this way, liberalism is a policy that promotes globalization. As such, many authors link them interchangeably, raising their sights beyond any descriptive role for the concept of globalization (Rosenburg 2003).<sup>2</sup> Instead, globalization is here used to describe only the level of interaction that states (and the entities within them) conduct with the international community. This is an important distinction, as liberalism is a process that contributes to providing the preconditions to globalization, but is not the same thing. A state may

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<sup>1</sup> Keohane and Nye (2000) distinguish that the density of networks, institutional velocity and transnational participation have increased “not in degree but in kind.” As trade networks multiply and deepen, so too do social and cultural bonds.

<sup>2</sup> See Dollar and Kraay (2002) or Milner and Kubota (2005) for examples of globalization being used to describe an increase in trade.

employ openness in some segments of the economy, but restrict it in others, while still enjoying a high level of trade in those segments. This does not mean that the aforementioned state is necessarily liberal regarding their economy as a whole.<sup>3</sup> In this study, trade is just one component of globalization, along with social and political interactions.

This definitional of globalization also runs slightly counter to the more traditional one given by most liberal scholars. Yale Ferguson and Richard Mansbach state that globalization is the “triumph of the market form at a global level (2003; 324).” What distinguishes globalization from previous periods of high levels of globalism, such as the early 20<sup>th</sup> century, is the number of people that are involved due to the reduced transactions costs of interconnectedness. This is a subtle, albeit key, difference from the traditional liberal definition. Globalization is not just increased levels of trade between the wealthy segments of the population in select countries; rather globalization allows expanding levels of people from differing economic classes and various countries to have access (though with differing levels of equality) to the global market and social and political global interaction. James Rosenau describes this process as the rise of the “global middle class,” as wide segments of society are for the first time able to interact globally, rather than just political elites and a small class of merchants that had traditionally (2003; 348-368). In this way, economic globalism, while important, is not the only component of globalization; cultural is as well.

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<sup>3</sup> An historic example of this are the so called ‘Asian Tigers’ states of Taiwan, Singapore, Hong Kong and South Korea. While these states were heavily engaged in international trade, their economies were far from liberal, in that significant restrictions existed on capital flows and foreign products and investment. A contemporary example of this can be seen in China.



States that employ liberal policies also have differing domestic policies; therefore, there are varying types of policies that incorporate liberal trade principles. While many states have implemented liberal trade policies, they have differed regarding the role and degree of government intervention within the economy. Some states utilize extensive welfare systems while others pursue more minimalist policies to limit government costs for theoretical or pragmatic reasons.

This paper will attempt to analyze what impact on economic growth the differences in macroeconomic policies have under varying conditions of globalization. In general, what set of policies lead to increases in growth? Does any set of policies actually generate growth? These are questions that may be considered given the changing nature of macroeconomic policy prescription by international institutions and the response to them. Following the stagnation of the Swedish economy, neoliberal policies were widely pronounced as the clear successor to the welfare state, as “there [was] no alternative (Munck 2005; 60).” However, reaction to the policies imposed by the IMF in response to the Asian financial crisis of 1997 led to a search for alternatives to quell rising ‘discontent’ (Stiglitz 2003).

The paper is outlined as follows. First, an examination of the previous literature will provide a background for the thesis presented here. Next, the theory and the hypotheses that arise from it are discussed. Following this, the dependent, independent and control variables, as well as how they were operationalized, are listed and justified. A discussion regarding the methodology used and the limitations that arise from it are subsequently given. After this, a rigorous examination of empirical data will be presented

and assessed. Finally, the implications of this research and new questions that arise will be provided.

## **CHAPTER 2. LITERATURE REVIEW**

The layout of this section is as follows: first, the impact that globalization plays in terms of generating economic growth, how it impacts the role of the state and how and if it impacts economic policies will be examined. Second, the debate both for and against democracy in promoting economic growth will be explored. Third, the literature regarding neoliberal policies will be presented. Finally, previous arguments for neoliberal and institutionalist approaches will be made.

### **2.1 Globalization**

The role that globalization has played in generating economic growth is often disputed. While many argue that trade resulting from increased interactions promotes benefits for all (or most) (Dollar and Kraay 2002; Friedman 2005), others are more concerned with the relative gains and losses (Gilpin 1981; Waltz 2001) or claim that globalization has led to benefits for certain classes while the majority has not benefited and may actually been hurt (Duménil and Lévy 2005, Clark 2005, Shaikh 2005). Additionally, globalization may be fundamentally changing the role of the state (Ferguson and Mansbach 2003; Nye and Keohane 1971; Radice 2005; Rosenau 1990; Wendt 1999), though this is disputed (Gilpin 1981; Rosenberg 1994; Waltz 1979). Finally, there is debate related to the convergence of economic policies under globalization, with some arguing that regulatory bodies must act uniformly (Friedman 1999), while others posit that there is room for differing domestic preferences within the globalization's larger logic (Chang 2003a and 2003b; Stiglitz 2003; Wolf 2005).

Open trade policies are advocated by liberals to promote growth. According to Adam Smith, often described as the forerunner of capitalism, without interference, economic advantages would soon attract attention and people would join in competition with the original advantaged firm or individual. This “would be the case in a society were things were left to follow their natural course, where there was perfect liberty, and where every man was perfectly free both to choose what occupation he thought proper, and to change it as often as he thought proper (Smith 2003; 138).”

The chief source that Smith and David Ricardo, another early influential capitalist, cite for increases in production is the division of labor. This is in part caused by advances in technology. Instead of paying initial costs and time wasted learning new crafts or moving to new equipment, labor can be employed working in one particular field, or in factories, on one task. This leads to dramatic increases in production.

Benefiting from the increase in production are consumers, who are the chief winners in free trade. As the supply increases while the demand remains stagnant, prices will drop. However, since man is inherently selfish<sup>4</sup>, with prices lower they will tend to want more of the product. When increases in demand occur, more suppliers will attempt to gain entry into the market. Therefore, “the natural tendency of profits is to fall . . . This tendency, this gravitation as it were of profits, is happily checked at repeated intervals by the improvements in machinery connected with the production of necessaries (Ricardo 2004; 70-71).” This also keeps states from reaching perfect opulence which would result in stagnation and decline, as growth is necessary to keep wages and capital increasing (Smith 2003; 132). At the same time, this demonstrates the liberals’ optimism that the

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<sup>4</sup> Smith (2003; 115-117) asserts that when labor’s wages are increased, their productivity increases. This is due to the view that a greater gain will cause them to work more, in search of an even greater gain. Ricardo (2004; 48), agrees, saying that seeking the opportunity for higher returns is man’s natural, selfish state.

future will continue to improve and the necessary rate of technological progress is accepted as a given.

To further heighten a state's economic capabilities and production, Ricardo advances the idea of a comparable advantage. Rather than looking at absolute advantages, states should focus on production at what they are best at compared to others. "Under a system of perfectly free commerce, each country naturally devotes its capital and labor to such employments that are beneficial to each. This pursuit of individual advantage is admirably connected with the universal good of the whole (Ricardo 2004; 81)." These policies are the building blocks of contemporary liberalism and the foundation for globalization.

According to some liberals, there are three main stages to recent world history: history prior to 1820, the rise of globalization from 1820 until the mid twentieth century and the more recent trend from the mid twentieth century until the present. These three different periods can be marked by increasing economic integration and marked until the more recent trend by increasing inequality. The recent move to more open markets by many countries has contributed to this process, as trade is easier to conduct with lower transaction costs (Dollar and Kraay 2002; 447-454).

The level of production in the recent period of globalization has been substantially greater than it was in the nineteenth century. David Dollar & Aart Kraay conclude that "human productivity has increased almost unimaginably" since the 1820's and developing countries have grown faster than developed countries since 1980. Dollar and Kraay state that "the current wave of globalization...has actually promoted economic

equality and reduced poverty (2002; 448).” They attribute this to market-oriented economies, particularly in the world’s two largest countries, China and India.

This increase in productivity, illustrated by Dollar & Kraay’s proclamation that in “two to three years...the world economy produce[s] the same amount of goods and services that it did during the entire nineteenth century (447),” is strongly correlated to trade. The increase in trade allows specialization and increased profits while increasing efficiency and lowering costs for consumers.

At the same time, communication technology has increased, allowing companies and individuals to communicate almost instantly from nearly anywhere in the world. This reduction in the time-space compression is quite evident in the contemporary world. While a person awaiting information in Paris from Tokyo in the past would have been forced to wait for weeks or even months for communication by either land or sea, the same information can now be sent via the electromagnetic field almost instantaneously. This increased connectedness is described as a process of globalization and allows transaction costs to be further reduced.

Thomas Friedman (2005) argues that such reduction of distance creates a level playing field, as the rules of the game are the same for all participants, while others disagree.<sup>5</sup> A time-space compression allows some sectors of the economy to transform quite quickly, most notably the financial sectors. This can make them susceptible to speculation and potentially weaken the state. At the same time, too great of levels of interdependence may increase the opportunities for conflict or may even, as Hans Morgenthau contends, result in economic imperialism (1960; 59). Similarly, increased

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<sup>5</sup> See David Harvey (2005) or Chang (2003a), for differing accounts of what the ‘rules of the game’ are and how they were established, the former’s view that of a radical and latter a historical-institutional account.

interdependence may cause states to be reliant on others for amassing goods that are necessary for security. For these reasons, realists are likely to oppose moves that allow states' economies to be too closely tied to 'foreign interests.'

Kenneth Waltz, perhaps the most influential neo-realist, offers a very different account of how economies work than Friedman. Far from creating an equal playing field, states that are already well positioned within the global economy are likely to attempt to continue, if not expand, their benefits. This is due to the maximizing nature, similar to firms, of states. While Waltz (2001) argues that it is clear within domestic economies that laws are used to prevent monopolies that would otherwise produce net negative outcomes, "it is less frequently understood that to expect each country to formulate an economic policy that happens to work to the full advantage of all countries is utopian (196)."

Liberals may point to institutions such as the World Trade Organization (WTO) as an effort to overcome this problem; however, while the WTO has had success forcing smaller states to adopt more open policies, it has had some difficulty in getting its wealthy member to surrender their subsidies in agriculture, as has been noted in the Doha Round.<sup>6</sup> Realists may contend that specific sectors are important to building a state's latent power,<sup>7</sup> which are also then protected by the powerful states from liberal trade laws, and that under "a condition of anarchy . . . relative gain is more important than absolute gain (Waltz 2001; 198)!"

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<sup>6</sup> This can also be seen among powers, as the United States has demanded the European Union remove the Cooperative Agricultural Policy (CAP), as well as allow genetically modified produce and livestock, while the EU cites health concerns. In addition, both the US and the EU have refused to remove subsidies despite the cries of the Third World, demanding that it will not budge until the other does, as well as citing the need to protect family farms.

<sup>7</sup> Latent power is described by one realist scholar as the "socio-economic ingredients that go into building military power (Mearsheimer 2001; 55)

Robert Gilpin adds that “economic interdependence and the promise of mutual gains have not eliminated the efforts of nations to advance their own interests at the expense of others and at the expense of the overall economic efficiency of the global economy (1981; 220).” He argues that “nations have become more apprehensive over the loss of autonomy” and that “[e]conomic nationalism has never been far below the surface (Gilpin 1981; 220).”

Radical, or Marxist, scholars also dispute liberals’ assertion of open trade leading to growth and agree with realists that relative gains are of significant importance. Like realists, they argue that the “international trade regime [the WTO and the General Agreement on Tariffs and Trade before it] is the main mechanism through which the global market is regulated and disputes are resolved through a formalized system” and that “this set of international rules is negotiated by the powerful states of the world that dominate the multilateral economic organizations; they are not generated spontaneously as neoliberals would pretend (Munck 2005; 62).” Unlike realists, however, they examine the role of class and principle-agent problems in addressing globalization, claiming policies to promote enhanced globalization actually reduce real growth.

Radicals argue that globalization “is fundamentally a *new world order* in which the power and income of the upper fractions of the ruling classes—the wealthiest persons—was re-established in the wake of a setback (Duménil and Lévy 2005; 9).<sup>8</sup> Despite a decline in growth rates since its implementation following the Keynesian financial crisis, radicals contend that wealth concentration of the economic elites<sup>9</sup> rose to levels not seen since the Second World War. A common criticism levied by radicals

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<sup>8</sup> Emphasis in original.

<sup>9</sup> Economic elites in wealthy states were not the only beneficiaries; elites that served the foreign interests at the expense of their state’s citizens and environment were rewarded and advocated such policies as well.



against liberals is the claim that such an action was morally justifiable, as it rewarded the hard working and skilled and punished the lethargic due to the mechanisms of greater competition. This justification was quickly embraced by the economic elites within states that utilized liberal policies and by the working classes that aligned their own interests with them.

According to this account, liberal policies have not led to the promised increased economic growth; instead, it has led to a decline in growth. This is partially due to the revamping of the economy under neoliberal policies. Rather than seeking growth and increased employment, financial institutions are increasingly attractive to business leaders, leading to patterns of capital accumulation as dividends replaced profit rates, reducing actual growth (Duménil and Lévy 2005; 13). Furthermore, states that had opened to neoliberal policies experienced the negatives of foreign capital, in that it aimed at liquid assets that can quickly be pulled out at signs of potential turbulence (Duménil and Lévy 2005; 16-18).

To justify the transition of income to the elites, the market is frequently described as the best resource to fulfill society's needs by free choice. Simon Clarke (2005) objects to this, countering that neoliberal doctrine as "an instrument of 'natural selection' that judges not on the basis of the individual's ability to contribute to society, but on the basis of the individual's ability to contribute to the production of surplus value and the accumulation of capital (55)." Free choice is manipulated and free information is not allowed to flow allowing the wealthiest, as the only ones that can afford to participate in the mass media, to dictate choice, restrict information and create 'need'.

In addition, far from promoting growth, neoliberal policies allow the advanced, wealthy states and elites within them to grow while the poor and weaker states are forced to either further exploit their destitute labor or be forced to join that labor market themselves, as they cannot keep pace with the increases in marginal profit generated from expensive technological investments. Rather than reduce trade imbalances, these policies enhance it. This contemporary line of thought is similar to the world systems theory developed by Immanuel Wallerstein (1974).

In addition, radicals point out that the concept of comparable advantage is in contrast to all other principles of trade within a single competitive market, as would be the case under a global, open market. In Ricardo's model, it is assumed that exchange rates are fixed. However, under conditions of global financial markets, surplus traders would have access to capital markets that enhance their ability to purchase technology and keep real costs low compared to those that do not have a comparable, or only a minimal, profit margin (Shaikh 2005; 47). This leads to a continued imbalance in trade.

How globalization has impacted and changed the state is also heavily debated. Many scholars argue that international relations are undergoing a dramatic shift. Politics between states is no longer the most common nor interesting interaction of political entities (Rosenau 1976). Instead, politics is now global within states and between subunits within different states. States are losing authority; not only upwards to regional and global bodies, but also downwards to local ones (Rosenau 2003).

Territorial distance has also lost some of its impact in the modern world. Ferguson and Mansbach declare that a "moral community presumes a normative consensus among individuals *at least on some key issues* which is expressed explicitly or implicitly as a

politically relevant identity (2004; 130).”<sup>10</sup> Martin Wolf notes that a “sense of belonging is a part of people’s sense of security (2005; 276).” Such a community is not based on territory; instead, individuals are linked by agreed upon values, be that religious, financial, political ideology or otherwise. Rosenau (2003) describes this situation as one of “distant proximities,” as individuals may be part of a moral community that is made up of a relatively few number of members that span the length of the globe, yet may have little in common with others that are within a close physical proximity.

Related to this concept is psychological distance. Ferguson and Mansbach define this as “the degree of dissimilarity between cognitive frameworks or ways of looking at, assigning meaning to, and coping with the world regardless of geographical distance (2004; 69).” Wendt (1999) argues that many states are beginning the transition out of the ‘Lockean age’ and into the ‘Kantian age.’ This transition is a change in the logic of anarchy<sup>11</sup>, as states decreasingly see anarchy as based on conflict and instead see one another on more friendly and common terms, as the psychological distance between them has been reduced. Conflicts may still arise, but war is not imaginable and cooperation is preferred and sought.<sup>12</sup>

Similar to the concept of a moral community is that of an epistemic community. Peter Hass defines an epistemic community as “a network of professionals with recognized expertise and competence in a particular domain and an authoritative claim to policy-relevant knowledge within that domain or issue-area (1992; 3).” This type of community encompasses business and occupational groupings. These groups share an

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<sup>10</sup> Emphasis in original.

<sup>11</sup> See Wendt (1992) for how anarchy is a social construct.

<sup>12</sup> Wendt (1999) points to relations within the European Union, as well as NATO members to demonstrate a change in how sovereignty is characterized and how norms shift over time.

expertise in a specific interest area and identify themselves as such. Antonio Gramsci also expressed such a sentiment, saying that as tasks become more complex, “that each practical activity tends to create a new school for its own executives and specialists and hence to create a body of specialist intellectuals (1971; 26-33).” In turn, these groups are looked at by society at large when situations that are related to their field arise.

Inherent in these groups, as well as in any actor that participates in global politics, are values. Values are what unite individuals in these groups. Ferguson and Mansbach define values as “abstract aspirations for improving the human condition that may be pursued only indirectly through the acquisition of scarce objects that serve as stakes in political contests (2004; 23).” Such a context is how groups identify themselves and their interests. Individuals’ hierarchies of identities change depending on the issue. In this way, an individual may be in several moral communities at the same time.<sup>13</sup> These groups are also not restricted to distance, as the basic unit—the moral community—may exist regardless of territorial space.

This hierarchy of identities applies not only to the individual, but to various moral communities. Far from being the highest loyalty of its citizens, the state may actually be in competition with a number of other polities depending on the issue. It is important to clarify what is meant by polity. According to Ferguson and Mansbach, “a polity (or political authority) has a distinct identity; a capacity to mobilize persons and their resources for political purposes, that is, for value satisfaction; and a degree of institutionalization and hierarchy (leaders and constituents) (1996; 34).” This goes

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<sup>13</sup> An example of this may be an individual that is a teacher, a member of teacher’s union, a member of the Sierra Club, a member of the NRA, of a member of a local softball team, a local volunteer fireperson and a citizen of the United States. Depending on the issue, this individual may identify with whichever group is applicable and change that identify if another issue emerges.

beyond the state; as many organizations can be classified as a polity under this criterion. These can range from the state, to the family, to the local city among others.

History, real or imagined, is also important to this globalization as it impacts culture. Without examining culture—which are “socially collective ways of viewing the world” (Ferguson and Mansbach 2004; 153)—the actions of polities cannot be understood. As individuals identify with polities other than the state, the states’ role decreases. While neoliberals and cosmopolitans suggests that international institutions and regimes are absorbing much of this authority (Keohane 1986, Hasenclever et al 1997, Held and McGrew 2003), Rosenau challenges this, saying that “globalization is but one component of the transformative dynamics that underlie the emergence of a new epoch” and that “localization is also a powerful force at work throughout the world (Rosenau 2003).” In this way, the state is challenged from both the top and bottom.

This view of the state as declining in its role is not universal. Wolf argues that since states implement policies to open their markets, they are still the dominant actor in global politics (2005; 251). Others argue that the state is vital in the creation and implementation of capitalism. Karl Marx argued that the state, through ‘primitive accumulation,’ laid the foundation for capitalism by creating the necessary conditions for it through political, non-market, means.<sup>14</sup>

One role that the state still has an impact on is areas where distance still matters. Because individuals exist in physical space, territory will always matter to some degree (Wolf 2005; 16). Physical protection of property rights requires some form a physical enforcement. In this way, the state, which is the provider of physical security in most of

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<sup>14</sup> For a further explanation of primitive accumulation, see Marx (1976; 872-940). For a brief overview of this, see Bynes (2005).

the world, still has role. However, the state is now more expected to provide basic services that help the functioning of the market, such as infrastructure, education and other public goods.

Realists, such as Waltz, argue that those that focus on the effects of non-state actors are missing the point. Waltz states that “the units of greatest capability set the scene of action for others as well as for themselves (1979; 61).” States are still the dominant actors because “when the crunch comes, states remake the rules by which other actors operate (Waltz 1979; 89).” Gilpin asserts that contrary to modern science and technology contributing to shared norms and values, “modern science and technology may intensify the conflict over the globe’s resources.” He continues that “nationalism, with its roots in seventeenth century Europe, has become the predominant religion of modern man (Gilpin 1981; 225).”

Finally, there remains debate whether globalization forces a convergence around specific macroeconomic policies. The argument for convergence is based on the idea that no alternative policy is reasonable than to fully embrace the market. Friedman (2005) describes this as the ‘golden straightjacket’ because states have no choice put to enact specific policies, but they will be rewarded for doing so. State’s hands are forced due to technological innovations that render it unable to control the spread of ideas or finances.

Likewise, neoliberals demand that states establish parameters and then remove themselves from economics in order to allow the market to allocate resources. Ha-Joon Chang notes that “over the last decade or so, [the] push for a minimal, pro-business state has been further intensified with the rise of the globalization discourse that sees the

nation-state at best as an anachronism and at worst as an obstacle to human progress (2003b; 1).”

However, Karl Polanyi (1944) counters this assessment, arguing that as the market is institutionalized within the social and political framework of a society, social pathologies fearing enhanced economic insecurity result. This dialectic is due to the inherent contradiction within institutionalizing something that by its very logic is anti-institutional. Owing to this contradiction, minimal state regulations devolve into no state regulation, as enforcement of regulations are increasingly viewed as state intrusion.

Wolf argues that globalization and democracy can co-exist, as there continues to be a variety of policies<sup>15</sup> that can be enacted under its conditions, that there is no convergence around one form of capitalism. To do this, he examines several institutionalist European models. These countries embrace globalization while at the same time utilizing a large and functioning welfare state. Far from suffering from a flight of capital, Wolf finds that these states actually attract capital. He accounts this to the idea that “a generous social security system increases people’s sense of security and so may make them more willing to embrace change (2005; 257).” Wolf also argues that values that are reinforced by democratic means, such as education and specific behaviors, are attractive to corporations and capital. Wolf states that this enables states continued benefits, because “as development proceeds, a region will build the foundations for its next successes . . . The high-income countries of today are the beneficiaries of such a positive feedback process over up to two centuries (2005; 264).”<sup>16</sup>

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<sup>15</sup> For examples of the various ‘varieties of capitalism,’ see Hall and Soskice (2001)

<sup>16</sup> This supporting statement seems to counteract Wolf’s previous argument that the global south is not victim to a perpetual vicious cycle while the global north’s benefits allow it to continually build on their historic advantage, but I digress.

These types of policies are what Munck (2005) refers to as the ‘high road,’ as opposed to the ‘low road,’ of capitalism. High road capitalism focuses on service and technological industries, where human capital is vital, whereas low road tend to be labor intensive industries. Differing state goals lead to differing macroeconomic policies depending on which road a state attempts to travel.

## **2.2 Democracy**

The rise of democracy and its consolidation also has many appeals. The most recent wave of democratization, the so-called ‘Third Wave’, has occurred on a scale surpassing both previous waves and has been one of the major changes in human history (Huntington 1991). Democratic norms and values have gained prominence all over the world and are currently more widespread than at any other time in history. Some even argue that liberal democracy is the final form of political institution and that, following the end of the Cold War, there are no ideologies that can challenge democracy’s appeal (Fukuyama 1993). In 2000, Freedom House claimed that 63% of the world, 120 countries total, were democratic (Diamond and Plattner 2001). Of that, 37% of the world is classified as liberal democracies (Diamond 2000). This is in stark contrast to just one century prior, when no countries met the current standards of democracy.

Even as we may now be seeing a retraction of democratic growth (Diamond 2008), it is reasonable to speculate about its relationship with the global economy. Interestingly, the world itself adds more curiosity to the study of the relationship. The majority of wealthy countries are free, liberal democracies. Of the twenty countries with GDP per capita of \$30,000 or more in 2005, only Qatar is listed as not free by Freedom



House. On the other hand, only one, Sao Tome and Principe, of the thirty-three poorest countries meets the Freedom House's standard to be free.<sup>17</sup>

Whether democratic systems are better at establishing economic development than other regime types is an interesting topic which has been studied by numerous scholars with mixed results, as some research shows a clear positive relationship between them (Jakobsen and de Soysa 2006; Jensen 2003; Milner and Kubota 2005), whereas others do not (Li and Resnick 2003; Oneal 1994) and some are quite mixed (Cho and Nieman 2008; Doucouliagos and Ulubasoglu 2008).

Examining this empirical evidence, MacEwan (2005) notes, “when the political process in a country is not democratic and political regulation of the market is used to create and protect the wealth and privileges of an elite, then deregulation – neoliberalism – can be readily associated with democracy (174).” The old axiom that a free market can exist without democracy, but democracy cannot exist without a free market appears to be, on the surface, true. MacEwan continues that “historically . . . democracy (however limited) and the market advanced together against the regulation of societies dominated by monarchs and nobility (174).”

## **2.3 Macroeconomic Policy**

### **2.3.1 Neoliberalism**

Neoliberalism values the efficiency of the market above all else as the “market symbolizes rationality in terms of an efficient distribution of resources (Munck 2005; 61).

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<sup>17</sup> IMF World Outlook Economic Database.

This is in part due to its measure of efficiency in purely monetary terms as opposed to welfare or equal opportunity. Neoliberal theorists, such as Robert Nozick (1974) and Friedrich Hayek (1944; 1976), suggest that efficiency measured in any other way undermines liberty. By equating efficiency in the market to freedom, any obstacle to the production of the largest possible aggregate of monetary gains is viewed as an attack on the individual's freedom. Anything that is unproductive—that is, there is no direct or relatively immediate increase in capital from the enterprise, which includes medical and most social programs—is undesirable; if money is taken from everyone to this type of enterprise that may benefit others it violates the individuals' ability to achieve their own ends to help another group achieve theirs. This has a profound impact in what regard neoliberal theory permit the state to behave. The results are a minimalist state that protects property rights, strongly enforces the predetermined rule of law and does little else. As the state is removed from the market, and the impediments that are created by it, global integration through trade increases.

Adhering to liberal markets becomes the epitome of freedom; anything done to restrict their activity is to be considered to limit freedom. Neoliberalism regards “economic freedom [as] essential to the existence of all other forms of freedom, including religious, political and intellectual freedom (Overtveldt 2007; 63).” The market reflects what people want better than the government, as people know their own individual wants while the government does not. As a result, there exists a strong “belief in the power of markets and the related case for limited government (Overtveldt 2007; 198).” Neoliberal policies are operationalized as policies which attempt to remove any impediment or legislation that in any way restricts the actions of the market.

This faith in the market allows the individual to pursue their own individual aims. Any attempt to administer community goals may violate goals of some individuals. In order to prevent totalitarianism or to violate the freedom of any person, “the individual must mostly aim not at some ultimate ends but at procuring means which they think will help them to satisfy those ultimate ends (Hayek 1976; 8-9).” The way to do this is with money, which allows the individual to purchase those means. The aggregate desire and willingness to achieve these ends produces the market.

In order to prevent the government from becoming totalitarian in dictating to the individual what the individual’s aims *should be*, governments must be hamstrung in some way. Milton Friedman, an influential neoliberal economist, wanted to restrict governments’ ability to arbitrarily change monetary policy. Friedman argued that “the precise rate of growth, like the precise monetary total, is less important than the adoption of some stated and known rate (Overtveldt 2007; 167).” This restricts the ability of governments to change policy during depressions or other crises. This faith in the markets to be self correcting is fundamentally at odds with liberal interventionist policies to correct market failures advocated by John Maynard Keynes and Gunnar Myrdal.<sup>18</sup> Instead, governments must adhere to predetermined ‘rules of the game,’ which Friedman predicts will result in economies that are apolitical and free of bias.

Rather than create policy, the government should instead restrict itself to rigorously protect property rights to ensure that the market works well and ensure their citizen’s physical security. Fritz Scharf adds that “if the state intervenes in the economy, it is likely to interfere with, and potentially to disable, the intelligence of decentralized information processing and, ultimately, to paralyze the dynamism of the capitalist

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<sup>18</sup> The policies suggested by Keynes and Myrdal will be explored in the following section.

economy (1999; 371).” The potential for government intervention to limit or even prohibit growth runs “contrary to the view of those who believe that legislators and officials are responsible for rising standards of living,” whereas George Schultz and Kenneth W. Dam argue that “the market system itself has been our most resilient and versatile economic tool—a superior problem-solver, both in satisfying private wants and in achieving public goals. Yet too often . . . market solutions have too often been set aside at precisely the time when needed most.”<sup>19</sup> All of these scholars maintain that the “invisible hand” approach noted by Adam Smith provides the greatest economic growth and that state action, however well intended, restricts the market and leads to suboptimal outcomes. Thus, neoliberal policies favor markets and restrict and reduce the financial and economic role of the state.

Most social programs are held in low esteem by neoliberal theorists. While the idea of many social programs may be commendable, the implementation by the government requires that they take resources from someone else to pay to help another group. For Hayek, no matter the plight of the poor or downtrodden, nor any sympathies one may hold for them, they do not constitute any moral obligation on the part of society to help them. Hayek continues that “outside the sphere of individual responsibility there is neither goodness nor badness, neither opportunity for moral merit nor the chance of proving one’s desires to what one thinks right.” He concludes that “only where we ourselves are responsible for our own interests and are free to sacrifice them, has our moral value (Hayek 1944; 216).” In fact, Margaret Thatcher, one of the first practitioners of neoliberal policies on a wide scale, said that there was “no such thing as a society, only

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<sup>19</sup> Schultz and Dam (1977) cited in Overtveldt, *The Chicago School*, 329

individual men and women.”<sup>20</sup> Neoliberalism’s goal is, to turn homo sapiens away from being social creatures and into homo economus: a purely economic creature and that policies that respect and promote actions of the individual for their own gain that will, in the end, benefit society as a whole.

### **2.3.2 Institutionalism**

Critics have argued that neoliberal policies miss many important aspects of the role of governments. One critic, David Harvey, makes the claim that neoliberalism is fundamentally anti-democratic, as democracies tend to support some interventionist policies and that they reduce the absolute rights of the individual.<sup>21</sup> Such interventionist policies interfere with and obstruct the market. This point is supported by Dani Rodrik’s assertion that “since trade policy almost always has redistributive consequences...one should not expect broad popular support for trade when trade involves exchanges that clash with (and erode) prevailing domestic social arrangements (1997; 380).” Institutionalists view the market as only one tool to be used among many in order to promote and maintain economic growth while at the same time protecting the individual’s liberty.

In order to protect one, if not the most, important goals of liberalism—democracy—some have advocated institutional, or embedded, liberalism as an alternative to neoliberalism. Ferguson and Mansbach state that “[p]eople are losing their ability to control their own lives or to choose how to live them.” They refer to this as “a growing democratic deficit (2004; 324).” One way in which the individual is impaired is noted by

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<sup>20</sup> Margaret Thatcher, October 1987, *Women’s Own* as cited in Simon Clarke (2005)

<sup>21</sup> See Harvey (2005) Ch 3, 64-86 for how practiced neoliberalism supports intervention in ways that undermine democracy.

Dam. The ability of firms to lobby agents in democracies with votes or resources gives them an unequal fair of the political influence that is at odds with the liberal principle of individual liberty.<sup>22</sup> Arthur MacEwan argues that “[p]rivatizations raise issues of democracy especially sharply when they involve enterprises where public and private interests are likely to dictate very different sorts of decisions (2005; 172).” Markets limit democracy in this setting because contrary to the “fundamental principle of democracy – *one person, one vote*” in a society dominated by the market “is ruled by *one dollar, one vote*” which “effectively limits democracy and supports the continuance of capitalist authority (MacEwan 2005; 171).”<sup>23</sup> John Rawls documented this tendency and attempted to counter it when he developed his liberal principle of fair equality of opportunity (1973; 83).

Arising from the democratic deficit is what Strange calls “Pinocchio’s problem (1996; 199).” Once the state’s surrender their authority act in the market, there is nothing to balance the results of the market. When collective action problems arise, there is little that can be done. Evidence of this is that states can no longer protect their domestic economies or money markets from outside forces, in particular speculative attacks by private firms that can become self-fulfilling prophecies.

To combat this, liberal welfare economic models are designed to allow the state to intervene when the actions of individuals do not add up to optimal outcomes, thus producing market failures. The most widely institutionalized theory prior to neoliberalism

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<sup>22</sup> Dam (2001; 291-292) as cited in Overtveldt (2007; 330). Dam says that some of the policies he advocated would not have succeeded without the pressure of interest groups. This is reminiscent of a statement by Mill that states, “the ‘people’ who exercise power are not always the same people with those over whom it is exercised, and the ‘self-government’ spoken of is not the government of each by himself, but of each by the rest (2005; 6).” However, institutional models may restrict this and, as Rawls (1973) advocates, ensure the principle of political equality where the market itself cannot.

<sup>23</sup> Italics in original.

is the Keynesian model, which was prevalent following World War II. Another prominent theory is institutionalism, which is coordinated market economy strategy, which unites organized labor and business together under supervision of the state to formulate policy. This is associated with Gunnar Myrdal and the policies he established in Sweden while another noted scholar, Ha-Joon Chang (2003a), suggests that the institutional model is best developmental policy and claims that every developed state employed its practices to reach their level of development.

All of the alternate liberal economic strands are loosely based off of the work of the classic liberal John Stuart Mill, particularly in his later years. According to Mill, some income redistribution is acceptable in order to increase utility. In addition, Mill validated worker unions, despite their increase in the cost of goods to the consumer, along the same grounds.

Mill argues that after a certain point, the wealthy should not gain goods in excess and that the amount of people possessing such goods should increase. It does not matter to Mill if the laboring classes have resources to compete within the market with the upper classes or not, they should receive the goods. In this way, the total utility is increased, as more gain the initial utility of the good, rather than the diminishing returns of utility of that the upper classes receive from hoarding a good. Mill says this should occur regardless of whether there is an increase in the production of the good or not. “Whether the aggregate produce increases absolutely or not, is a thing in which, after a certain amount has been obtained, neither the legislator nor the philanthropist need feel any strong interest: but, that it should increase relatively to the number of those who share in it, is of the utmost importance (Mill 1921; 752).”

Regarding trade unions, while accepting that unions increase the costs of goods to consumers, Mill counters that the “cheapness of goods is desirable only when the cause of it is that their production costs little labor, and not when occasioned by that labor’s being ill remunerated.” Mill disputes that this puts undo costs on others of the laboring classes, saying that “when it is a permanent thing, the principles . . . show that it can have no such effect (1921; 935).” This demonstrates that Mill holds faith in the market to overcome the collusion of workers and that the minimal utility costs to consumers is overcome by the greater increase in utility of the employees. Again, Mill demonstrates that the market is simply a tool for achieving the greatest aggregated utility to society, which may and often does differ from monetary aggregates. This is due to the diminishing returns as more and more of a good or of money is collected.

The first of the alternate policies that will be examined is embedded liberalism, better known as Keynesian economics. One of its theoretical defenders, John Rawls (1973), argues that inequalities must be contained in order to provide basic rights, which includes a right to subsistence, in addition to the security right that Hayek (1976) touts in *Law, Legislation and Liberty*. In addition, the government should be an ‘employer of last resort,’ providing health insurance and constrain inequalities in order to provide citizens equality of opportunity (Rawls 2002).

In order to do this, states follow Keynesian economic policy, which advocates full employment by means of state intervention when the business cycle experiences a downturn through alterations to the monetary policy.<sup>24</sup> Previously, governments would reduce spending and increase taxes when economic depressions occurred, exacerbating the problem. Keynes stressed the need of governments to take efforts to increase

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<sup>24</sup> See Keynes (1997) book IV chapter III for an explanation of trade cycles. 335-344.



consumption during depressions rather than focusing on the supply side of economic analysis. Keynes argues that employment levels are dependent on the expected income that a firm has (1997; 89). On account of this, Keynes developed the propensity to consume function, which is that the “aggregate consumption mainly depends on the amount of aggregate income (1997; 96).” Therefore, if income is increased, people will purchase more goods, which in turn creates heightened expectations of sales, which leads to greater employment.

Conversely, “a diminished propensity to consume has *cet. par.* a depressing effect on employment (Keynes 1997; 211).” Due to this, Keynes criticized the classic liberal notion that savings is equal to investment, instead arguing that the liquidity preference—the preference of the individual to have their capital in money form to purchase goods—determines how quickly money circulates in the economy. Keynes also favored income redistribution because wealthy individuals save more, thus keeping money out of circulation (1997; 373).

This policy does not necessarily depend on the state, as is often stated. It requires only that one central authority dictates macroeconomic monetary policy, such as interest rates. An example of a non-state entity doing this is the European Central Bank in the European Union, or countries that give up their sovereignty and tie their currency to the United States, leaving them vulnerable to the decisions of the Federal Reserve with little room for recourse or risk uncertainty in their currency. Rawls (2002) actually advocates a world tax body and that liberal and “illiberal yet just peoples” can join, even if it lacks many of the characteristics of the state.

Garrett also points out that we do not see a “pervasive policy race to the neo-liberal bottom among the OECD countries, nor have governments that have persisted with interventionist policies invariably been hamstrung by capital flight (1997; 396).” This is because strong states, the ones that were able to relatively enforce policy in the past, still do so. In addition, interventionist policies can provide many benefits to a state to compete in a globalizing world. In fact, at times, the markets actually value it. Intervention often provided stability to a state and its economy, something firms look for. In order for states to provide the education and infrastructure that many firms want, particularly middle to high end firms, a state must have some taxation. States that can provide human capital are more successful in attracting investment (Garrett 1997; 384-402). This shows that this policy still has relevance in the present world if varying polities in a region choose to adhere to the policies of it, even if states continue to surrender certain responsibilities

The next alternative to neoliberal economic policy was credited to Gunnar Myrdal and is in many ways similar to what Keynes presented. Myrdal advocated what came to be known as the ‘Stockholm School of Economics.’ This line of thought is social corporatist and sets policies under the consideration of organized business, organized labor and the government. Myrdal notes that price is reflective of anticipated changes in a dynamic market, refuting the partial equations that are favored by neoliberals.<sup>25</sup> Rather than balanced budgets, Myrdal advocates a position of two budgets: one running and one of capital investment.

Myrdal’s dual budgets are designed to allow the government to intervene in the economy to stimulate, much like Keynes, however, he attempts to constrain the

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<sup>25</sup> From a collection of Myrdal compiled by Appelquist and Andersson (2005).

government from continued expansion and debt with required over budgeting and medium term balancing. Nevertheless, this does not endear him to neoliberals. Myrdal's model includes significant state intervention in welfare programs and his capital investment budget is one of state owned business. He expects state monopolies and businesses to turn a profit, but they are the businesses that would receive significant resource increases to stimulate the economy in times of depression. Therefore, the state would control important sectors of the economy that possess far-reaching implications on the economy as a whole.

Myrdal also subscribes to a holistic, rather than prescriptive, method of dealing with social problems, such as crime and healthcare. Using an eclectic approach, finds that it would be cheaper and more efficient in the long run to deal with the root causes of expensive social costs, like crime. To do so, other social sciences can provide their expertise on what these root causes are. In turn, the government will provide these prescribed applications in kind, rather than in actual money, to ensure the cause is dealt with.

Results of this approach are mostly positive, reflected by the Scandinavian countries low crime rates. However, such a model may be more difficult to carry out in states with less cultural and ethnic homogeneity, as differences in application may become evident. To counter this, Myrdal made these in kind resources available to nearly the entire population. Firms could still compete against the government, but more than likely it would have to be in higher end versions, as the government would create minimum standard goods. Open trade is also likely under such a model, as organized

labor covers multiple segments of the population that benefit from the gains that free trade and integration to the international economy provides.

The costs for this are also very high initially. Myrdal advocates accounting the large investments over time by amortizing them, saying they will pay for themselves in time. Additionally, since many problems are interconnected, the state must make minimum standards and make these available to all in areas such as housing, infrastructure, education, health care, etc. This is the only way to ensure everyone an equal opportunity, thus meeting Rawls' criteria of justice. Additionally, firms will also benefit as they face less transaction costs and the state pays for 'unproductive' areas of investment, such as health care.<sup>26</sup>

The final alternative liberal approach is the institutional approach of Chang. Previously, it was argued of the importance of the role of property rights within the neoliberal theoretical lineage. However, Chang counters the argument that "without the property ownership to appropriate the efficiency gains from better management, managers do not have the incentive to improve enterprise efficiency" with the assertion that "most large private enterprises are not run by owners either (2003b; 9)." In addition, it could be argued that this is why more corporations and other firms have implemented profit sharing, which goes strongly against Ricardo's desire that workers receive no more than what is required to feed and cloth the employee's family.<sup>27</sup>

Chang argues that intellectual property values are also overstated in their importance. The reason for this is that "there is a 'natural' imitation gap, which allows for

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<sup>26</sup> For more on Myrdal's vision and the politics he helped implement in Sweden, see *The Essential Gunnar Myrdal* by Orjan Appelquist and Stellan Andersson (2005).

<sup>27</sup> Ricardo declares that "the natural price of labor is that price which is necessary to enable the laborers . . . to subsist and to perpetuate their race, without either increase or diminution (2004; 52)."

the innovators to enjoy monopoly positions (and therefore extra profits) long enough to recoup their investments in innovation (Chang 2003b; 13).” This falls in line with Schumpeter’s theory of why monopolies are actually a positive, which runs counter to the traditional liberal doctrine. Schumpeter claims that innovation is impossible under perfect competition due to innovation causing this to be “temporarily suspended whenever anything new is being introduced (1994; 105).”

Under the institutional approach advocated by Chang, the state acts as a visionary that provides the foundation and direction in goals that private firms then fulfill. Chang argues that “by providing such a vision at the early stage of change, the state can drive private sector agents into a concerted action without making them spend resources on information gathering and processing, bargaining and so on (2003b; 53).”

This is possible because the “capitalist system is made up of a range of institutions, including markets as institutions of exchange, firms as institutions of production, and the state as the creator and regulator of the institutions governing their relationships.” Moreover, “there are some regulations that are essential for the very existence, not to speak of the effective functioning, of many markets (Chang 2003b; 90, 8).”

The state can provide insurance to firms by guaranteeing a certain level of income, which in turn can “improve the productivity of the economy in the medium to long run by encouraging risk taking in general and investments in specific assets.” This encourages the market to be dynamic. When the state fails to do this, “people will be reluctant to take risks (Chang 2003b; 61).” This type of model can manifest itself in both democratic and authoritarian societies, as is demonstrated in by the industrial policy

states (such as Singapore and Taiwan) and the social corporatist states (Scandinavian states).<sup>28</sup> In both cases, there is the “existence of a political and/or bureaucratic elite which had a stronger commitment to social goals such as industrialization and structural change than is usually regarded as possible by the neoliberals (Chang 2003b; 68).” These policies, also demonstrated noted in Robert Kuttner’s (2008) analysis of Denmark in a case study of alternative institutionalist models, demonstrate how a welfare state can be compatible with, and even encourage growth and investment, in a globalized state.

Both Keynes’ and Myrdal’s approaches can fit under the guise of Chang’s institutionalism. These will provide the counter to the neoliberal approach that will be examined in this study.

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<sup>28</sup> For more on how each of these types or institutionalism work, see Chang chapter 2, 45-74.

### CHAPTER 3. THEORY AND HYPOTHESIS

Globalization is changing the state's role in economic development. Johan Van Overtveldt wrote that "globalization, which is nothing more than the application of free-market policies across borders, cultures, and continents, has triumphed worldwide on a heretofore unseen scale (2007; 358)." Neoliberalism as a policy can be very attractive to certain sectors<sup>29</sup> of the business community as it advocates an efficient market that is conducive towards removing costs and any obstacles to business in order to produce the greatest aggregate amount of money, regardless of distribution.<sup>30</sup> "[P]rominent members of the business community backed economists who preached the advantages of free competition and capitalism" Overtveldt (2007; 267) observed.

At the same time, globalization has caused a dramatic shift in the employment structure. In advanced, industrialized states, "the two traditional and, until recently, leading sectors of employment, that is, agriculture and industry, have everywhere contracted (Iverson and Cusack 2000; 314)." As this shift occurs, many people find themselves ill-equipped, due to lack of skills in new and different industries, to find employment.<sup>31</sup>

Social uneasiness and calls for insurance to offset the loss of job and retraining are sought by populations. The rising tide of globalization, however, is now widely seen as a hindrance to a government's ability to meet these demands and even a cause of

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<sup>29</sup> In particular, the financial sector has enjoyed liberation attributed to neoliberal policies, as the financial profits as a percent of total domestic profits has increased from roughly 15 percent in 1970 to just under 40 percent in 2005 (Economic Report for the President, 2008). For an account of the benefits, see Wolf (2005) Ch 13; for potential drawbacks, see Duménil and Lévy (2005).

<sup>30</sup> At the same time, inefficient sectors and those that control capital in a capital scarce region are likely to oppose liberalization policies.

<sup>31</sup> Rosenau refers to these people as "alienated" with globalizing forces. For further discussion on the types of alienation within the "private world," see Rosenau 2003 Ch 6, 153-169.

government cutbacks. This can result in what Rodrik calls “social *disintergration* (1997; 379).”<sup>32</sup> Governments that focus on an institutionalist approach are more adapt at responding to labor concerns and building the infrastructure to facilitate economic growth, rather than relying solely on the market.

The chapters discussing globalization, neoliberalism and institutionalism provide an important backdrop to this study. At their core, both neoliberalism and institutionalism arise from the liberal tradition. As such, they both are likely to generate overall high levels of openness to trade and other economic activities. States that promote economic openness are likely to experience greater foreign intrusion and investment than those that legislate against it.<sup>33</sup>

Another important consideration for governments is the level of welfare that they are to provide for their citizens. In states that possess societies that desire positive rights, governments are likely to fund programs that provide these. This is frequently referred to as the ‘welfare state,’ as the state provides many different services, ranging from healthcare and education to housing and unemployment and retraining programs for employees. The amount of welfare provided by the state can vary quite dramatically. States that favor more limited roles for government are likely to possess governments that are commonly referred to as ‘minimal states.’ This can be due to a variety of reasons, including but not limited to a desire for low taxes, a strong desire to protect negative freedoms and fear of government intrusion or a lack of the resources to provide a welfare state.

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<sup>32</sup> Emphasis in original. Also see Ferguson and Mansbach (2004) Rosenau (2003) for further explanation of how this process occurs..

<sup>33</sup> An example of a country that primarily opposes foreign involvement in its domestic economic affairs, as well as more generally, is Zimbabwe. Evidence of this can be seen by President Mugabe’s ‘ownership’ laws that demand all businesses must be majority owned by nationals (BBC.com, 9 March 2008).



Table 1. <i>Categories of Contemporary Economic Models.</i>		Domestic Welfare	
		High Levels	Low Levels
Openness to Globalization	High Levels	Institutional	Neoliberal
	Low Levels	Socialist	Clientist

Therefore, government economic policies can fall into one of four categories. As depicted in Box 1, those in the first quadrant are globally open economies with a significant contribution towards welfare on the part of the state, characterizing an institutional approach; the second quadrant consists of globally open economies with minimal state welfare, which characterize neoliberal policies; the third quadrant contains globally closed economies with high levels of state welfare, which characterizes many clientist states and socialist states; and finally the fourth quadrant holds states that are closed and contribute little in the way of welfare to their citizens.

The basic theory of this thesis is that the state is changing in its basic function due to globalization. The state's primary function is to promote economic growth for their populations. This includes not only aggregate changes, but per capita changes. Owing to this shift away from identity as the primary role of the state, other aspects of the state impact economic growth as well. Government regime type and macroeconomic policy interact within the context of the level of globalization that a state has experienced. All three of these variables contribute to the augmentation or contraction of the economy.

Each of these factors contribute individual on economic growth. The regime type that is in place impacts that legal structure of a society, creating differing apparati that enhance or restrict the action of a state's members. Macroeconomic policies also directly impact economic growth by provide differing benefits to investment and domestic

concerns. How engaged a state is in globalization also provides differing economic results. The sharing of technology and perspectives towards the world contributes to economic growth in addition to purely economic restrictions. As ideas are shared and levels of engagement among populations increase, global norms are impacted. This does not mean that every state will have the same norms or that one state's norms will dominate the rest; rather a mixture of ideas and norms will result, creating global concerns and procedures. Instead of resulting in a dialectic synthesis, all parties are impacted from globalizing influences and cannot return to the condition that they were in, at least socially and psychologically, after engagement.

None of these factors occur in a vacuum, however. The interaction of regime type, macroeconomic policy and level of globalization impact domestic economic performance.

The first hypothesis presented is that increased with interaction on a global scale, economic performance is increased. The spread of ideas, norms, goods and services across state borders promotes growth. This also can upset domestic power relations, particularly if new ideas and norms undermine traditional power structures. However, the negative effects of this on economic growth are offset by the knowledge gained and acquisition of new or higher quality goods.

H<sub>1</sub>: ↑ Level of Globalization → Economic Growth

Thus, the countering hypothesis would be

H<sub>2</sub>: ↑ Level of Globalization has No Effect or Decreases Economic Growth

The third hypothesis posited here is that democratic regimes experience greater economic growth than authoritarian regimes. This is due to table laws which create a level playing field and clear rules of the game are integral to promoting a vibrant and dynamic market. Democracies greater number of institutions and veto players prevents the government from behaving in a predatory manner

H<sub>3</sub>: ↑ Level of Democracy → Economic Growth

This leaves the counter to this hypothesis as

H<sub>4</sub>: ↑ Level of Democracy Fails to Generate Economic Growth

The next series of hypotheses are related to macroeconomic policy. In particular, neoliberal policies limit economic growth, particularly in low-income countries. This is due to their inability to produce high-value added goods and lack of absolute advantages in trade in a competitive global market. On the other hand, institutionalist policies allow for some sectors to be protected while keeping the economy as a whole open. Institutional regimes will work within market confines to correct imbalances, through subsidies and services in kind. In addition, institutionalist policies counteract the minority segments of the population that lose in free trade through welfare, retraining and redistributive programs and maintaining social continuity. This is true not only of low-income countries, but high income countries as well. High-income states often lose the two 'traditional' labor markets to low-income states due to higher labor costs, leading to higher real costs. As such, the lack of welfare and distribution of goods and services by the government hit these particular segments of the population especially hard. Neoliberal

policies open up the markets, resulting in an increase in consumer choice, but at the expense of often sizeable portions of the population. The instability caused by this democratic deficit provides turbulent rates of growth and can at times worry investors, resulting in capital flight. Socialist policies generate greater social equality, but at the expense of foreign investment, which is a significant source of technology and expertise (Jensen 2003; Li and Resnick 2003). As such, there is no exogenous force to help stimulate development. Lastly, Clientist policies reject foreign investment in much the same way as socialist ones. Additionally, the government plays a much smaller role in the economy. This results in less capital in the economy, making growth difficult. However, individuals are allowed to significantly control their own economic affairs, or, if they are apart the ruling regimes political party or coalition, they may benefit. Economies are likely to remain relatively small due to the limited size of economic actors.

This leads to a series of hypotheses:

H<sub>5</sub>: Institutional Policies → Economic Growth

H<sub>6</sub>: Neoliberal Policies → Economic Growth

H<sub>7</sub>: Socialist Policies → Economic Growth

H<sub>8</sub>: Clientist Policies → Economic Growth

Conversely, the alternative hypotheses to these are:

H<sub>9</sub>: Institutional Policies Do Not Lead to Economic Growth

H<sub>10</sub>: Neoliberal Policies Do Not Lead to Economic Growth

H<sub>11</sub>: Socialist Policies Do Not Lead to Economic Growth

H<sub>12</sub>: Clientist Policies Do Not Lead to Economic Growth

Finally, there is the issue of interaction between the level of globalization, regime type and macroeconomic policy.

H<sub>13</sub>: Interaction between the Level of Globalization + Regime Type +  
Macroeconomic Policies → Economic Growth

H<sub>14</sub>: Interaction between the Level of Globalization + Regime Type +  
Macroeconomic Policies Does Not Impact Economic Growth

## CHAPTER 4. METHODOLOGY

The data is constructed according to a pooled time-series cross sectional (TSCS) data analysis.<sup>34</sup> The independent variables are lagged by one year to prevent reverse causation. The following regression models of the research are analyzed based on a Prais-Winsten ordinary least squares (OLS) regression with panel-corrected standard errors (PCSEs) for each country over the selected time period. PCSEs analysis is used in order to deal with the problem of heteroskedasticity, autocorrelation, and contemporaneous correlation in the error term in TSCS data sets.<sup>35</sup> In order to account for the previous year's growth, a moving average auto-regression order 1,2 model (ARMA(1,2)) is employed. The research tests the hypotheses presented here according to the one-tailed Z-statistics since the hypothesis is directional. 90 countries are examined between the years 1975-2003 in this study. They are selected according to data available from the KOF Globalization Index<sup>36</sup> and the Polity IV project<sup>37</sup> from the University of Maryland.<sup>38</sup>

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<sup>34</sup> This model is used by Li and Resnick (2003)

<sup>35</sup> Beck and Katz 1995 quoted in Li and Resnick (2003) and Jensen (2003)

<sup>36</sup> Dreher (2006). Updated in Dreher, Gaston and Martens (2008)

<sup>37</sup> The data was obtained in <http://www.cidcm.umd.edu/polity/index.asp>

<sup>38</sup> This type of methodology, while lacking the precision of some other models, is valuable in that it provides a general analysis. Any conclusions or results drawn from such a model should be viewed with certain caution and is not intended to be indicative of a 'one size fits all' policy prescription. Rather, it intends to provide a general sense of overarching trends. A more comprehensive and insightful model could perhaps be employed at a later time under the direction and supervision of an advanced statistician, of which the present author is not.

## **CHAPTER 5. VARIABLES AND OPERATIONALIZATION**

### **5.1 Dependent Variables**

The dependent variable used to test the hypotheses is economic growth. A change of the state from the primary identity to that of a secondary identity would change the function of the state. One function the state would continue to hold is that of an economic facilitator. Economic growth is operationalized as the growth rate of Gross Domestic Product (GDP) per capita. This is more telling than simply the growth rate of GDP, as it emphasizes only the aggregate and ignores population size. Examining only the growth rate of GDP also makes economies that are small appear to be stronger than larger ones, as an increase in a weak economy appears larger than an equal increase in a larger economy. By operationalizing economic growth as GDP per capita, the study hopes to find the impact of economic growth for each member of the society. Data of GDP per capita are obtained from the World Bank's World Development Index 2005.

### **5.2 Independent Variables**

A three part interaction variable will be employed to measure the impact of the level of globalization that a state has interacting with the global market, the level of democratization (or authoritarianism) that characterizes a state's government, and finally whether a state takes an institutionalist or neoliberal approach. Using an interaction variable allows the research to examine the role that each variable plays in impacting economic growth.

The first independent variable is the level of globalization. Globalization is operationalized as a combination of the KOF index of globalization. This is a weighted

variable that measures the effect of economic, social and political globalization. As economic interdependency increases, it may increase the number of people that are engaged in global trade. These are taken from the economic indicators of the KOF globalization index. This index is made up of information that demonstrates actual flows data (trade as a percent of GDP, flows of foreign direct investment as a percent of GDP, stocks of foreign direct investment as a percent of GDP, portfolio investment as a percent of GDP and income payments to foreign nationals as a percent of GDP) and restriction data (hidden import barriers, mean tariff rate, taxes on international trade as a percent of current revenue and capital account restrictions). The political globalization component (embassies in a country, membership in international organizations and participation in U.N. Security Council missions) and social globalization elements, such as personal contact data (outgoing telephone traffic, transfers as a percent of GDP, international tourism, foreign population as a percent of total population, and international letters per capita), informational flows data (internet users per 1000 people, cable television per 1000 people, trade in newspapers as a percent of GDP, and radios per 1000 people) and cultural proximity data (the number of McDonald's restaurants per capita, the number of Ikea per capital, and trade in books as a percent of GDP) demonstrate how much a state's civil culture is interlinked into globalizing forces. It is expected that the more open a state is, economically, politically and socially, the greater the level of trade and economic growth that accompanies it. States that create barriers to foreign trade can expect less economic dynamism.

The second independent variable is the level of democratization, or type of government within the state. The level of democracy is operationalized on a scale of -10



being the most authoritarian to 10 being the most democratic. This data is obtained from the Polity IV project from the University of Maryland. The data was originally on a 21 point scale (0-21), but is placed for convenience into the -10 to 10 point scale used here. The more democratic a state is, the more likely it is than its authoritarian counterpart to have a growing economy.

Economic policy is the final independent variable. There are two types: neoliberal policies and institutionalist policies. In this research, a proxy variable is used to attempt to measure this. An index was created based on government consumption as a percent of GDP.<sup>39</sup> This was obtained from the World Bank's World Development Index 2005. Government consumption, while not an ideal indicator, captures the core idea of institutionalism, as it includes the gross spending on social services by a government. Redistributive, infrastructural and in kind welfare are likely to make up the greatest share of government consumption, even in states that experience high levels of corruption, simply owing to the volume that is required of them compared to that which can given to cronies. Based on the amount of government consumption, each state is assigned a value on an 11 point scale, with -5 being the least generous and 5 indicating the most welfare provided. It is expected that institutionalist democracies will generate the highest growth rates, as they provide both the infrastructure that many highly productive industries, particularly service industries, seek while at the same time provide the social safety net that employees often desire. In the tables displayed in the empirical data analysis section, this is listed as the 'Level of Welfare.'

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<sup>39</sup> Originally, total taxes was going to be included. Unfortunately, data access problems resulted in only the percent of taxes of industries, such as the service industry, being available for most countries. Total taxes were available for OECD countries. Government consumption is highly correlated with total taxes for those countries and for the service industry taxes as a percent of GDP for the total sample. Therefore, for simplicity, only government consumption was used.

In addition to each of these independent variables, an interaction variable consisting of all three will also be employed. While each independent variable may provide an impact of economic growth on their own, the impact may be confounded when they operate together. This appears to be the case after examining the real world, as most of the wealthy countries of the world provide some form of welfare to their citizens while existing as democratic states, as was earlier noted. In addition, these wealthy countries, largely centered in Europe and North America, though also existing in some other parts of the world, also tend to be highly globalized.

### **5.3 Control Variables<sup>40</sup>**

Polity IV data is used to determine a durability variable. Durability is important for investors, as past stability is an indicator of current and future government stability. MNCs are more likely to invest in countries with consistent policies and governments. Durability is expected to have a positive impact on economic growth.

GDP per capita purchasing power parity is used to determine each country's economic level. Developed countries tend to have higher economic levels than developing countries. Therefore, it is expected that developing countries are likely to experience higher rates of economic growth owing to their low starting point in absolute terms, making it possible to have larger relative growth rates compared to large, developed economies. Developed economies require a great deal of growth in order to

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<sup>40</sup> All of the control variables are obtained from the World Bank's World Development Index 2005 unless otherwise noted.

experience marginal growth due to the sheer size of their economies. Economic level is squared to account for Kuznets curve.<sup>41</sup>

Natural resources tend to affect government type and economic policies. States based on natural resources tend to result in authoritarian regimes and groups within the state attempt to monopolize the resources and distribute them among their members. Likewise, states whose economies are highly reliant on natural resources also suffer from Dutch Disease, the economic phenomenon that causes all non-resources exports to drop in value as a response to the flood of capital inflows that is associated with specific mineral resources.<sup>42</sup> Natural resources are measured as mineral depletion being equal to the unit resource rents and the quantity extracted. This is the primary exports as a percentage of GDP.<sup>43</sup>

Oil production is expected to have a similar impact to natural resources. Oil is not included under the mineral standards of natural resources. A dichotomous measurement is used for oil producers, with 1 being an oil producer and 0 producing little to no oil. Data is gathered from the Energy Information Administration (EIA). Net exporters are those that exceed net exports of 1 million barrels per day. Large producers are those countries that produce 2 million barrels per day. Both are included as oil producing countries in the study.

The next variable that will be controlled is ethno-linguistic diversity. A common charge against states that use institutionalist models, regardless of type of government,

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<sup>41</sup> Kuznet's curve is the assumption that as countries develop income equality increases until it reaches a critical point at which it decreases.

<sup>42</sup> For more information about Dutch Disease and its effects, see Ebrahim-zadeh (2003)

<sup>43</sup> Data obtained from Sachs and Warner (1995)

are that they are fairly homogenous.<sup>44</sup> To control for this, ethnic, language and religious data is used.<sup>45</sup>

Economic inequality is controlled for and is operationalized as the Theil index.<sup>46</sup> While the Gini coefficient is also a commonly used variable in the literature, how it is computed over time has changed, making it a less than ideal measurement. On account of this, the Theil measurement is used in this analysis. It measures, based upon the income of each person within a subset, which in case is the state, the level of economic inequality within a subset. The larger T is, the greater the amount of economic inequality. Inequality is controlled for as dramatic and widespread inequality is likely to lead to unstable political conditions and limit growth.

Population is also controlled for, as larger population provide the potential for large markets. This makes them more likely to be targeted by firms and sought for trade and global engagement. Smaller populations are easier for governments to control and prevent from engaging in global trade in the modern age.

Lastly, the previous year's GDP per capita is controlled for. This owes to the idea that the strongest predictor of future growth is examining the past. As such, if a country is growing economically, it is likely to perpetuate this trend by attracting growth and reinvesting previous growth.

The model utilized here, with all variables, looks like the following:

$$\{\hat{Y}_{t(j)} = b_1x_1t(j) + b_2x_2t(j) \dots \}t_1$$

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<sup>44</sup> The Scandinavian states and the so-called 'Asian Tigers' come to mind.

<sup>45</sup> Wacziarg, Alesina, Devleeschauwer, Easterly and Kurlat (2003)

<sup>46</sup> Data obtained from the Galbraith's "Inequality Project" at the Lyndon B. Johnson school at the University of Texas.

The Moving Average (MA2) model looks like the following:

$$\hat{Y}_t = B_1 X_t + B_2 X_{t-1} = BX_t$$

Finally, the final model, with the auto-regression order 1 model looks like

$$\hat{Y}_t = BX_t + C_1 Y_{t-1} = DW$$

## CHAPTER 6. EMPIRICAL DATA AND ANALYSIS

In this section, the study will not turn to inspect the empirical evidence that was gathered during the 29 year period. The results of the sample of the time period as a whole are available in Table 2.

Table 2. *Effects of Globalization, Regime Type and Macroeconomic Policy on Economic Growth, 1975-2003.*

Variable	Coefficient	Standard Error
Level of Globalization	0.07514***	0.01559
Level of Democracy	0.02684	0.02895
Level of Welfare	-0.23000***	0.09665
Interaction of Independent Variables	-0.00001	0.00015
Durability	0.00818*	0.00592
Economic Level	-0.06222	0.02485
Natural Resources	-0.12553	0.09973
Oil	-0.62076	0.49071
Ethno-Linguistic-Religious Fractionalization	-1.75481*	1.13856
Economic Inequality	0.02027	0.06409
Population	0.00134**	0.00078
Previous GDP Growth	0.25253***	0.07347
N = 1050 R <sup>2</sup> = 0.1387 rho = 0.08763		
Note: OLS Z-statistics and P-values in are based on panel-corrected standard errors (PCSE) with AR(1) correction *: Z <sub>.1</sub> = 1.283. **: Z <sub>.05</sub> = 1.645 ***: Z <sub>.01</sub> = 2.33.		

From this, the study finds that of the three independent variables examined in the study, the level of globalization that a state has undergone and the level of welfare that a state provides are significant. That is, states that experience increased levels of economic, social and political globalization experience greater levels of economic growth. From this analysis, it appears that macroeconomic policies do matter, however, they do not behave in the expected manner. For the sample as a whole, the evidence suggests that neoliberal policies are associated with enhanced growth rates. With each point shift in the ‘Level of Welfare’ index towards a more generous welfare state—institutionalist policies—there

appears to be a reduction in economic growth. The hypothesis that democracy promotes economic growth is also not supported. Likewise, the interaction of the independent variables appears to be insignificant. That is, looks as if there is no statistically significant relationship between the how engaged a state is globally, the type of regime that governs it and the type of macroeconomic policies that it employs.

Of the control variables, durability is found to produce positive economic growth, though it is significant only at the .1 level. Also significant at the .1 level is ethno-linguistic-religious fractionalization. Increased levels of fractionalization seems to result in a highly negative way with economic growth. Large populations also seem to generate additional economic growth at a statistically significant level. Last and not surprisingly, the previous year's GDP growth seems to provide a boost to economic growth, as history may be an indicator of future success. No other variables produced significant results.<sup>47</sup>

After examining the results, some subgroups seem to behave in ways that run counter to results seen in Table 2. These will be looked at next.

The study will now turn towards differences between developed and developing countries in terms of generating economic growth. Using the World Bank's standards of high-income countries<sup>48</sup>, states with a Gross National Income of \$11,116 or more, we find some differing results.

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<sup>47</sup> It is also worth noting that natural resources and oil both just missed the .1 threshold.

<sup>48</sup> In this study, a country need not have always been high income to be included in the high-income group, just that it currently meets the World Bank's standards. In that way, states that have undertaken tremendous economic growth are included and their development strategy included with the actions of traditional members of the First World, for better or worse.

Table 3. *Effects of Globalization, Regime Type and Macroeconomic Policy on Economic Growth on High-Income countries, 1975-2003.*

Variable	Coefficient	Standard Error
Level of Globalization	0.10842***	0.02286
Level of Democracy	0.21379	0.17088
Level of Welfare	0.09171	0.68900
Interaction of Independent Variables	-0.00028	0.00096
Durability	0.00420	0.00560
Economic Level	-0.36815***	0.07881
Natural Resources	0.26880	0.37395
Oil	0.69715*	0.43252
Ethno-Linguistic-Religious Fractionalization	-4.1872***	0.95407
Economic Inequality	0.15315	0.18787
Population	0.01336***	0.00479
Previous GDP Growth	0.27775**	0.12204
N = 411 R <sup>2</sup> = 0.2917 rho = 0.17083		
Note: OLS Z-statistics and P-values in are based on panel-corrected standard errors (PCSE) with AR(1) correction *: Z <sub>.1</sub> = 1.283. **: Z <sub>.05</sub> = 1.645 ***: Z <sub>.01</sub> = 2.33.		

Looking at Table 3, the level of globalization remains statistically significant. The level of democracy also continues to have no impact on growth rates and, again, the interaction of the independent variables is insignificant, though it minimally missed the .1 threshold. It is also important to note that in this model, the level of welfare provided by the government is no longer significant and contains large standard errors, indicating a high degree of variance..

As for the control variables, economic level, as would be expected, provides a negative relationship with economic growth. Somewhat surprisingly, oil appears to generate economic growth in wealthy countries at the .1 level. Ethon-Linguistic-religious fracturing again has a strongly negative relationship with economic growth and is highly



Table 4. *Effects of Globalization, Regime Type and Macroeconomic Policy on Economic Growth on Low-Income countries, 1975-2003.*

Variable	Coefficient	Standard Error
Level of Globalization	0.08538***	0.02107
Level of Democracy	-0.00762	0.04175
Level of Welfare	-0.28679***	0.08848
Interaction of Independent Variables	-0.00002	0.00029
Durability	0.00978	0.01267
Economic Level	-0.07009***	0.02311
Natural Resources	-0.09907	0.09365
Oil	-0.25898	0.64863
Ethno-Linguistic-Religious Fractionalization	-0.71802	1.25668
Economic Inequality	0.02210	0.05851
Population	0.00148**	0.00076
Previous GDP Growth	0.24495***	0.7668
N = 639 R <sup>2</sup> = 0.1396 rho = 0.02863		
Note: OLS Z-statistics and P-values in are based on panel-corrected standard errors (PCSE) with AR(1) correction *: Z <sub>.1</sub> = 1.283. **: Z <sub>.05</sub> = 1.645 ***: Z <sub>.01</sub> = 2.33.		

significant. Large populations again are positive and significant, as is the previous year's rate of economic growth, though GDP is not as significant as in Table 2.

All countries that did not meet the World Bank's threshold for high-income countries were labeled as low-income. Table 4 contains their results.

In this model, as in both of the previous ones, globalization continues to produce a significant, positive relationship with economic growth. Both the level of democracy and interaction variables was insignificant. The level of welfare holds a statistically significant, negative relationship with economic growth.

Likewise, economic level also provides a significant and negative influence. The impact of population, while still positive and significant, is significant only at the .05 level rather than the .01 as in the first model. The previous time period's economic growth is positive and strongly significant.

These results, particularly the difference in the role of welfare between the high-income and low-income states, seemed worth further inquiries. After several exploratory analyses of the data based on region, a review of the Asian countries apart from the other in the study seemed relevant.

This was deemed relevant not only from these analyses, but also while the welfare indexes were being compiled. As was noted in the section about independent variables, using government consumption as a proxy for the level of social welfare as an indicator of institutional macroeconomic policies was not a perfect match. However, based on data availability and its correlation with taxes and redistribution programs, government consumption seemed as though it provided at least a general indicator of the basic idea. However, as Chang (2003a, 2003b) and Hall and Soskice (2001) note, many Asian states, particularly those of Southeast Asia, utilize institutionalist policies, providing a theoretical flaw in the methodology of attempting to quantify macroeconomic policy concepts. This is partly owing to the state rarely owning the banks that directly subsidizes industries—instead directing corporate production and bank loans and other financial actions through close, sometimes family, ties and legislation—is not reflected in this analysis. Indicative of this is that the average welfare rating for Asian states is -3.76, which does not appear to be reflective of reality and again reflects a flaw in the methodology and formula of the analysis due to data constraints.

In an attempt to account for this, Asian states are excluded from the general model in Table 5 on the following page.

Table 5. *Effects of Globalization, Regime Type and Macroeconomic Policy on Economic Growth, negating Asian countries, 1975-2003.*

Variable	Coefficient	Standard Error
Level of Globalization	0.07411***	0.01618
Level of Democracy	0.03581	0.03984
Level of Welfare	-0.03419	0.10587
Interaction of Independent Variables	-0.00019	0.00016
Durability	0.01235**	0.00612
Economic Level	-0.07032***	0.02930
Natural Resources	-0.05481	0.10251
Oil	-0.65037	0.52968
Ethno-Linguistic-Religious Fractionalization	-3.10002***	1.15662
Economic Inequality	0.04989	0.06621
Population	0.00247**	0.00335
Previous GDP Growth	0.18534**	0.08102
N = 854 R <sup>2</sup> = 0.1187 rho = 0.10650		
Note: OLS Z-statistics and P-values in are based on panel-corrected standard errors (PCSE) with AR(1) correction *: Z <sub>0.1</sub> = 1.283. **: Z <sub>0.05</sub> = 1.645 ***: Z <sub>0.01</sub> = 2.33.		

Globalization is again positive and significant. Neither the level of democracy nor the interaction variable were significant. The level of welfare is not significant for this model, which combines high and low-income countries, excluding Asian countries. This is in stark contrast to Table 1 and Table 3.

As for the control variables, durability was significant. As was true of the other models, the previous year's GDP was a significant indicator of present growth. Economic level and ethno-linguistic-religious fractionalization were also significant. Population continued to be positive and significant. The analysis will now turn from the results to their impact on the hypotheses.

Regarding H<sub>1</sub>, that the level of globalization generates an increase to economic growth, the study is unable to reject this, as each model generated found a statistically

significant increase on economic growth with each increase in the level of globalization. Thus,  $H_2$ , its null hypothesis, is rejected.

The level of democracy was not statistically significant in any model. Owing to this,  $H_3$ , an increase in the level of democracy leads to an increase in economic growth, must be rejected and its converse of  $H_4$  the study is unable to reject.

Macroeconomic policies produced mixed results. In Table 2 and Table 4, increases to the level of welfare seemed to reduce economic growth. However, for high-income countries and in the model controlling for Asian states due to theoretical issues with the proxy variable, a relationship between macroeconomic policies and economic growth was not demonstrated at a statistically significant level. As a result to this,  $H_5$  and  $H_7$ , hypotheses that predicted economic growth resulting from increases in the level of welfare, either due to institutional or socialist practices, must be rejected. However, the study also finds that limited welfare models of governance do not appear to generate economic growth in all contexts either. In Table 2 and Table 4, neoliberal policies of reduced welfare while operating with levels of globalization does generate economic growth. However, as was noted earlier, Tables 2 and 4 do not support this. Thusly, the study is unable to reject neoliberalism in all contexts. Nonetheless, it remains a somewhat unsettled debate, as its converse cannot be rejected in high-income countries or in a model consisting of all but Asian states. Regardless,  $H_7$  and  $H_8$ , which concerns socialist and clientist states, can be rejected as the relationship between increased openness to globalization is statistically significant across all models.

Finally, no model found the interaction variable of the three independent variables significant. Therefore,  $H_{13}$  is rejected and the study is unable to reject  $H_{14}$ .

## CHAPTER 7. IMPLICATIONS AND FUTURE RESEARCH

The previous section contained an analysis of the empirical data related to the effects of the independent variables of globalization, regime type and macroeconomic policies on the dependent variable of economic growth. Unfortunately, it is difficult to draw any clear results from the analysis and only general inferences can be drawn.

From the analysis, it is clear that the level of globalization, economically, socially and politically, tends to generate positive impacts on economic growth. However, it is unclear what effect policy has on this.

Looking at the original hypotheses, only  $H_1$ —higher levels of globalization generate greater economic growth—can be supported with full confidence. Democracy seems to have no clear impact on generating economic growth, nor do macroeconomic policies appear to always matter. In already wealthy states, macroeconomic policies do not seem to play a significant role in economic growth. While trade openness is associated with increased globalization, it is unclear which causes the other, as Wolf points out (2005).

Bloated state bureaucracies reduce economic growth. This may help explain why low-income states have a statistically significant negative relationship between the level of welfare and economic growth, as they are more likely than high-income states to be authoritarian or perhaps have less effective governance. Unfortunately, the operationalization used is not necessarily reflective of the intended measurement, as it is only a proxy due to data constraints. As such, the institutionalist models and bloated governments may be categorized together. Adding to the difficulty is that both neoliberal and institutionalist approaches are within the greater umbrella of liberalism. While the

data analysis demonstrates that lean, efficient governments generate more economic growth, it does not definitively demonstrate that institutionalist policies do not, or that they promote growth more slowly.

In future research, a more comprehensive index could be compiled to more accurately reflect the differences of neoliberal policies in contrast with institutional policies. This could also indicate that macroeconomic policymaking does not have the impact on economic growth that many theorists and practitioners believe. If this is the case, perhaps normative considerations should play a larger role, particularly in wealthy countries.

One possible implication of is that neoliberal policies are beneficial for developing as they essentially ‘cut the fat’ from inefficient states. As the state is exposed to social and political globalizing factors, it may experience challenges to the traditional power structure. However, this may remove inefficient processes, as well as practices that are viewed globally as unwarranted or undesirable.<sup>49</sup> Once a state has achieved a certain point of wealth, it may be able to enact more institutional (and egalitarian) policies.

As was demonstrated in the first three models, population seems to play a positive role in economic development. This may be owing to the logic that large populations are large markets, thus attracting capital. Smaller states with negligible populations may be ignored by global capital. This seems to suggest that the widespread fear of overpopulation in some states is not the driving force of economic stagnation or even depression.

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<sup>49</sup> This may include an expansion of human rights or gender and minority equality, as constructivist would argue that the increase in global civil culture, manifested in non-government organizations such as Amnesty International, Doctors Without Borders or Human Rights Watch, indicate changing norms. These norms would be spread through globalization in the as societies interact more with each other.

Perhaps more emphasis should be placed on geopolitical factors, which may provide an insight into why some areas seem to attract trade and eventual global openness while others do not. Geopolitical factors can create self-perpetuating cycles of economic growth. Specific goods and services are more readily available at reduced costs in specific areas as opposed to others. This is true not only of area-specific resources, but of specific industries that require overhead or especially skilled labor that is trained at a specific location. This may attract more capital, as the initial costs are already paid, resulting in continued development and further dynamism. In future research geopolitical factors will be addressed.

## **Chapter 8. CONCLUSION**

The primary result of this study is that globalization—the increase in participation and deepening of the spread of people, but more importantly goods and ideas—generates increased economic growth. This may result as norms and civil culture spread and become more readily available to a larger spectrum of the population. In addition, economic benefits are also spreading. The total impact of globalization is that it generates economic growth. As this study has demonstrated, democracy and increased levels of welfare do not generate economic growth. However, democracy does not, and under certain conditions, neither do welfare macroeconomic policies, prevent growth. As such, normative considerations should not be ignored under the guise of economic stagnation. Rather, states are free to select policies that fit their populations' democratic sense of justice.



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