Homeland Defense, Individual Freedom, and the Rule of Law [1]

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Today no one can give a speech in the United States, or perhaps even in the world, without referencing September 11 and the changes that we have all undergone since then. But, at the same time, some longer-term truths are once again being brought to the fore.

This topic is virtually limitless so I am going to focus on three; the new world order in relation to homeland defense, property rights, and economic freedom.

In the United States we have more than 40 separate government agencies involved in various aspects of our homeland defense. And until last year, no one person or agency in the federal government had clear responsibility to coordinate the different parts of this massive and complex system.

In the wake of September 11, the American homeland defense system has started to shape up. President Bush appointed a homeland security office with Pennsylvania=s Governor Tom Ridge at the helm. Director Ridge is charged with developing and coordinating a comprehensive national strategy to strengthen protections against terrorist threats or attacks in the United States.

So far, Governor Ridge=s office has begun by improving border security through agreements with Mexico and Canada. The

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Office of Homeland Security has also expanded our national pharmaceutical stockpile. It has established a Crisis Coordination Center in the Office of Homeland Security. It has developed a Homeland Security Advisory System in order to quickly inform the American people of the level of risk of terrorist attack. And it continues to consult extensively with state and local government officials and with the private sector.

Governor Ridge and the Office of Homeland Security face a difficult task: Does he have sufficient authority to complete the mission he was assigned? How does he deal with the real and political opposition to some of his proposals, particularly those that attempt to move resources or budgetary funds from one Executive Branch to another? How does he merge the various bureaucratic cultures of different agencies in the U.S. federal government? These represent real obstacles to implementing an effective long-term policy.

Congress is Ridge=s other major obstacle. To modestly quote Ed Feulner=s Fourth Law, AThe Congress does two things wellCnothing and overreacting@Cand with airport security policy, it=s the latter! A micro case perhaps, but the Congress is so outspoken on Aprofiling@ that Heritage=s 75-year-old Board Chairman was virtually Astrip searched@ before being permitted to board his plane, while swarthy able-bodies young men, many of whom appear to be black belts in kung fu, were waved through; something is amiss.

This past January, my colleagues published a major study: ADefending the American Homeland.@ It was the first of a series of publications by our Homeland Security Task Force. The task force was chaired by two veteran policymakers with real Ahands-on@ experience dealing with terrorism and homeland security: Paul Bremer, Chairman of the National Commission on Terrorism during the Reagan administration and former Ambassador at Large for Counter Terrorism, and Edwin Meese, the 75th U.S. Attorney General and a Distinguished Fellow at Heritage.

The report advocates a coordinated four-part approach, with more than 90 specific recommendations, to prioritize actions like how to coordinate military operations. Civil defense requires involvement and coordination among all levels of government, but it=s largely a bottom-up responsibility. Even today, when I ask an audience who was the Afirst responder@ after the airplane crashed into the Pentagon on September 11, I very seldom get the right answer. [The Arlington Country, Virginia Fire Department was the first responder.]

The task force concludes, for instance, that intelligence gathering and surveillance conducted by state and local personnel are at least as important as those conducted by the FBI and the CIA. These local sources are the individuals closest to the people who might require assistance, or who might be under threat of attack or who might have useful information. So we recommend relying more heavily on our 17,000 state and local police departments to spot potential terrorist threats and to help identify possible suspects.

Another priority is to improve information-sharing among all levels of government because access to timely and reliable information is a first line of defense for all law enforcement agencies. And, unfortunately, on September 11, and even today, we are learning that most of America=s law enforcement departments cannot Atalk@ to each other with the same radio frequencies and that their computer software is incompatible with each other, making data sharing very difficult.

Let us examine some of the results of the report so far: The Federal Aviation Administration (FAA) is currently looking at using data-mining and predictive software to cross reference aircraft passenger details with government and private databases; the administration (HHS) is studying a health surveillance network that would link emergency health responders to public health officials in order to promote information sharing and facilitate early warnings of terrorist activities; and, the proposed Homeland Security Information Sharing Act would require the intelligence communityCincluding the Director of the DIA and the Attorney General (who supervises the FBI) to develop procedures for sharing information across federal, state, and local levels of government. These are positive initial results.

In addition to defense measures, there are many other measures that are just as critical to preserving national security. My emphasis is less on issues like reducing the threat from bio-terrorism or consolidating all of our nation=s nuclear waste storage at one site in Nevada. Rather, my concern is with other, fundamental questions. For example, what institutional changes are required to enhance physical security while not reducing personal freedoms?

Let me discuss with you the questions of property rights, free trade, and tax competition.

In Heritage=s annual *Index of Economic Freedom*, which we have published jointly with *The Wall Street Journal* since 1995, we measure 50 independent variables divided into ten broad factorsCfrom barriers to trade, to the rule of law and labor market regulations. All 50 of these variables are examined to measure and to determine both the absolute level of economic freedom in 161 countries as well as the relative economic freedom of one country to another.

In the current 2002 edition, Estonia=s economy ranks 4^{th} most free in the world, out of 161 nations, and it is tied with Ireland, Luxembourg, and the Netherlands for the most free in Europe. In 1996, Estonia ranked 26 out of 140. This enormous leap in only six years is an amazing and commendable accomplishment for a former communist nation. How did they do it?

Many positives contributed to Estonia=s good ranking, not the least of which is sound property rights. In just a few years, Estonia created a legal system from the remnants of the Soviet legal system, Property ownership is recognized and enforced and the legal system is increasingly effective at protecting and encouraging the acquisition and sale of all property rights.

When we examine property rights, the key question always is: is the Alittle guy@ treated equally before the law as the highest-ranking in the land? Estonia passes this basic test with flying colors. Estonia=s economic success should be a model for other nations.

The rule of law is basic. Predictability under the rule of law, rather than the rule of man, means that everyone will be treated the same in similar circumstances. It means real security in ownership and control of private property.

The economic effects of secure property rights and a well-functioning legal system are reasonably straightforward. Since people act basically in their own self-interest, they tend to undertake hard work and investments only if they have a reasonable probability of enjoying the fruits of their efforts. Thus, if property rights are less secureCfor example, because of high crime rates or high tax ratesCpeople tend to work less and to invest less.

The same relationship between economic and legal security and investment holds true for companies. Without strong property rights, countries will fail to attract long-term investment from these firms.

If you take two countries with nearly the same per capita income in 1929 and examine the effect of their government=s policies over the past seven plus decades, you see two drastically different economic results. For instance, in 1929, Argentina had a per capita GDP of $4,367 and Australia=s was $5,000. In other words, Argentina=s per capita GDP was 90% of Australia=s. Today, Argentina=s per capita GDP is $8,100 and Australia=s is $24,240; Argentina=s per capita GDP is now 30% of Australia=s. Australia=s economy prospers while Argentina continues to suffer from its own governmental policy mistakes.

American companies are attracted to the Australian market for its stable legal and political system, excellent communications and transportation infrastructure, and sophisticated financial system. Conversely, the outlook for Argentina is dim. Businesses in ArgentinaCboth foreign and domesticCstill face problems involving inconsistent application of regulations, fraud, and corruption. Despite the fact that Argentina has received $30 billion from the international Monetary Fund (IMF) since 1983. Argentina=s political, economic, and institutional stability is decreasing rapidly. People are rioting and attacking politicians in the streets, looting supermarkets and stores, and withdrawing money from banks to buy U.S. dollars. Clearly this is not an attractive environment for investment, either foreign or domestic.

Investors do not flee safe havens or investment environments based on sound market economies in which heftyCor even, reasonableCreturns can be made; instead, investors flee countries ravaged by government corruption, currency manipulation, unsound financial institutions, disdain for the rule of law, and other harmful and wrong-headed government policies.

I have visited Asia more than 100 times in the last 25 years. During these trips I have had the opportunity to visit with leadersCpolitical, business, academic, and journalistsCin virtually every nation on many occasions. In these travels, particularly since the 1997 Asian financial crisis, I have seen first hand that Indonesia has done less than any Asian country to implement real structural reforms. A recent survey on corruption in Asia by the Political Economic Risk Consultancy (PERC) reports that Indonesia is the most corrupt country in Asia. Even with this reputation, it is hard to believe that the problem of corruption in Indonesia could grow worse, yet that is what is happening. The entire national legal system is in shambles, so the courts cannot offer any significant protection. With the 1997 financial crisis, in one year, Indonesia=s economic freedom score in the Heritage *Index of Economic Freedom* dropped nine percent, a change five times higher than the average. And, before the financial crisis, Indonesia=s economy was ranked 57th in the world; this year, it is down to 105.

The solution is that countries experiencing economic turmoilCnot to mention social and political turmoilCmust adopt comprehensive economic reforms in order to foster an environment that supports long-term economic security, market efficiency, and individual and corporate prosperity.

Another major promoter of economic freedom and security is expanded free trade. Trade expansion fosters adherence to the rule of law and promotes real protection of private property rights; in other words, this forces trading countries to play fair with each other.

Trade expansion agreements encourage good government. In this light, at least theoretically, the World Trade Organization should be viewed as a freedom-enhancing agency because it outlines the rules of the game. With more nations following the same rules, increased freedom should follow. Under WTO rules, once a commitment has been made to liberalize a sector of trade, it is difficult to reverse. The rules also prevent a range of unwise policies. Policies must be transparent. For businesses, these rules mean greater certainty and clarity about trading conditions. For governments, these rules often mean good discipline. When rules are broken, WTO members face the consequences of their actions.

New members such as Taiwan and China have agreed to change many of their practices. For instance, as a WTO member, China must crack down on the pirated software that is so common throughout the nation. (In fact, China is the world=s largest source of pirated compact disks and software.)

Undoubtedly, the recently begun Doha Round will continue to enhance further rules-based conduct. The new Round will strengthen the international trading system and, under the rule of law, will address more trade disputes in the future.

There is an attractive alternative method to the World Trade Organization for enhancing international trade. It is a Global Free Trade Association. The current trade agenda comprises comprehensive, multilateral negotiations through the WTO, regional trade agreements like the North American Free Trade Agreement (NAFTA), and bilateral agreements like those between Mexico and Chile, Canada and Chile, or Israel and the United States. Advocates of one route are prone to criticize the other, but these criticisms are more abstract than practical in nature.

The proposal for a Global Free Trade Association is not intended as a substitute for the other routes, but as an alternative at a time when the advance of global free trade has slowed and perhaps even stalled. Unlike the current options, which, at least for the moment, are insufficient, the GFTA will advance the free trade agenda. I am a free trader. My primary guiding principle has been to Apush for expanded free trade by any route.@

The embryonic GFTA will consist of countries that share a commitment to free trade and free capital movementsCin other words, open markets. It will not be geographically based. It will be a voluntary and inclusive association, based solely on a demonstrated commitment to a liberalCthat is openCtrading order. The plan is, in that sense, rules-based. It embraces recognition of each state=s national sovereignty; only its economic policies, and the choices they represent, will determine whether a country qualifies for membership in this association of free nations.

Global Free Trade Association countries are eligible automatically if they meet certain criteria. Specifically, four of the factors utilized in the *Index of Economic Freedom*, taken together, constitute a measure of how open a country=s markets are. The four areas are: trade policy, capital flows and foreign investment, property rights, and regulation. If a country does well in each of these four areas, it may fairly be said to have open markets. At present, 11 countries already qualify as having open markets and 26 others fail to meet the criteria by missing the grade in only one area. We will be pushing this idea in the months ahead.

The advance of free trade cannot continue to be held hostage to the politics surrounding the WTO or NAFTA. [The cultural underpinning of the GFTA countries is one that values the individual in politics and economics.]

$ Politically, that culture transforms into an anti-statist ethos favoring limited government: an ethos that supports the rights of citizens and their representatives over that of centralized governmental power.

$ Economically, individualism leads to entrepreneurship and innovation, invention and prosperity, growth and development.

Tax competition is another liberalizing force throughout the global economy. Tax competition occurs when individuals can decide where to work, save, and invest by choosing among political jurisdictions with different levels of taxation. When tax competition exists, politicians face pressure to keep tax rates lower in order to dissuade workers, investors, and entrepreneurs from shifting their productive activities to lower tax environments, which may be a continent or a country or a state away. Savings are inherently mobile, unlike factories and equipment. Hence, savings can be moved or shifted with a few computer clicks depending on various factors, like the reliability of the banking and legal structures and the level of local taxation. Tax competition thus makes it more difficult to over-tax income that is saved and invested. This means more economic growth, more private-sector job creation, and increased economic opportunity.

Consider what has happened in the world=s economy since Ronald Reagan and Margaret Thatcher began major reductions in tax rates 20 years ago. Every single developed nation subsequently reduced its top income tax rates. Corporate income tax rates in OECD nations, to cite an important example, have dropped, on average, by 20 percent points.

These lower tax rates and other competition-driven reforms helped resuscitate western economies. That is the good news.

The bad news is that politicians from high-tax countries want to curtail this kind of sensible fiscal competition. High-tax welfare states want to stop the flow of jobs and capital to nations with market-friendly tax systems with lower rates, and they are using the EU and the UN to pursue their agenda. Like many low-tax jurisdictions, the United States has been targeted by these international bureaucracies because it is Aunfairly@ competitive. In other words, our taxes are too low!

One group out to eliminate tax-competition between countries is the Organization for Economic Cooperation and Development (OECD). The OECD is attempting to achieve this by forcing all countries to participate in a system of global information exchange through which governments would collect and share private financial data, according to their own report entitled *Harmful Tax Competition: An Emerging Global Issue*. This would allow countries to tax income on the basis of where investors and entrepreneurs live, rather than where income is earned.

The OECD proposal is bad tax policy, bad privacy policy, bad sovereignty policy, and bad foreign policy. Under this type of plan, residents of high-tax nations would not be able to reduce their tax burdens by moving to or buying from a lower-tax area. This would insulate politicians from having to compete for business, investment, and entrepreneurial talent.

Another dangerous initiative is the European Union=s Savings Tax Directive. This proposal would require unlimited and automatic information sharing of private financial data for nonresident investors between all EU nations and six non EU nations, including the United States. Financial privacy and Adue process@ legal protections would both disappear if this proposal is adopted.

The EU proposal seeks to impose bad tax policy on the rest of the world. It wants a uniform tax policyCuniform at the highest possible rates. Good tax policy does not impose extra layers of tax on making money, yet the EU proposal intends to double-tax savings and investment: Good tax policy does not tax income earned in other nations, yet the EU proposal is designed to facilitate extra-territorial taxation.

The European Union is trying to create a tax cartel, an AOPEC for politicians,@ that will result in higher taxes and less economic growth. And, if the EU is successful, it will in effect be illegal for a nation to have a territorial tax system that does not punish savings and investment. The United States, for instance, would be guilty of Aharmful tax competition@ if we enacted a flat tax.

The United States should object to the EU Savings Tax Directive. But our rejection of bad tax policy is not just for the purpose of protecting our own citizens and our respective national interests. If we can defeat the EU Savings Tax Direction, we also strike a mortal blow against the OECD=s so-called Aharmful tax competition@ campaign. Almost all of the Acommitments@ from low-tax jurisdictions to this Paris-based bureaucracy were predicated on all low-tax OECD member nations agreeing to implement the same policies. If we can successfully veto the EU tax scheme, we will be able to preserve the ability of all countries to adopt a free market tax policy. A competitive tax policy that encourages work, savings, and investment will encourage real competition and real freedom by advancing the cause of lower tax rates rather than uniform higher taxes.

Actually, cries against the notion of so-called Atax harmonization@ are not new. Let me quote from a writer from an earlier age:

AAn inquisition into every man=s private circumstances, and an inquisition which, in order to accommodate the tax to them, watched over all the fluctuations of his fortunes, would be a source of such continual and endless vexation as no people could support.... The proprietor of stock is properly a citizen of the world, and is not necessarily attached to any particular country. He would be apt to abandon the country in which he exposed to a vexatious inquisition, in order to be assessed to a burdensome tax, and would remove his stock to some other country where he could either carry on his business, or enjoy his fortune more at his ease. By removing his stock he would put an end to all the industry which it had maintained in the country which he left. Stock cultivates land; stock employs labour. A tax, which tended to drive away stock from any particular country, would so far tend to dry up every source of revenue both to the sovereign and to the society. Not only the profits of stock, but the rent of land and the wages of labour would necessarily be more or less diminished by its removal.@

Adam Smith wrote that in *The Wealth of Nations* in 1776. High taxes and people=s response to them have not changed in the intervening two and one quarter centuries.

We see, then, that in order for security and freedom to exist in this new world, much more than just a competent homeland defense system must be in place. Among the economic freedoms that contribute to security and individual freedom are secure property rightsCintellectual, physical, financial, and personal property alikeCexpanded free trade, and regional tax competition.

In his essay *Liberalism*, Ludwig von Mises states that Awhen a peace-loving nation is attacked by a bellicose enemy, it must offer resistance and do everything to ward off the onslaught.? And, this is what the leaders of the freedom-loving nations of the world must do on a multi-faceted front. In order to preserve our freedom, we must shore up our homeland security. We must encourage all nations to follow basic guidelines in order to promote security and freedom among them (such as a GFTA). We must make our countries safe for foreign investment. And, we must encourage expanded international trade.

Indeed a pervasive feeling of peace among the peoples of a nation and among nations is critical to preserving freedom. Von Mises knew that Athe development of a complex network of international economic relations is a product of ... liberalism and capitalism,@ and only under this Ashelter of security@ can such freedom be realized.

Ultimately, the primary determinant of economic development of a country is its own policies. As Milton Friedman wrote in *Capitalism and Freedom*: AIt is widely believed that politics and economics are separate and largely unconnected; that individual freedom is a political problem and material welfare an economic problem; and that any kind of political arrangements can be combined with any kind of economic arrangements...such a view is a delusion.@ And we conservatives believe that there is a close and necessary connection between property and human freedom, and that economic freedom is an essential, integral part of human freedom.

The potential for achievement as a result of human innovation is limitless, and such innovation leads directly to better living standards, increased prosperity, and human fulfillment. Open economies are characterized by a culture of freedom. In closed economies that open up, the culture of freedom takes root. We see this in surprising placesClike EstoniaCtoday. The culture of freedom flourishes whenever a society of free people emerges, engendering a self-confidence that permits a nation to open itself to an inflow of ideas, practices, and goods. And, if we want to secure this culture of freedom, we must protect and promote a free people=s right to make economic decisions without the arbitrary and heavy hand of the state. This is the new world order we should be striving to build.