

ECONOMIC REFORM AS A SECURITY STRATEGY

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In both the United States and Israel, sound economic policy has been a political casualty of the demands of intense military and security mobilization. But robust, growing, resilient economies have been critical to success in long-term security confrontations in the past—and they are likely to be of even greater importance in the war on terror.

A Generational Commitment

The new epoch of international politics crept up insensibly in the 1980s and 1990s, in the form of intermittent terrorist attacks on American and Israeli targets, and then revealed itself with tremendous violence on September 11, 2001. We are calling it the "war on terror" for the time being, awaiting a name like the previous "Cold War" that more fully captures the epoch's essential circumstances. But we already know what those circumstances are.

First, a nihilistic political movement, combining modern totalitarian ideology with a radical interpretation of Islam, has emerged from the misery of the failed Arab-Muslim societies.¹ Second, modern science, technology, and organizational methods have made it possible for small, cohesive groups to operate with a high degree of anonymity and massacre large numbers of people by surprise.² The radical Islamist movement is employing these methods, often in collaboration with secular or theocratic dictatorial states, to mount terrorist attacks on civilian populations. The movement's immediate goal is to demoralize the societies of the Free World, including those of Arab and Muslim nations (most prominently Iraq) that are adopting free and pluralist political institutions. Its intermediate goal is nationalist—to destroy Israel and drive the United States from the Middle East; and its ultimate goal is messianic—to replace Western "infidel" civilization with Islamic civilization.

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These circumstances suggest that we have indeed embarked on a new epoch—a "generational commitment," as President Bush's national security adviser, Condoleezza Rice, has put it—rather than a short-term security problem with immediate solutions and a clear end-point. So far, the war on terror has consisted of (1) identifying terrorist leaders, hunting them down, and killing or incarcerating them; (2) deposing governments that have provided terrorists with material and diplomatic support and bases of operation; and (3) keeping terrorists away from civilian populations—with elaborate security procedures at borders, airports, and commercial centers in the United States and Israel, and in Israel also with a physical fence. But these responses, while necessary, will not be sufficient. Hunting down individuals across the globe is very difficult, and the pool of replacement terrorists is very large. The number of potential terrorist targets is equally daunting. Military action against complicit governments is feasible only in limited circumstances. Highly lethal technologies of destruction and radically disaffected social movements are long-term rather than transitory conditions.³

The war on terror, like the Cold War, will require new kinds of military, intelligence, and diplomatic action and new adaptations in politics and public opinion. All of this will take many years, but some of the requisite changes have already begun:

- At the level of public opinion, the most recent Palestinian *intifada* has produced a conspicuous change of Israeli attitudes from the Oslo years of the 1990s, when many Israelis believed that their nation might with little effort become a placid Netherlands of the Mediterranean. Since September 11, American public opinion has also changed. The American Civil Liberties Union sees harbingers of totalitarianism in new security precautions—that suspected terrorists should be held without conventional legal rights, that lodgers should have to show photo identification to hotel clerks, that librarians might have to show patronage records to the FBI. But most Americans accept these and other impositions, and they would surely accept, indeed demand, many more following another major terrorist attack.

- At the level of military doctrine and strategy, President Bush has propounded a new National Security Strategy and a "Bush Doctrine" of preemptive military action against states posing imminent threats.⁴

- At the level of military organization and planning, the Pentagon is shifting from army-to-army war-fighting to global counterinsurgency—emphasizing mobility, flexibility, decentralized command-and-control, and extemporary collaboration with local military and civilian allies.⁵

- At the level of diplomacy, President Bush has articulated a new set of policies for promoting political and economic freedom in the Arab-Muslim world and in Iran, essentially reversing U.S. "stable-dictatorship" policies pursued since the late 1940s and still favored by our Department of State.⁶ Apart from the singular case of Iraq, these policies have yet to be coupled with immediate actions aimed at the Arab and Iranian dictatorships that are obviously promoting and financing terrorism here and now. But in themselves the "Arab Freedom" initiatives are far-sighted and probably essential; one hopes that the State Department will permit them to move beyond the talk stage.

Security Mobilization and Economic Freedom

An aspect of our new circumstances that has received less attention than it deserves is the problem of domestic economic policy in a time of prolonged security mobilization. The twentieth century witnessed two world wars, several major regional wars, and a forty-four-year Cold War. It also witnessed unprecedented growth in the size and scope of government—not only (of course) in the Communist world and in the nations that embraced less totalitarian forms of socialism, but also in the liberal democracies of Western Europe, North America, and Australia. Throughout the century, the size of government was strongly correlated with military and economic success: The nations where government grew the least, and where economic freedom remained the greatest and private market organization the most pervasive, won the major hot wars and the Cold War and were the most dynamic and prosperous nations at century's end.⁷ Largely for these reasons, the socialist dream has died almost everywhere, and the "social democracies" such as Germany are struggling to reform politically entrenched, economically enervating programs of industrial regulation, income transfer, and heavy taxation.⁸ The only serious holdouts are a few Communist relics such as North Korea and Cuba and most of the nations of the Middle East.

This pattern may seem to suggest that domestic economics will be no problem at all in the new epoch. The Arab-Muslim nations that are the sources of radical Islamism and terrorism are very poor and backward economically; their pockets of great wealth consist mainly of *rentiers*, not entrepreneurs, and they have squandered their oil wealth rather than investing it in productive human and physical capital. Their major target, the United States, experienced the least government growth during the past century and is today the world's richest and most "market-oriented" nation. Economically, the nations of the British Commonwealth, Europe, and Japan are much, much closer to the United States than to the Arab states and Iran. Although Israel remains mired somewhere between European-style social democracy and outright socialism, and its economic performance has been poor since 1973, it is much freer and much wealthier than its Arab neighbors, including Saudi Arabia (only two small Gulf states, U.A.E. and Qatar, exceed Israel in per capita GDP). On the scores of economic wealth and large and dynamic private sectors, the Free World possesses immense and seemingly invincible advantages over the Terrorist World.

It would be prudent, however, to take a less sanguine view of the matter. One of the most remarkable features of the new epoch is that organizations such as al-Qaida and Hezbollah, which are socially and economically primitive, are nevertheless able to assimilate and deploy modern technology and organizational methods successfully. Unencumbered by the bureaucratic sloth and economic perversities of the Communist and socialist states, the most proficient terrorist groups are themselves fiendishly "market-oriented" and entrepreneurial. They excel at informal contracting, joint venturing, extended networking, global financing, and the securing of favors from friendly governments, all with a high degree of discretion and confidentiality. In operations and tactics, they borrow from the West's civic and commercial freedoms with the purpose of disrupting and undermining those freedoms.

And the battlegrounds of the new war are the homelands—the civil societies, economies, and political systems—of both combatant civilizations. As the Islamists attempt to penetrate and demoralize the West, the West will attempt to penetrate and remoralize the Arab and Persian Middle East. Our success at promoting the institutions

of private markets and economic growth in the homelands of terrorism will depend to a significant degree on our maintaining those institutions in our own nations, both as exemplars and as engines of trade.

These circumstances suggest a more profound relationship between domestic economic policy and international security policy. An analogy may be drawn from the need for new military strategies. Terrorism and "asymmetric warfare" have not made the West's traditional advantages in army-to-army war-fighting obsolete; rather they have made it necessary to extend those advantages with other, more subtle and flexible techniques. Nor have terrorism and "asymmetric freedom" made the West's traditional advantages in economy-to-economy output and dynamism obsolete; rather they have made it necessary to extend and deepen those advantages. Over the long run, our initial defensive expedients—such as imposing new government surveillance and controls over communications, transportation, finance, and other aspects of commerce—will be less important than extending our offensive advantages—our market-driven capacities for continuous innovation, spontaneous adaptation to changing circumstances, and resiliency in the face of unexpected reversals.

Moreover, the twentieth-century record suggests that maintaining economic freedom and robust private markets in times of war presents special difficulties. War and military preparedness have always been a drain, sometimes an enormous drain, on a nation's economic resources; in modern democratic times they may also prompt other forms of government growth that are economically stultifying. There is a respectable school of thought that the twentieth century's wars were an important *cause* of the growth of government in the Western democracies. The argument is that each war brought large increases in government spending and economic controls that were rolled back somewhat, but not all the way to the *status quo ante*, when the war was over. For one reason or another—because new bureaucracies became entrenched during the war or because the public had accommodated itself to bigger government—there was a "ratchet effect," with each successive war yielding a new and higher baseline for further public sector growth.⁹

The War Theory of Government Growth (I am taking liberties here—in its full form the theory covers other public crises, such as the Great Depression, as well as wars) is not uncontroversial. A contending view holds that the recent growth of government has not been episodic but rather evolutionary—the consequence of broad social trends such as increasing economic equality, the emergence of an educated middle-class, and falling costs of government administration.¹⁰ In this view, increased taxing and spending has been a response to the demands of modern electorates which are at once (a) educated and wealthy enough to be adept at using the political process for the benefit of various social, regional, and occupational subgroups, and (b) large and homogeneous enough to have ameliorated the social conflicts that prevented governmental growth in earlier eras. This may be called the Sweden Theory of Government Growth, after one of the several nations that were uninvolved in the twentieth century's major wars but nonetheless established very high rates of taxation and an abundance of programs of social insurance, income redistribution, and economic regulation.

The War Theory and the Sweden Theory point to different tendencies in modern politics. The War Theory sees war and other crises as the occasions of perdurable increases in governmental claims on the private economy, while the Sweden Theory emphasizes the continuous peacetime competition of political groups to gain economic advantages through government regulation and redistribution. The two theories are not, however, mutually exclusive: one can see both tendencies operating in tandem to promote governmental growth, as I will suggest later in this paper. The theories are also incomplete. After all, the United States is a supremely prosperous, egalitarian, middle-class nation, and it did most of the heavy lifting during the extended political-military mobilization of the Cold War—and it is where government has grown the least.

In a brilliant recent book, *In the Shadow of the Garrison State: America's Anti-Statism and Its Cold War Grand Strategy*,¹¹ Aaron L. Friedberg argues that America's "anti-statist" political ethos—our preferences for personal freedom, low taxes, free trade, and a growing consumer economy—explains our success in resisting excessive governmental growth during the Cold War. And Friedberg shows that these

preferences, which were widely regarded as weaknesses vis-à-vis the Soviet Union, turned out to be critical strengths. Although military challenges as grave and prolonged as the Cold War had produced "garrison states" in other societies, this never happened in the United States. American political leaders promptly lifted economic controls following World War II despite a looming new military threat and worries over a revived Depression; thereafter they consistently resisted "military protectionism" and required the Pentagon to depend on the private sector for its material needs and to compete for budget resources with manifold domestic priorities, including tax reductions to accommodate private investment and consumption.

These policies yielded high rates of economic growth and technological innovation, and equally important capacities of social resiliency and dynamism, that eventually overwhelmed the lumbering Soviet juggernaut. The period of the late 1960s and 1970s was the exception that proved the utility of U.S. anti-statism: President Johnson's "guns and butter" policies—combining a major foreign war with the "Great Society" and other expensive domestic spending initiatives—contributed to a decade of high inflation, low growth, social division, declining military budgets, and a succession of Communist victories. Then, of course, anti-statism returned in full force in the 1980s with the election of Ronald Reagan. By decade's end the Soviet Union was no more. But the Vietnam–Great Society period is a useful cautionary for our own period that, as we shall see, resembles it in important respects.

Friedberg's study does not disprove the War Theory of Government Growth. Rather it demonstrates how powerful are the centralizing, regimenting forces unleashed by the demands of military mobilization—and what powerful opposing forces are required to hold them in check. During the Cold War, the opposing forces came from America's libertarian political ethos. The resistance to bigger government was not a matter of deliberate strategy; indeed it appeared to contemporaries to be a serious strategic impediment rather than an advantage, and it faltered during one critical period. The question now is whether the resisting forces will remain sufficiently strong in the course of a prolonged war on terror with different characteristics than the Cold War, and whether they might be summoned in nations with different political traditions.

The United States

In the United States, government expenditures and regulation unrelated to defense and homeland security have grown dramatically since September 11, a period when the Republican Party has controlled both houses of Congress and the White House for the first time in a half-century. Short-term measures of government spending are notoriously slippery, and measures of government regulation are even more problematic, but the following shreds of evidence provide a fair picture of recent developments:¹²

- U.S. domestic spending on discretionary, non-security programs grew by 15 percent from 2001 through 2003 and is projected to grow at an even higher rate in 2004; it will probably grow by at least 25 percent in the course of President Bush's first term. This expenditure category excludes national defense, homeland security, September 11-related programs such as victim compensation and physical rebuilding, and domestic "entitlement" spending such as Social Security and Medicare. It includes such things as education programs, unemployment benefits, general grants to state governments, and a variety of energy, agricultural, commercial, and regional-development subsidies. Post-September 11 spending of this sort has been growing at a much faster rate than during the Clinton administration in the 1990s.

- The growth of domestic non-security spending contrasts with *reductions* in domestic spending during World War II (1940–1945) and the Korean War (1950–1953). Domestic spending grew, and at an even faster rate, only during the height of the Vietnam War (1965–1971)—recall Friedberg's argument. Total federal spending now exceeds \$20,000 per household (in 2003 dollars) for the first time since World War II.

- President Bush recently (December 8, 2003) signed a major expansion of the Medicare health insurance program for older Americans, adding a prescription-drug benefit and extending federal regulation of the health care sector in many important respects. Unlike the original 1964 Medicare legislation and previous expansions of its benefits, the new legislation includes no taxes to cover its costs. According to careful analysts, the new legislation adds at least \$10 trillion to the federal governments net (i.e., unfunded) liabilities and is likely to lead to price controls on covered

pharmaceutical drugs (just as the existing program has led to price controls on hospital and physician services).¹³

- Government regulation of financial markets, energy markets, accounting services, and management-shareholder relations in public corporations has also expanded dramatically. A new independent agency has been created to regulate accounting standards, with unilateral authority to set and collect taxes on all publicly held U.S. corporations. In the critical telecommunications sector, deregulation initiatives of the Federal Communications Commission have been countermanded by the Congress, and the FCC and state regulators are considering new restrictions to slow the growth of dynamic technologies such as Internet telephony. These developments constitute a sharp reversal of the steady abolition of New Deal-era regulatory controls during the previous twenty-five years.¹⁴

- U.S. leadership in trade liberalization—a critical component of post-World War II reconstruction policies and Cold War strategy and a bi-partisan issue in U.S. politics for more than fifty years—has essentially collapsed. Although the Bush administration has advanced several proposals for regional free-trade pacts and multilateral liberalization, these initiatives have foundered over rancorous U.S.-European and U.S.-Latin American trade disputes, efforts to condition free trade on "harmonization" of domestic environmental and labor standards, and the Bush administration's own imposition of restrictions on steel imports.¹⁵ In the primary campaigns for the Democratic Party's 2004 presidential nomination, all of the major candidates have been forthright protectionists, a sharp departure from the free-trade policies of Bill Clinton and his Democratic predecessors. Today, there is a bi-partisan consensus of sorts that the growth of the Chinese and Indian economies is harming the U.S. economy; how will America react if the Arab Freedom initiatives succeed and the Arab-Muslim nations, too, begin to prosper?

These developments have not come about because of any pronounced change in Republican Party doctrine. To be sure, President Bush campaigned for office as a "compassionate conservative"—a slogan intended to balance traditional limited-government principles with greater concern for the poor and minorities. Long before

September 11, he favored a Medicare drug benefit and a larger federal role in education than his Republican predecessors. But his pre-war initiatives entailed vastly less expansion of federal spending and regulating than has since come to pass, and they included many market-based reforms that have since fallen by the wayside. And his proudest domestic policy achievement remains his vigorous campaign for tax reform, yielding two major reductions in personal, corporate, and estate taxation, one enacted in 2001 before the terrorist attacks and the second in 2003. President Bush was and still is a strong conservative on matters of government spending and regulation, and he enjoys strong support in the House of Representatives, whose Republican majority was and still is the most anti-statist House majority in more than a half-century.

The best explanation for the across-the-board surge in government activity is the necessities of government mobilization that followed the attacks of September 11. Three forces seem to be at work:

- First, the attacks, and the civil and military responses to the attacks, have increased the popular prestige of government, subduing for the time being the libertarian, anti-statist impulse in American politics.¹⁶

- Second, the political and managerial demands of the counter-terrorism campaign have absorbed most of the reservoirs of leadership of the President and his senior aides. In peacetime, domestic spending and regulating are shaped by the pressures of innumerable narrow interest groups—farmers, teachers unions, business firms, environmental groups, etc., etc., each extracting a subsidy here, a regulatory advantage there. The natural, eager-to-please forums for such groups are the government's special-purpose institutions: the congressional committees and the administrative and regulatory agencies of the Executive Branch. Asserting the public interest over the multitude of parochial claimants that collectively threaten it requires, in the American system and probably all political systems, leadership from the top. George Bush's two tax-reduction campaigns succeeded only by dint of tremendous personal effort and the time and energy of his senior officials. But since September 11, the President and the White House have been preoccupied with other things: the military campaigns and subsequent political problems in Afghanistan and Iraq, nuclear threats

from Iran and North Korea, a succession of domestic security emergencies, and other incidents of the war on terror. Little time has remained for domestic policy leadership; Congress and the bureaucracies have been left to their own devices.

- Third, emergency mobilization is more than absorbing: it requires positive accommodation to many interest groups and legislators. When the President is adamant to secure a law or appropriation, whether a tax reform bill or an appropriation for rebuilding Iraq, everyone in Washington knows it. To get what he wants, a President must acquiesce in much that he regards as incidental or even obnoxious; the price of necessary legislation includes the building of many unnecessary dams and other pork-barrel projects.

Notice how these circumstances conjoin the political tendencies emphasized by the War Theory and the Sweden Theory of Government Growth at a time when the countervailing, anti-statist animus emphasized by Aaron Friedberg is in abeyance. The terrorist attacks were against American civilians on American soil, and much of the immediate response was the work of civilian authorities. This has generated popular appreciation for government in general, not just the armed services. At the same time, the threat of successive attacks has been relatively abstract and shrouded—certainly as compared to the all-out war following Pearl Harbor and to the Cold War years when the Soviets and Chinese were regularly detonating nuclear weapons and invading neighboring nations. This has dulled the spirit of patriotic sacrifice that accompanied past mobilizations; indeed, Bush administration officials have exhorted their countrymen to continue traveling, shopping, and going about their business, unintimidated by the terrorist threat. If citizens are to continue their peacetime consuming ways, why not Washington politicians and interest groups as well? The upshot is "guns and butter"—not from deliberate calculation, as during Vietnam, but as the unintended consequence of ad hoc adaptation to new political circumstances.

Israel

Israel is a singular case in many respects. Its political heritage is explicitly socialist and it would probably look something like Sweden even if it had not lived in a continuous state of siege for its entire existence.¹⁷ It attracts, and fails to attract, foreign investment

and immigration for reasons that go beyond conventional economic calculations— attracted by religious and cultural allegiance but discouraged by fear of war and violent loss. Many Israelis believe, rightly or wrongly, that their national survival depends on heavy public and private financial support from the United States and elsewhere; this has not bred a culture of dependency anything like that currently on sickening display in South Korea, but it has certainly produced a certain lassitude regarding the politically difficult tasks of domestic policy reform. Finally, being surrounded by mortal enemies in a continuous state of war, hot and cold, Israel has had to divert enormous resources to military, intelligence, and domestic-security needs and has been deprived of the surest source of wealth to a small nation rich in human resources, which is gains from specialization and trade with its neighbors.

But for all of these unique and melancholy constraints, Israel's potential for unilateral economic policy improvement is tremendous.¹⁸ The government's direct claims on the private economy are extraordinarily high: personal tax rates exceeding 50 percent of income for much of the middle class, a corporate earnings tax of 36 percent, a value-added tax of 18 percent on goods and services, very high customs duties, government spending of 55 percent of GDP, and government employment of one-third of the workforce. Israel's highest income tax rates are clearly on the right, downward-sloping side of the Laffer Curve (which plots government revenues as a function of tax rates); this means that tax-rate reductions would *increase* government revenues, a simple and unproblematic step toward more controversial cuts that would reduce the government's take but increase the prosperity of the total economy. And Israelis are as over-regulated as they are over-taxed. Their economy is viced by a profusion of state-sanctioned monopolies—economic toll-gates extracting daily tribute from every citizen, more from the poor than from the rich, more costly and dolorous than the nation's many physical check-points. Israel's inbred, uncompetitive financial sector misallocates capital on a grand scale and bears a heavy share of the blame for its recent, Japanese-style economic depression.

Although Israel made several improvements in monetary, fiscal, and foreign-exchange policy following the economic crisis of the mid-1980s, it has lagged far behind

other, comparable nations in privatization, de-monopolization, tax reform, and spending restraint. Consider a single policy comparison with Ireland. In 1992, Ireland looked pretty much like Israel: both nations taxed corporate income at a rate of 40 percent and personal income at similar rates (Ireland's top rate was 48 percent, Israel's a bit over 50 percent), and the average incomes (per capita Gross Domestic Product) of their citizens were about the same—\$15,700 in Ireland and \$14,300 in Israel. Then, in the mid-1990s, Ireland embarked on an aggressive program of tax reform, focused on reducing corporate taxation. By 2002, it had slashed its corporate tax rate to 16 percent, while Israel's still stood at 36 percent (and Ireland had reduced its highest individual tax rate to 42 percent, while Israel's was still 50 percent). The result was a boom in capital investment in Ireland that generated large increases in labor productivity and large increases in the wages of Irish workers. Average income in Ireland had soared to \$30,200, while that in Israel was a stagnant \$16,800: in one decade, the Irish had nearly doubled their incomes while Israeli's incomes had grown only 18 percent. From a position of near parity, the Irish had become nearly 80 percent wealthier than the Israelis. And, not incidentally, the Irish government's revenues from the corporate tax had surged as well, growing more than 50 percent faster than her rise in GDP.¹⁹

This is just one example of Israel's abundant opportunities for economic reform, which would greatly increase her security as well as domestic welfare. Why has she failed to seize them? The explanation, I suggest, lies in political circumstances that are extreme forms of those operating in the United States since September 11:

- First, Israel's political ethos is strongly communitarian—the opposite of the individualistic, anti-statist ethos that is usually very strong in America although in recession during the last two years. Socialism, as an explicit creed, long ago lost its motivating power over (most of) Israel's political, commercial, and intellectual leaders. But the ethic of collective provision and social solidarity remains; and to Israelis, probably more than to any other people, the sense of patriotism is tied not to the land or society or a "way of life" but to the state itself. Where interest-group machinations or political contingencies create pressures for government growth or impediments to

government reform, Israel's political traditions and popular inclinations provide not countervailing pressures but rather reinforcement.

- Second, Israel's citizenry is highly educated, articulate, and politically engaged, and is highly homogeneous in two important respects—religious heritage and aggressively hostile neighbors. To be sure, income distribution is less equal than in the European nations (it is more like that of the United States, with greater extremes of wealth and poverty), and recent waves of immigration have produced a rather polyglot population and some sharp social conflicts. But as a general matter Israel exemplifies the refined, all-in-the-family social circumstances that adherents of the Sweden Theory have identified as conducive to high taxing, high spending, redistributive government.

- Third, Israel's political leadership is absorbed, indeed obsessed, with extreme, ever-present security threats. To a degree that few outsiders can fully appreciate, Israeli politics is consumed by the brutality, complexity, and mortal risks of the Israeli-Arab conflict. In the words of British historian Paul Johnson, "By one wrong decision, an Israeli leader cannot only lose the war in one afternoon, he can lose half the Jewish people too. This helps to explain why the Israeli elite is hagridden with anxiety, obstinate, and often closed to argument."²⁰ The gravity of her circumstances leaves Israel's leaders with little time, energy, or political capital to devote to domestic issues. At the same time, the idiosyncrasies of Israel's constitutional system, which provides disproportionate power to marginal political groups, obliges her leaders to accommodate the demands of a profusion of political factions and economic interest groups—much more so than in most other parliamentary systems or in presidential systems such as that of the United States.

The career of Israel's premier economic reformer, Benjamin Netanyahu, dramatizes the problem. When elected prime minister in 1996, he was determined to devote himself to economic policy reform, but after a brief initial flurry he became almost completely absorbed by the demands of Israeli-Palestinian military, security, and diplomatic issues for the remainder of his three-year tenure. And even in his current position as finance minister, where he has single-handedly led the boldest campaign for policy reform in Israel's history, he has been repeatedly distracted. [At the December

2003 Herzliya Conference, where this paper was presented as a talk, Minister Netanyahu's one-hour presentation, billed as an address on budget priorities and economic reform, was devoted almost entirely to the latest exigencies of the Arab-Israel conflict.]

I argued in the previous section that, in America, the security preoccupations and mobilization needs of national political leaders have been the proximate cause of the surge of government spending and regulating since September 11. In Israel, these needs and preoccupations are a permanent condition. The leaders of Israel's unions, banks, and other interest groups understand the condition all too well.

It is difficult to envision a path to economic policy reform in Israel that does not involve a fundamental shift in public opinion. Perhaps in time the Shalem Center and the Israel Center for Social & Economic Progress will persuade Israelis that the most productive kind of communitarianism is based on voluntary cooperation rather than state coercion. As a first step down this road, reformers might consider the principle of competition. Since their social emancipation in the mid-nineteenth century, Jews have excelled at precisely those occupations characterized by unbridled competition and relative freedom from government control: finance; medicine, law, and other professions; science and other academic disciplines; and the performing arts.²¹ To be sure, the choice of unregulated, human-capital-intensive pursuits was expedient—a strategy for making headway in societies where discrimination was still pervasive and sanctioned. But the pursuits themselves have produced a practical appreciation, even zest, for the virtues of competition that might with a little rhetorical effort be adopted for policy argument.

In the United States, as in Israel, popular appreciation for the virtues of competition is much more widespread than appreciation for the virtues of “the private market” or the principles of economics. In recent years, our most important policy debates have become debates over competitive provision of public goods: competitive supply is the heart of our current controversies over school reform, health-care reform, and pension reform, and the grounds on which reformers are making the greatest headway.²² In Israel, the debates would begin with easier issues such as banking and

finance, food staples, energy, transportation, and communications, which are for the most part acknowledged to be jobs for the private sector rather than the government.

The Clash of Civilizations

But my purpose here is not to offer strategies for policy reform. I wish simply to call attention to the relationship between economic policy and security policy, and to warn that in our preoccupation with immediate threats we are neglecting a component of security strategy that has proven critical in the past and is likely to be equally important in the war on terror. It is often said that the Islamist radicals hate Western civilization not for its sins but for its virtues—the virtues of freedom and prosperity. They fear as well as hate us for these virtues, and we ought to take them seriously. As in epochs past, meeting the challenge that has been hurled at us will require not only playing to our strengths but augmenting them—taking our civilization to yet higher levels of practice.

Notes

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2 Martin Shubik, "Terrorism, Technology and the Socioeconomics of Death," *Comparative Strategy*, Vol. 16, No. 4, October-December 1997, pp. 399–414.

3 On the social ecology of religious terrorism, see James Q. Wilson, "Who Becomes a Terrorist?", *City Journal*, forthcoming Winter 2004, www.cityjournal.org.

4 *The National Security Strategy of the United States of America*, September 17, 2002, www.whitehouse.gov/nsc/nssintro.html; see also Thomas Donnelly, "The Underpinnings of the Bush Doctrine," *AEI National Security Outlook*, January 2003, www.aei.org/publications/pubID.15845/pub_detail.asp.

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10 Sam Peltzman, "The Growth of Government," *The Journal of Law & Economics*, Vol. 23, No. 2, October 1980, pp. 209–287; Allan H. Meltzer and Scott F. Richard, "A Rational Theory of the Size of Government," *Journal of Political Economy*, Vol. 89, No. 5, October 1981, pp. 914–927, and "Why Government Grows (and Grows) in a Democracy," *The Public Interest*, No. 52, Summer 1978, pp. 111–118. Recent contributions to this literature include James B. Kau and Paul H. Rubin, "The Growth of Government: Sources and Limits," *Public Choice*, Vol. 113, No. 3, December 2002, pp. 389–402; Christopher DeMuth, "After the Ascent: Politics and

Government in the Super-Affluent Society," Francis Boyer Lecture, American Enterprise Institute, February 2000, www.aei.org/news/newsID.11289/news_detail.asp, and "Why the Era of Big Government Isn't Over," *Commentary*, April 2002; and Gary S. Becker and Casey B. Mulligan, "Accounting for the Growth of Government," University of Chicago, November 1999, www.src.uchicago.edu/users/cbm4/account.pdf. Again, I am truncating these theories to simplify the exposition.

11 Princeton University Press, 2000. For a detailed historical study of American public opinion documenting the "anti-statist" attitudes emphasized by Friedberg, see Karlyn H. Bowman, "Attitudes toward the Federal Government," *AEI Studies in Public Opinion*, August 6, 2003, www.aei.org/docLib/200308071_government.pdf.

12 The propositions in the following two paragraphs are from Veronique de Rugy, "The Republican Spending Explosion," Cato Briefing Paper No. 87, March 3, 2004, www.cato.org/briefs/bp87.pdf, and recent analyses by Brian M. Riedl of The Heritage Foundation: "Omnibus Spending Bill Hikes Discretionary Spending by 9 Percent in 2004," Heritage WebMemo #385, December 16, 2003, www.heritage.org/Research/Budget/wm385.cfm; "\$20,000 per Household: The Highest Level of Federal Spending Since World War II," Heritage Backgrounder No. 1710, December 3, 2003, www.heritage.org/Research/Budget/BG1710.cfm; "Another Omnibus Spending Bill Loaded with Pork," Heritage WebMemo #377, December 2, 2003, www.heritage.org/Research/Budget/wm377.cfm; "Most New Spending Since 2001 Unrelated to the War on Terrorism," Heritage Backgrounder No. 1703, November 13, 2003, www.heritage.org/Research/Budget/BG1703.cfm.

13 See Joseph Antos, "Don't Ask, Don't Tell," *AEI Health Policy Outlook*, March 2004, www.aei.org/docLib/20040301_%2316424graphics.pdf; Joseph Antos and John E. Calfee, "Of Sausage-Making and Medicare," *AEI Health Policy Outlook*, January-February 2004, www.aei.org/publications/pubID.19765/pub_detail.asp; Joseph Antos and Jagadeesh Gokhale, "A Benefit That Is Bad for America's Health," *Financial Times*, June 20, 2003, www.aei.org/news/newsID.17782/news_detail.asp; and Jagadeesh Gokhale and Kent Smetters, *Fiscal and Generational Imbalances* (AEI Press 2003), www.aei.org/docLib/20030723_SmettersFinalCC.pdf.

14 Trends in government regulation are not amenable to numerical measurement, but the surge in U.S. economic regulation, and the collapse in the deregulation movement, are documented on the website of the AEI-Brookings Joint Center for Regulatory Studies, www.aei-brookings.org.

15 See Claude E. Barfield and James K. Glassman, "The Real Cancun," *The Weekly Standard*, September 29, 2003, www.aei.org/news/filter.all,newsID.19248/news_detail.asp.

16 See Karlyn H. Bowman, "America After 9/11: Public Opinion on the War on Terrorism, the War in Iraq, and America's Place in the World," *AEI Studies in Public Opinion*, March 5, 2004, www.aei.org/docLib/20040304_Terror05.pdf. For examples of "big government is back" political enthusiasm following the terrorist attacks, combined with an argument for resisting it similar to that of this paper, see Michael S. Greve, "Federal Power, Post-9/11," *AEI Federalist Outlook*, November 2001, www.aei.org/publications/pubID.13292/pub_detail.asp.

17 It is worth noting, however, that, consistent with the War Theory of Government Growth, public expenditures in Israel for domestic transfer payments and other purposes grew explosively in the years following the 1973 Yom Kippur War. See Avi Ben-Bassat, "The Obstacle Course to a Market Economy in Israel," Avi Ben-Bassat (ed.), *The Israeli Economy, 1985–1998: From Government Intervention to Market Economics*, MIT Press, 2002, pp. 1–58.

18 The studies and reports of the Israel Center for Social & Economic Progress and the editorial commentary of its director, Daniel Doron, in *The Jerusalem Post* and elsewhere—posted on the ICSEP web site, www.icsep.org.il—are excellent sources of information on Israeli economic and regulatory policy and reform initiatives. See also the striking essay of Daniel Polisar, "Death by Taxes," *Azure*, No. 15, Summer 5763/ 2003, pp. 23–32; the studies collected in *The Israeli Economy, 1985–1998*, *supra* note 14; and Yitzhak Sabato, "How Taxes Keep High-Tech Investors Away from Israel," Policy Study No. 51, Institute for Advanced Strategic and Political Studies, Jerusalem, November 2001.

19 The numbers in this paragraph are from an American Enterprise Institute database of international tax-rate and related statistics compiled from PricewaterhouseCoopers' *Worldwide Summaries*, the International Monetary Fund's *Government Finance Statistics*, and the OECD's *Revenue Statistics*. Irish and Israeli average income figures are in 1995 U.S. dollars. For an analysis of the global trend of reduced rates of taxation on corporate income, see Eric Engen and Kevin A. Hassett, "Does the U.S. Corporate Tax Have a Future?", *Tax Notes*, 30th Anniversary Issue, 2002, pp. 15-27, www.aei.org/docLib/20021222_raengehass0212.pdf. This study shows that Ireland's corporate tax revenues as a percent of GDP have been highly correlated with the corporate tax rate—higher rates have produced lower revenues, and lower rates have produced higher revenues.

20 "Israel on the Edge," *National Review*, May 6, 2002, www.aei.org/include/pub_print.asp?pubID'13859.

21 See Charles Murray, *Human Accomplishment: The Pursuit of Excellence in the Arts and Sciences, 800 B.C. to 1950*, HarperCollins, 2003, pp. 275–282.

22 Christopher DeMuth, "Competition as a Policy Principle," December 2003, unpublished manuscript on file with the author.