# Chapter 6

# Trade in a Challenging World

William Appleman Williams was one of the Cold War's most notable historians. A Naval Academy graduate, World War II Naval officer, and civil rights activist, Williams was both prolific and controversial. He was a champion of the leftist-revisionist histories that began to come out of the academy in the wake of the Korean War. Williams's *Tragedy of American Diplomacy*, published in 1959, argued that the problem with the United States is that Americans thought they had all the answers and they didn't. America, Williams argued was engaged in "Open Door Imperialism," a ceaseless quest for economic dominance and the establishment of an informal empire designed to sustain U.S. economic prosperity and prevent revolutionary agitation against the American global system overseas.[1]

The Cold War, Williams argued, was just the United States looking out for itself. The Truman Doctrine and Marshall Plan were, he believed, an example of "two sides of the same coin of America's traditional program of open-door expansion."[2] Although Williams had little use for Truman, he thought even less of Eisenhower, whom he considered the coldest of the Cold War warriors. As far as Williams was concerned, after Ike things did not get any better. Vietnam, for Williams, was the apogee of American hubris. He became a vocal critic, not just of U.S. history, but of contemporary foreign policy as well. "I prefer to die as a free man struggling to create a human community than as a pawn of empire," he wrote in 1976 in the wake of the tragedy of Vietnam.[3] Williams built a career out of speaking truth to power—or so he thought.


Trade during the Cold War. U.S. agricultural products loading for shipment overseas. (COURTESY OF THE U.S. DEPARTMENT OF AGRICULTURE)

At the University of Wisconsin–Madison, Williams became known as the father of the "Wisconsin School," a generation of leftist diplomatic historians that found economic determinism at the root of virtually every episode of American foreign policy. Sadly, the Wisconsin school generated more heat than light. The evils of dollar diplomacy made for good reading. Yet, as powerful and evocative as Williams's writings were seen to be in the 1960s and early 1970s, it is questionable how well they have stood the test of time and distance from the raw emotion of the Vietnam era. The Marxist view of the past that underpins Williams's analysis—the critique of capitalism based on the presumed exploitation of the masses—all seems a bit old-fashioned and silly in the wake of the collapse of the Soviet empire. In many ways Williams has become, like McCarthyism, another of the Cold War's ghosts from Wisconsin.

Sometimes it is more important to pay attention to history than to historians. Williams, like Charles Beard and other progressive historians, stretched the evidence to fit the thesis. Often, both the theses and the historians were simply wrong. Much of the United States' economic role in global affairs was simply Americans doing business in the world without any secret plan or ulterior motive. Likewise, although every major foreign policy decision may have had global economic consequences, that did not mean that checkbook strategy was behind every U.S. action.

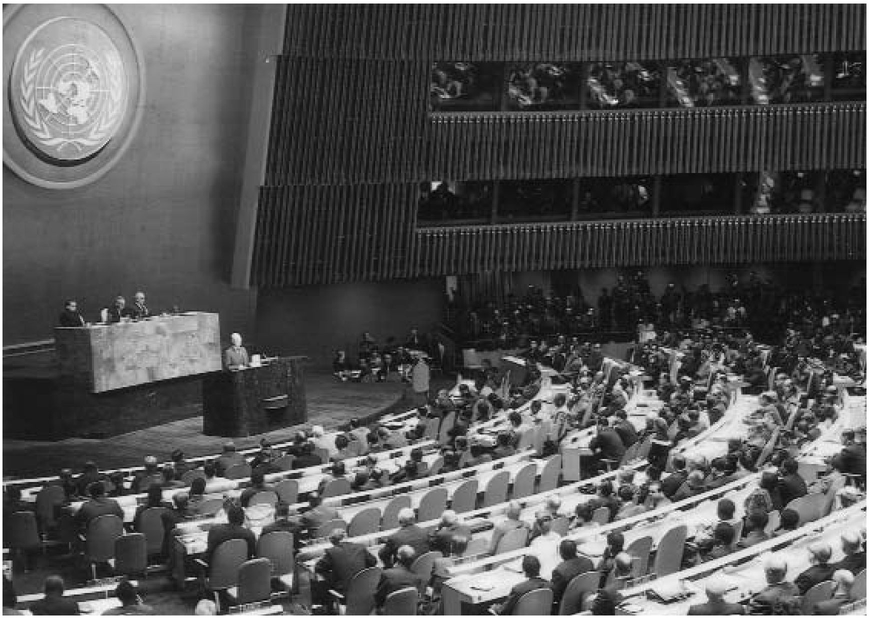
Williams's history of the Cold War was more a reflection of the ideological debates that accompanied the long struggle between democracy and communism than an accurate and insightful analysis of the lessons that can be learned from that troubled time. Still, his writings remain a powerful and important reminder that U.S. history, particularly since the turn of the twentieth century has been the history of the United States in the world. It is virtually impossible to talk or think about the global economy without thinking about the American economy.

There were voices during the Cold War that called for retrenchment and disengagement from the global economy and global affairs. That was never a realistic choice. Neither is retreating from the global economy much of an option today. It is true that the trade and commerce that carry goods, services, ideas, and people to and from our shores can also carry terrorists and their weapons—but we cannot live in a world without global trade and commerce. America is inextricably linked to the global economy, because 96 percent of the world's consumers live outside the United States and America is the world's largest exporter. We have to trade. One of the principal tasks of long war strategy is to preserve both free trade and security—in equal measure.

## Trading Places

William Appleman Williams got it exactly wrong. Trade was not the enemy of freedom during the Cold War; it was the West's savior and it remains the lifeblood of freedom today. In the modern world, free trade stands as the driving force in global economic growth. Countries that have pursued liberalization have witnessed an increase in GDP. As countries open their markets, per capita GDP increases. This is a simple fact. The International Monetary Fund (IMF) survey of the literature on trade and growth found that "many cross-country econometric studies have concluded that trade openness is a significant explanatory variable for the level or the growth rate of real GDP per capita."[4] In plain language, what the IMF found was that countries that opened their markets and became global traders made more money.

No country demonstrates the importance of free trade to economic growth more than the United States. One of the more remarkable achievements of the United States in its long confrontation with the Soviet Union was that it sustained a military standoff while becoming a more open society, not just as a civil society, but also as a global trading partner. "The growth in



President Dwight D. Eisenhower addresses the 15th Session of the General Assembly of the United Nations, September 22, 1960. (Courtesy of the United Nations)

trade over the past 50 years," concludes a U.S. Commerce Department report, "fueled by falling trade barriers, has contributed directly to the most rapid sustained economic growth in U.S. history."[5] Throughout the darkest days of the Cold War, America kept its doors open, and as a result, it finished the long war stronger than it started.

Free trade has made the United States more competitive and innovative. Innovation constantly provides new technologies that allow Americans to produce more. The resulting economic growth generates jobs, higher standards of living, and a greater appreciation of the benefits of living in a peaceful society.[6]

Free and fair trade also spurs efficiency. The drive to produce "better, faster, cheaper" improves the competitiveness of manufacturing enterprises and service industries.[7] In turn, competition brings lower prices. The big winner is the American consumer. According to a University of Michigan study, the North American Free Trade Agreement (NAFTA) and the World Trade Organization's (WTO) Uruguay Round of trade negotiations have increased the savings and gains of the average American family by $1,300 to $2,000. The income gains and tariff cuts from NAFTA alone were worth up to $930 each year for the average American family of four.[8] Additionally, the

WTO found that "in the United States, 12 million people owe their jobs to exports; 1.3 million of those jobs were created between 1994 and 1998. And those jobs tend to be better-paid with better security."[9]

The benefits of free trade are not confined by borders. The achievements of trade in North America offers the best example. The gains from NAFTA and the WTO Uruguay Round can be seen across the board, ranging from manufacturing to the local farmer. U.S. manufacturing output rose 44 percent (in real terms) in the 1990s and real hourly compensation increased by 14.4 percent in the ten years following the signing of the NAFTA agreement.[10] American farmers have seen a huge increase in exports. Mexico has become one of the fastest growing markets for U.S. beef. U.S. pork exports to Mexico and Canada have increased by more than 230 percent since the implementation of NAFTA.[11] In 2003, total U.S. exports to Canada exceeded $169 billion and total exports to Mexico exceeded $97 billion. Likewise, Canada's export industry benefits greatly. According to Canadian Prime Minister Paul Martin, "Canada exports more to Home Depot [a U.S.-based company], than we do to France."[12] NAFTA has benefited Mexico as well. Gary Hufbauer of the Institute for International Economics notes, "Between 1993 and 1999, Mexican exports grew from $48 billion to $120 billion. If Mexican exports had grown only as fast as real Mexican GDP (plus U.S. inflation), the 1999 figure would have been $63 billion. The extra $57 billion of exports boosted Mexican GDP potential by $12 to $28 billion (3 to 6 percent)."[13]

Nor is the capacity of trade to stimulate economic growth limited to North America. Any country willing to tear down barriers and open its market can experience the benefits of these policies. (See Appendix 13.) Hong Kong embraced free trade and is now one of the premier centers of finance and commerce in the world.[14] Hong Kong has a per capita GDP that is nearly $25,000. Likewise, Singapore is very open—with a weighted average tariff rate of 0 percent.[15] Singapore's per capita GDP is over $27,000. In contrast, countries that have isolated themselves from the global economy have suffered as a result. Burma, which has restrictive trade policies, has a per capita GDP of only $152.[16]

Not only is free trade the right approach to promoting economic growth, it also serves to address, rather than exacerbate, many of the ills commonly (though often wrongly) associated with globalization. Free trade, for example, improves environmental standards. Mike Moore, former Director-General of the WTO, points out that, "All serious research shows that poverty is the greatest threat to the environment. People don't live in polluted squalor by choice, nor do they trek miles to strip trees for charcoal by choice. There is a direct connection with rising living standards and better environmental outcomes."[17] Countries enjoy a superior environmental quality when they can afford to establish and sustain environmental standards. Trade creates wealth. In turn, when incomes rise, more money becomes available to spend on the environment. (See Appendix 14.) In short, countries that have a higher degree of trade openness have a higher level of environmental sustainability.[18]

Trade also improves labor standards. Poverty, not trade, creates sweatshops, slumlords, and exploitative child labor. A Brookings Institution study found that in countries with a per capita income of $500 or less, 30 percent to 60 percent of children between the ages of 10 and 14 work, whereas in countries with a per capita income within the $500 to $1,000 range, only 10 percent of children in that age bracket work.[19] The increased per capita GDP that an open market brings can only help—not hurt—a country's labor standards.

Finally, free trade is the handmaiden of security. There is a reason why thriving democracies never go to war with each other. The U.S. National Security Strategy points out:

> A strong world economy enhances our national security by advancing prosperity and freedom in the rest of the world. Economic growth supported by free trade and free markets creates new jobs and higher incomes. It allows people to lift their lives out of poverty, spurs economic and legal reform, and the fight against corruption, and it reinforces the habits of liberty. We will promote economic growth and economic freedom beyond America's shores.[20]

In short, there are few better weapons in a long war than free trade. Trade makes a nation's economy stronger and it improves global conditions generally. The tide raises all boats.

## Free Trade's Champion

No one is more passionate about the value of free trade than Robert Zoellick, the United States Trade Representative under the Bush Administration. If William Appleman Williams stood at one pole representing the way Americans thought about the impact of the U.S. economy on the world, Zoellick would be standing at the other. "Free trade is about freedom," Zoellick would often say. "Openness is America's trump card."

Even before 9/11, Zoellick passionately believed that free trade was as crucial to dealing with the ills of the post-Cold War world as it was in saving the West in the long struggle against communism. "Over the last decade," Zoellick is fond of reminding audiences, "trade helped to raise 140 million people out of poverty, spreading prosperity and peace to parts of the world that have seen too little of both."[21] The end of the Cold War, in fact, brought new opportunities to extend the advantages of free and open trade to virtually every nation in the world. Zoellick's mission was to ensure that no one—anti–free-traders, protectionists, or terrorists—closed the open door.

Zoellick's career as a high priest for free trade bridged the sunset of the Cold War and the rise of the so-called New World Order. The young man from Naperville, Illinois, armed with law and public policy graduate degrees from Harvard, joined the U.S. Treasury Department in 1985. Later, Zoellick served as State Department undersecretary beneath James Baker. In 1991 and 1992, he served as the President's personal representative at the G-7 economic summits.

On February 7, 2001, Zoellick assumed his duties as the nation's trade representative. The following year, Congress granted the President Trade Promotion Authority (TPA), often called "fast track authority." TPA involves special procedures for the negotiating and implementing of trade agreements. Although the Constitution gives Congress authority to set the terms of international commerce, fast track is a means for Congress to delegate responsibility to the President for speeding trade negotiations. Under fast track, once the President negotiates a deal and turns it over to the Hill to become law, Congress limits itself to twenty hours of debate and an up or down vote on the final bill (with no amendments allowed). Created in 1974, Congress allowed presidential negotiating authority to lapse in 1994. The United States had been falling behind ever since. Of the 150 free trade agreements in the world in 1994, the United States was party to only three.

It is not a coincidence that at the dawn of the war on terrorism, the Bush Administration turned its attention to rekindling momentum for the expansion of free trade. Long wars demand strong economies and free trade is the ultimate engine of economic growth.

Since Zoellick took over, the President has signed agreements with Chile and Singapore and has completed negotiations for agreements with Central


Robert Zoellick advocating to extend the President's authority to negotiate free trade agreements. (PHOTO FROM THE HERITAGE FOUNDATION COLLECTION)

America, Australia, Bahrain, and Morocco.[22] In 2004, the trade representative negotiated the Free Trade Agreement of the Americas, as well as conducting bilateral free trade agreement negotiations with Panama, Thailand, and the Andean countries. "By pursuing multiple free trade initiatives," Zoellick argues, "the United States is creating a 'competition for liberalization' that provides leverage for openness in all negotiations, establishes models of success that can be used on many fronts, and develops a fresh political dynamic that puts free trade on the offensive."[23] That is, simply put, the right trade strategy for a long war.

## Advancing Free Trade

The United States is not alone in this endeavor. By the end of 2003 there were already 250 bilateral and multilateral agreements in place around the world. Over half of them have been put in place since 1995 and about fifty more are believed to be on the way.[24] With luck, that will be only the beginning. The WTO's Doha Round of trade negotiations (launched in Qatar in November 2001) began by calling, in particular, for ensuring the inclusion of the developing world. "International trade can play a major role in the promotion of economic development and the alleviation of poverty," the Doha Declaration concluded. "We recognize the need for all peoples to benefit from the increased opportunities and welfare gains that the multilateral trading system generates. The majority of WTO Members are developing countries. We seek to place their needs and interests at the heart of the Work Programme adopted in this Declaration."[25] The challenge now is to put these words into action.

Despite the emphasis Doha places on expanding the free trade agenda, negotiations have been slow. That is not surprising. WTO decisions are made by a consensus vote of its 147 members. Because the WTO membership chooses to point fingers over who has the highest barriers instead of simply advancing trade, the organization has become less of an engine for change and more of a speed bump to progress.

Past WTO agreements have greatly benefited global growth. Future agreements will contribute to that growth and will strengthen the ties that bind the global economy. Security regimes must take this global economic system into account. Re-energizing the WTO, as well as pushing forward with other bilateral and multilateral trade deals, has to remain a high priority.

Here are some additional steps that the United States should be taking right now. We can start by keeping America free of protectionism. To that end, the government should:

- Advance as many free trade agreements as possible. Thus far, the Bush Administration has advanced free trade agreements with Chile and Singapore and has completed negotiations with Central

America, Australia, and Morocco. It should continue to negotiate free trade agreements with other countries around the world.
- Eliminate agricultural subsidies, antidumping measures, and other protectionist policies. Subsidies and special protections benefit small economic interests or sectors at the expense of millions of consumers and producers. They translate into higher prices—the impact of which is felt primarily by poor Americans.
- At the same time, the United States should push other developed and developing nations to adopt these policies as well, creating a level playing field for global competition.

## Terrorism and Trade

Clearly, free trade is here to stay. Likewise, security is not an option. Although free trade provides the strength to fight the long war, like every other instrument of conflict, it must be protected.

Transnational terrorism, if left unchecked, could represent a significant threat to the lifeblood of the global economy. For instance, in 2002, a labor dispute closed all ports on the West Coast for eleven days—ports that handled 60 percent of U.S. maritime imports and exports. Losses from the lockout stretched into "the billions of dollars."[26] The effects of this dispute reached beyond U.S. soil across the ocean to foreign producers trying to export their goods.

A terrorist attack might be capable of inflicting far more economic damage. The direct impact on the domestic economy would no doubt be substantial. The Port of Long Beach accounts for 30,000 jobs[27] and the Port of Miami-Dade generates more than 90,000 jobs and has an economic impact of $12 billion annually.[28] The consequences of shutting them down would be immediate and significant. Additionally, there could be huge ramifications on trade. U.S. producers and foreigner importers would likely face gridlock or a complete shutout for weeks—or even longer.

Thus, the United States faces a dual challenge. Asa Hutchinson, the Department of Homeland Security's Undersecretary for Border and Transportation Security, said it best: "[Our] borders and ports are not just 'openings' to be secured. They are economic doors that must remain open."[29] We must always keep both goals in mind.

In the wake of 9/11, trade quickly became a battleground for dueling experts. While economists argued for open borders, security experts campaigned

Trade and Transport: Lifeblood of the twenty-first century economy. (Photo from Photos.com)

for more regulations. Framing a debate between security and trade offers a false choice, much in the same way that arguing for security *or* civil liberties simply sets forth the wrong set of options. The answer is simple. It is security *and* trade. That is why the post-9/11 efforts to adopt layered security, public–private partnerships, and risk-management methods have established exactly the right kind of framework for providing good security for a global economy. This approach makes security simply another cost in the process of doing business, just like safety, labor, and environmental standards are factors that must also be accounted for in global commerce. They represent the right approach for the long war, reasonable measures that provide real security with the public and private sector each fulfilling its responsibilities for the protection of global trade.

Advancing both security and trade, however, can be easier said than done. Although rich nations, such as the United States and its trading partners in Asia and Europe, can well afford the security initiatives introduced since 9/11 to protect global trade, other nations cannot. Rising tides cannot lift boats that have no bottoms.

## Security and Emerging Economies

The U.S. National Security Strategy correctly calls for encouraging economic development through free markets, free trade, and enhancing the capacity of developing nations to compete in the global economy. Concurrently, however, the United States is rightly promoting international security regimes designed to prevent terrorists from attacking or exploiting the world's global trade networks. Meeting these requirements is difficult for developing countries that lack mature infrastructure, robust human capital programs, and adequate financing. Today, many of these countries are not major trading partners with the United States. Unless they determine how best to meet emerging international measures to combat terrorism, they never will be.

Good security costs money. The International Shipping and Port Security (ISPS) Codes offer a case in point. Established by the International Maritime Organization in the wake of 9/11, ISPS mandates new, unprecedented measures for securing commercial shipping. The "I code" requires that commercial ships carry an automatic identification system so that their location can be plotted moment by moment in the event of an onboard emergency.[30] Each must also appoint a security officer who must oversee the ship's security plan. Additionally, ships must provide a synopsis record of all movements, ports of call, cargoes, and ownership details.[31] Costs for non-compliance are likely to be very high. If a ship does not meet the new requirements, it is very possible that it will be turned away and not be allowed to dock at a U.S. port.[32]

Likewise, the ISPS code sets security requirements for ports, which must establish port security committees, conduct vulnerability assessments, and implement security plans. National authorities must certify that ports are

ISPS compliant. Ships that dock at non-compliant ports may also be denied entry to U.S. waters.

The cost of compliance appears to be substantial as well. More than 46,000 ships and almost 4,000 ports are involved in international trade and will be required to comply with ISPS. A 2003 Organisation for Economic Co-operation and Development report estimates the initial ISPS Code compliance burden on ship operators to be at least $1.3 billion and $730 million per year thereafter.[33] The costs of having to meet ISPS requirements are very difficult to estimate because of the variability of needs and costs (e.g., labor and materials) at the ports.[34]

There are a number of reasons why it will be hard for emerging economies to get there from here—and it's more than the problem of just lacking cold, hard cash to buy fences and guard dogs. Fundamentally, good security is about good governance. That means an established rule of law and law enforcement and trade officials that follow the law. It also requires an end to widespread corruption. It demands transparency in government action. It includes having personnel adequately equipped and trained to do their jobs. For some, it demands cultural change. It requires a mindset that envisions the role of customs, trade, and law enforcement to be the facilitation and protection of trade—not just generating revenue for the government by collecting tariffs, taking bribes, and pilfering goods. Finally, it demands governance that facilitates economic growth, which in turns creates the wealth that allows the public and private sectors to pay for the security their people deserve. Developing nations that lack the capacity for good governance will always lack the capability to provide good security.

Traditional foreign assistance programs have simply failed to address the issues of good governance or the need to help poor nations develop. The United States disbursed nearly $259 billion (in constant 1995 dollars) in development assistance between 1980 and 2001.[35] Yet the citizens of most recipient countries are no better off today (in terms of per capita GDP) than they were decades ago. Some, in fact, are poorer. Between 1980 and 2001, of the 77 countries that received economic assistance that accounted for at least 1 percent of their 2001 GDP (in constant 1995 dollars) and for which per capita GDP data are available:

- Thirty-three experienced a decline in real per capita GDP;
- Fifteen experienced negligible real growth—less than 1 percent compound annual growth—in per capita GDP; and

- Only 29 experienced real compound annual growth in per capita GDP exceeding 1 percent. Of these 29, only eight countries saw growth over 3 percent.[36]

U.S. aid programs are just not getting the job done. That is why President Bush proposed a new form of assistance in the Millennium Challenge Account (MCA)—a performance-based foreign aid program. The MCA is an innovative attempt to address the historic failure of foreign aid and to make it more effective. Under the MCA, nations would be eligible to receive assistance only if they adopt policies consistent with good governance and economic freedom—policies proven to lead to greater prosperity.

Will the MCA work? Probably, *if* it is done correctly. To manage the MCA, the government established the Millennium Challenge Corporation (MCC). The trick will be for the MCC to focus on each candidate country's progress toward more open markets. The Heritage Foundation's *Index of Economic Freedom* shows exactly how to do this.

Using the *Index* as a guide, the MCC could identify which candidate countries have been working hardest toward MCA goals. The *Index* measures economic freedom by examining ten factors: trade policy, fiscal burden of government, government intervention in the economy, monetary policy, capital flows and foreign investment, banking and finance, wages and prices, property rights, regulation, and informal market activity. As the *Index of Economic Freedom* has demonstrated for the past ten years, countries that open their markets have higher per capita GDP.

The MCC recently designated 63 countries as potential recipients of MCA grants. Appendix 15 shows the performance of the 49 of these 63 countries that are ranked in the *Index*. Using *Index* data, the table divides the 49 countries into quartiles based on the improvement in their levels of economic freedom during the past four years. Within each quartile, countries are listed according to degree of improvement, in descending order. Countries in the first quartile are progressing fastest toward economic freedom and would therefore benefit most from the MCA. Conversely, countries in the fourth quartile have shown the least improvement and, measured against the President's goal, are the least deserving of MCA grants.

The countries in the top quartile have slightly more than six times as much GDP growth over the past 10 years as those in the bottom quartile. Consistent with the President's mission, the top quartile countries are likely to move beyond their current dependence on aid. For instance, Cape Verde's level of economic freedom has steadily increased since 2000, directly contributing to Cape Verde's achieving a higher rate of economic growth than most other countries in the table. The Cape Verde government plans to continue this progress by privatizing the remaining state-owned companies, reducing the corporate income tax rate, and implementing other measures. On the other hand, Bolivia has failed to move steadily toward economic prosperity. As Appendix 16 shows, Bolivia's poor record in economic freedom is associated with plummeting economic growth.

The MCA represents a fundamental shift in development assistance because it would provide assistance only to countries with a proven record of adopting policies that are complementary and conducive to economic growth. Compared to traditional foreign aid, the MCA would be a far more effective means of providing assistance and of leading poor nations to adopt policies that would encourage economic growth and development—with or without foreign assistance. The MCA should be the centerpiece of U.S. foreign assistance efforts. It is the only initiative that, over the long term, offers the promise of adequately addressing the challenges of promoting economic growth and establishing international security regimes that incorporate the world's emerging economies.

In the short term, there is also more that can be done within existing assistance programs. Programs to provide technical help to countries for developing trade already exist. In fact, the United States is the largest single-country donor for Trade Capacity Building Assistance (TCB).[37] In 2003, the United States gave $752 million for TCB.[38] Currently, this assistance falls under two categories: addressing supply-side obstacles and assistance related to participation in the WTO Technical Assistance Plan and regional trade agreements.[39] These funds should be used to help developing countries comply with international security regimes by promoting good governance practices related to trade security. Just as we have given technical assistance to help countries join the WTO, the United States should assist countries in understanding and developing strategies to meet the requirements of global security regimes.[40] Helping these countries help themselves, in the end, helps all of us. Each country that joins the global security regime helps shrink the sanctuaries and opportunities for terrorists plying the global networks of trade and travel.

## Protectionism and Homeland Security

Perhaps the greatest threat to free trade during the long war, however, will not come from the terrorists or our incapacity to assist the developing world, but in our ability to hurt ourselves. Kennan's caution in the Long Telegram bears repeating here. "The greatest danger that can befall us in coping with this problem," he wrote, "is that we shall allow ourselves to become like those with whom we are coping." The terrorists would like to wall themselves off and create a world in which they reign without influence or contact from the rest of the universe, insulated from the corrupting influence of freedom and democracy. America cannot fight this kind of fascism if, in the name of fighting fascism, it imitates its methods. Thus, we must be watchful for those who would close the lifeline of free trade that fuels the American economy in the name of protecting that same economy.

## A Cautionary Tale

Like the ghosts from Wisconsin, the specter of protectionism—arguments that America would be better off eschewing free trade in favor of restrictive rules and tariffs that limit U.S. interaction with the global economy—visit us again and again. At the height of the Cold War, for example, congressional legislators smashed Sony TVs on the steps of the Capitol building and railed against Japanese and German cars under the impression that restricting trade with America's staunchest allies would somehow make us richer and safer. Today's version of mindless protectionism is found in complaints about outsourcing—the irrational fear that contracting with overseas companies for services will somehow destroy the American economy or open up new avenues for terrorists to threaten the United States.

It was bound to happen. Opponents of outsourcing have dragged the issue of homeland security into their protectionist arguments. Immediately after the Department of Homeland Security awarded a contract to Accenture LLP (the U.S. subsidiary of the Bermuda-chartered company, Accenture) to implement DHS's new U.S. Visitor and Immigrant Status Indicator Technology (US-VISIT), CNN's *Exporting America* ran a segment[41] about outsourcing America's security. In recent months, *Exporting America* has tried to tap into the public's fear of job losses by highlighting anecdotal stories while ignoring official statistics that show that fears about job loss are wildly overblown. Apparently, *Exporting America* has now incorporated homeland security concerns into its argument, claiming that outsourcing homeland security contracts poses a threat to America. The facts simply do not bear out these concerns.

Applying protectionist policies to homeland security would only work to compromise America's security. DHS's goal when awarding contracts should be to obtain the best security for the dollars invested. To ensure that America gets both good value and good security, Congress and the Bush Administration should:

- Remove all language from the Homeland Security Act and appropriations bills that restricts DHS's ability to award contracts to whomever is best equipped for the job;
- Insist that DHS establish and require companies to follow strict security practices in order to receive contracts;
- Direct DHS to establish a program comparable to the National Industrial Security Program (NISP), through which inspectors would inspect contractor facilities to verify that all security requirements are met; and
- Refrain from implementing protectionist policies that would limit DHS access to superior service and technology (and that might invite protectionist reprisals against the United States).

## An Overstated Argument

Some critics do not even understand their own arguments. The Accenture controversy, for instance, has nothing to do with outsourcing—which occurs when a U.S. company subcontracts some element of its operations to a foreign entity. Instead, it is a fight about whether a company with a foreign "parent" should bid for U.S. government contracts, especially if the parent company re-chartered in a jurisdiction with better tax laws. However, even by this criterion, opponents of the Accenture contract are inaccurate because Accenture was never a U.S. company. Rather, it is a related set of partnerships in various nations that chose Bermuda as a home base for purposes of incorporation.

In any event, complaints about outsourcing the US-VISIT contract are completely misdirected. They demonstrate how eager some are to link homeland security to the debate against outsourcing. Under the DHS contract, Accenture LLP will implement US-VISIT—a program that uses biometric identifiers, such as fingerprints and photographs, to make security determinations about individuals entering or exiting the United States. Accenture, the parent company, is a global management consulting and technology services company that is chartered in Bermuda. However, Accenture LLP—based in the U.S.—will do all of the contract work, and the dollars and tax revenue generated by the project will remain in the United States. Moreover, Accenture LLP met all of DHS's legal requirements for the US-VISIT bid and was awarded the contract based on its ability to do the job.

## The Benefits of Outsourcing

Even though the Accenture debate is not really about outsourcing, it is important to realize that the ability to contract outside national borders benefits the American economy and national security. Outsourcing opponents routinely focus on only one side of the issue, while ignoring the gains in lower prices, higher efficiency, and insourced jobs.

More Americans are employed today than ever before—a record high of 139 million workers, as reported by the Bureau of Labor Statistics. The unemployment rate has been dropping for one year and is steady at a low 5.6 percent—all the more impressive because the American workforce has grown by 2.84 million people since late 2001.[42] This robust performance—particularly when compared to the economic stagnation and high unemployment rate in Europe—can be attributed to U.S. reliance on the free market to allocate resources.

This market flexibility and dynamism does mean that some jobs are lost, but those job losses tend to be small compared to the number of jobs that are created. The only official study on the impact of off-shoring jobs (released by the Department of Labor on June 10, 2004) found that only 4,633 job losses were associated with overseas relocations in the first quarter of 2004.[43] That represents only 2 percent of total layoffs in America.

Aside from debunking inflated fears about the export of American jobs, it is necessary to recognize the many benefits of outsourcing. Outsourcing is a two-way street. There are currently 6.4 million jobs in the U.S. in which the employer is a foreign company. These "insourced" jobs are growing at a faster rate than jobs in general are being lost. According to the Organization for International Investment, "Over the last 15 years, manufacturing 'insourced' jobs grew by 82%—at an annual rate of 5.5%; and manufacturing 'outsourced' jobs grew by 23 percent—at an annual rate of 1.5%."[44]

Furthermore, outsourcing is a means of increasing output while reducing input costs. This leads to lower consumer prices, higher living standards, and more jobs in a growing economy. Outsourcing also lets competition run its course and encourages companies to become more efficient. In the end, having a pool of highly competitive and efficient companies bidding for homeland security contracts will only further the quality of America's security.

Policies that punish businesses that outsource jobs are protectionist and isolationist—and such policies have a long history of failure. They also erode U.S. competitiveness. Policies that encourage free trade, free labor, and free capital are not only necessary for economic growth, but are crucial to America's national security because they ensure that the U.S. will have access to the best technologies and systems for homeland security.

## Corporate Expatriation: Blame the Tax Code, Not the Companies

Much of the protectionist sentiment in the Accenture debate is not really about outsourcing, but is targeted at companies that choose to incorporate outside the United States. Many companies—including Tyco, Ingersoll–Rand, Cooper Industries, McDermott International, Nabors Industries, the Noble Corporation, and Foster–Wheeler—have dissolved their U.S. charters and reincorporated in low-tax jurisdictions that have territorial tax regimes. (This business practice is also known as inversion or expatriation.) Other companies, such as Accenture, chose low-tax jurisdictions when they first incorporated. On a similar note, a vice president of Intel remarked that, if Intel could start over, it would organize as a foreign company.[45]

The United States' high corporate tax rate and "worldwide taxation" policy simply make it difficult for corporations chartered in the United States to compete overseas. The federal government imposes a 35 percent tax on corporate income[46] and states take another 5 percent (on average). This cumulative 40 percent tax rate is significantly higher than the 29.96 percent average corporate tax burden in Organisation for Economic Co-operation and Development countries.[47] Indeed, the tax burden on U.S.-based corporations is currently the second highest in the industrialized world.[48] Additionally, U.S.-chartered firms must pay tax to the Internal Revenue Service on income earned in other countries, in addition to the local corporate tax. This "worldwide taxation" policy puts American-based companies at a disadvantage because most U.S. trading partners rely on "territorial taxation"—the commonsense notion that governments tax only income earned inside their borders.

The combination of these misguided policies is undermining U.S. competitiveness—as, for instance, when a U.S. company competes against a Dutch company in Ireland. Because Holland has a territorial tax system, the Dutch company pays only the 12.5 percent Irish corporate income tax on its Irish income.[49] The American company, though, must pay the 12.5 percent Irish tax and the 35 percent U.S. corporate income tax.

Companies like Accenture still have U.S. operations, and their U.S. subsidiaries pay tax to the IRS on all U.S. income. This certainly will be the case with Accenture's Illinois-based U.S. subsidiary. However, because the parent company is based in a jurisdiction with better tax laws, it avoids paying the punitive U.S. corporate tax rate on non-U.S. income. This is simply a smart business decision, which protects the interests of both workers and shareholders. In no way does this practice of having parent companies based in low-tax jurisdictions threaten America's homeland security.

## Getting Homeland Security and Trade Right

Applying protectionist policies for the sake of homeland security would stifle innovation and increase costs—working against the goal of getting the best security (and the best value) for the dollars invested. Where the contract is fulfilled—whether in Boston, Britain, or Bermuda—does not necessarily add or detract from the end goal of obtaining safe and secure services. More important are the safeguards in the contract. The federal government should ensure that its contracts outline stringent security and data protection requirements. It is imperative that the government award contracts to companies that both meet those security standards *and* possess the expertise to complete the projects. In general, it should insist that contract work is conducted in countries that have a cooperative relationship with the United States across a broad spectrum of security initiatives, including:

- Harmonization of security requirements and acquisition processes;
- Security of supply;
- Export procedures;
- Security of information;
- Ownership and corporate governance;

- Research and development;
- Flow of technical information; and
- Security of trade.[50]

Additionally, both the federal government and the private sector have the responsibility to perform "due diligence," ensuring that services are being provided under conditions consistent with the rule of law and good management and security practices. These criteria, rather than geographic location, are the best guarantor of getting good value and good security. Improving homeland security is a vital national priority. Better security should not be sacrificed in the name of an emotional debate about outsourcing.

The homeland security "argument" against outsourcing and corporate inversion is a red herring. Instead of implementing protectionist measures that would harm the economy and impair national security, we should be exploiting the benefits of free trade to strengthen the nation.

## Rising With the Tide

It is asking a lot to follow Kennan's advice and have the "courage and confidence" to steer the steady course. Nowhere is the challenge greater than in guiding the U.S. role in the world economy. A prescription of sticking to a steady diet of free trade may sound like an all-too-simplistic answer to a complex challenge, but it is most assuredly not. Speaking of war, Clausewitz wrote that in any conflict, "Even the simple is difficult." His maxim applies to global economic policy just as well. While free trade is the right answer, it is a tough task to remain true to its principles. There is, however, no better option. Free trade is a vital component of winning the long war.

The next steps will be difficult. The United States must rebuild the momentum for free trade agreements. America must promote the practices that will lead the developing world to grow their own economies and join as solid partners in the task of creating the global security regimes needed to fight terrorists. Finally, we must fight off the impulses of protectionism that appear to axiomatically accompany any downturn in the business cycle.