

## REVIEW &amp; OUTLOOK

## John Kerry, Supply-Sider?

Now that he's escaped the fever swamps of the Democratic primaries, John Kerry seems to be taking economics more seriously. His new plan at least admits that U.S. corporate taxation is a problem, even if in the end he'd make things worse.

The most pleasant surprise—even shock—is that Mr. Kerry is endorsing the idea that cutting tax rates can increase incentives to create jobs. Supply-siders have been saying this for years, much to the derision of most Democrats. (We accept their apology.) On the other hand, Mr. Kerry would cancel out most of this benefit with his increase in tax rates on individuals and dividends, not to mention with the fine print of his corporate tax reshuffle.

The central problem here is that U.S. rates are among the highest in the world. The U.S. is also one of the few countries to tax companies on profits made overseas. The stop-gap U.S. response has been a system of tax deferrals allowing companies to avoid paying tax on their foreign income until they repatriate it. Not surprisingly, this has locked up a pool of as much as \$639 billion in capital overseas. It has also opened companies and their CEOs to the accusation that they are "traitors" who are moving jobs overseas merely to enjoy tax breaks.

The best remedy would be to bring U.S. corporate taxes closer to global norms and restrict the scope of taxation to profits earned within U.S. borders. Mr. Kerry proposes something different. His cut in the corporate rate to 33.5% from 35% is hardly enough to eliminate the disadvantage faced by American companies abroad. Recognizing this, the plan allows companies whose foreign operations target foreign markets to keep the old tax breaks. But those companies producing goods or services for the U.S. market would lose their special treatment.

This would amount to a big tax increase on American companies. Effectively, this regime would give an advantage to a German BMW factory over a Ford factory located in Germany. The solution for many companies would be either to move their headquarters overseas so that they are no longer considered a U.S. company, or sell their overseas operations. The effect would be to speed up the very migration of business overseas that Mr. Kerry says he wants to stop.

Second, the Kerry plan would make the al-

ready complex tax code even more convoluted. As companies scrambled to increase the portion of their overseas businesses judged to serve foreign markets, the main beneficiaries would be tax lawyers.

But perhaps the biggest problem with the Kerry plan is that it would use up a windfall that should be used to fund the transition to a more sustainable tax system. Republicans have proposed a one-year tax "holiday" so foreign profits can be wired home after paying a bargain-basement rate of tax. This would bring in a one-time boost for government coffers and could offset the cost of reducing the corporate tax rate and starting a system of territorial taxation.

Mr. Kerry has instead adopted the tax holiday idea but earmarked the money for corporate welfare. His minor tax cut would be funded entirely from closing the "loophole" for foreign subsidiaries. So the money from the tax holiday would go toward a "New Jobs Tax Credit."

His idea is that the government would pick the "losers" of globalization, those industries where outsourcing overseas is prevalent, and subsidize them. Washington would waive the payroll taxes for new hires in those industries, as well as manufacturers and small businesses. Apparently this is the best the Kerry braintrust could come up with as a way to fulfill his promise of 10 million new jobs by 2009.

This attempt at industrial policy would introduce distortions too numerous to list here. It would encourage companies that do not have a comparative advantage to add workers in the belief that government handouts will continue. Meanwhile, a company that was doing well and would have expanded anyway would get an additional advantage over another that is struggling to avoid layoffs. The Kerry plan undermines the principle of tax equity—that is, that two companies earning the same profits and employing the same number of workers should be taxed the same.

If Mr. Kerry really wants to follow President Kennedy as a tax-cutting Democrat, he'd skip the corporate welfare and use all the revenue from repatriated profits to fund a bigger cut in corporate tax rates. JFK understood that the best way to promote new jobs without creating perverse incentives is to lower marginal rates. Now that he's accepted supply-side logic, perhaps Mr. Kerry will focus more on the details.

## Beyond Reasonable Doubt

Yasser Arafat's Palestinian Authority "is a collection of security gangs, a collection of corrupt leaders." No, this is not our own assessment, although we agree with it. These were the words of Palestinian journalist Wissam Raffidi, a few months after Arafat rejected the Clinton/Barak peace deal in January 2001.

Arafat's corruption and his involvement in terror have been widely documented by the IMF, the World Bank, investigative reports, and courageous Palestinians like Mr. Raffidi. Earlier this year, Palestinian journalists demonstrated against attacks on colleagues who dared to criticize Arafat's corruption and 400 activists of Arafat's own Fatah organization resigned in protest to his corrupt rule.

So the European Parliament's special committee tasked with looking into the EU's aid policy to the PA would not exactly have to go out on a limb to find some harsh words for the way aid funds have been disbursed to the PA. Tomorrow the lawmakers will have to rule on whether the EU should have given more than €200 million in direct budget to the PA. Unlike other aid, which is normally tied to specific projects, these funds carried the proverbial carte blanche; they went straight into the PA's coffers where outside monitoring was impossible.

Chris Patten, the EU commissioner for for-

eign affairs, has staunchly defended this policy. But his defense against charges that money may have been siphoned off or ended up in terrorists' hands was largely legalistic, arguing that "no evidence to that effect has yet come to light." But the commission's own anti-fraud unit said it couldn't "exclude the misuse of funds." After all, money is fungible. It appears to us that the evidence produced so far, such as Arafat's signature on checks to terrorists, should have been more than enough to stop sending millions of euros to a regime known for its corruption and links to terror.

While the new Palestinian finance minister, Salam Fayyad, has made some progress in rooting out corruption, huge problems still exist. For instance, the PA continues to pay the salaries of the security forces in cash. Typically, the local commander receives a stack of money to distribute to his troops. This way, Arafat makes sure his officers stay loyal to him.

And this is where the crux of the problem is. As long as Arafat remains in power, the system of corruption and terror will continue. But instead of gearing its foreign and aid policy toward removing Arafat, Europe still regards Arafat as the Palestinians' "legitimate" leader. Unfortunately, this applies also to most European lawmakers. This is bad news for European taxpayers and the Palestinian people.

## Bottom-of-the-Sea Treaty

The Law of the Sea treaty, deep-sixed long ago by the Reagan Administration, has resurfaced and is now steaming toward a ratification vote on the U.S. Senate floor. If it gets there, we hope that body will send it back to the bottom.

Launched by the United Nations in 1982, the Law of the Sea Convention was a grand scheme to create "an oceanic Great Society," we said at the time. The pact is designed to place fishing rights, deep-sea mining, global pollution and more under the control of a new global bureaucracy, with disputes adjudicated by a new world court. Twenty years ago the U.S. objections centered on the seabed mining provisions, which were aimed at making sure the Third World got its "fair" share rather than ensuring a free market. President Reagan decided the U.S. didn't need to be part of this global resource grab.

Today treaty proponents argue that the Reagan objections have been fixed. It's been ratified by 145 nations, with the U.S. one of the few holdouts. But the treaty's central flaw remains unfixable: It is not in the best interests of the U.S. to have its maritime activities—military or economic—subject to the control of a highly politicized U.N. bureaucracy. That was a bad idea in 1982 and it's even worse today, as we fight the war on terror. It's also a terrible precedent, especially as we do more in space.

The Navy and U.S. shipping industry support the Law of the Sea because it codifies traditional navigational rights such as the right of passage through international straits. But navigational rights already exist in the form of "customary" law. If this system somehow broke

down, the world's pre-eminent naval power shouldn't have trouble enforcing it. In any case, interpretation is better left to the U.S. than to a supra-national legal body.

In the Senate, the Law of the Sea's biggest booster is Richard Lugar, who pushed it through his Foreign Relations Committee in February after a hearing last year at which only supporters were invited to testify. This galvanized the opposition, and now other Senators are beginning to pay attention. The Environment and Public Works Committee held a more balanced hearing last week, and the Armed Services Committee is expected to hold one soon. The Defense Department has been asked to send someone to testify but is having a hard time finding anyone who wants to go on the record as supporting it.

The Bush Administration has painted itself into a corner on this one. After allowing itself to be led by the State Department, the Navy and environmentalists into backing the treaty, the White House is finding it hard to back down. After Iraq—and after rejecting the ABM Treaty and Kyoto—the last thing it wants is a public fight over an American boycott of another international treaty. A senior Administration official told us Friday that "the Administration fully supports the treaty."

The solution that seems to be emerging is for Republican Majority Leader Bill Frist to conclude that there's no room on the tight Senate calendar to bring up the treaty this year. If President Bush won't follow Mr. Reagan's example and sink the pact, we hope he'll at least let Mr. Frist maroon it.

## Spain's New Course

By Miguel Angel Moratinos

In the wake of the brutal attacks on Madrid on March 11, Spain has shown that it is a strong democracy, able to overcome the most terrible blow with maturity and vision. No one should doubt the strength of our political system or of our institutions. And no one should believe that the defeat of the ruling Popular Party was any sort of message to the despicable terrorists that they "have won." The true message—delivered by a sovereign people exercising their popular will—was that Spain wished for profound political change. This desire for change predated March 11. The events of that fateful day, and those that occurred immediately after—to wit, the irresponsible manner in which Prime Minister José María Aznar handled the flow of information to the public—only reinforced the people's electoral inclinations.

In the last few days I have read as many simplistic and overheated interpretations of the Spanish vote as I have calm analyses of what the change in Spain's government will mean for its foreign policy and for the country's security, for its obligations in the fight against terrorism and its role in Europe, and for its trans-Atlantic relations.

The new Socialist Party government of Jose Luis Rodriguez Zapatero will make important shifts. But let no one be misled: these shifts will mean, in most cases, no more than a return to the foreign policy that Spain had in place since 1979 and which always enjoyed wide national support. This shift will not be difficult to execute: in spite of its clear negative impact, the foreign policy of Mr. Aznar was based more in rhetoric than in effective action, and it has now been unambiguously rejected by the Spanish people. Europe, the U.S., Latin America and the Mediterranean—including the pressing need to resolve the conflict in the Near East—will be the focus of our foreign action. Now Spain will return to a more familiar foreign policy.

Our determination in the fight against terrorism—be it ETA's or al Qaeda's—is today stronger than ever. We owe it to the victims of March 11; we owe it also to all our citizens—including those of the future—who have a right to live free from threat. If a society permits itself to fall into fear, it only hands victory to the terrorists. But the response of the Spaniards, whether in the streets or at the polls, has been firm and dignified, not that of a fearful people.

The permanent threat of terrorism is a problem that concerns us all, one that by its very nature should unite, not divide, us. However, what many responsible politicians and many millions of our citizens are asking is whether the present configuration of priorities, and the methods used to counter this threat—above all the war in Iraq—helps us achieve our objectives.

The answer is no. The world today is less safe than it was a year ago, and we have reached the stage when we must all think deeply, and calmly, and adopt a new strategy to fight the plague of terrorism. As that old sage from Cordoba, Seneca, once said so well, there are no favorable winds for those who have no direction.

Spain will continue to be committed to international security, not only in helping to strengthen the U.N. and the cohesion of the Atlantic alliance (which includes a Europe capable of assuming its global responsibilities), but also in helping out—to the extent that our operative capacity allows—wherever the Security Council asks us to. Our troops will continue in the Balkans; and our commitment in Afghanistan, where a force under U.N. authority is waging an authentic fight against terrorism, will be enhanced in the next few weeks.

The Washington Post/ By Jackson Diehl

## Listen to the Arab Reformers

A much-anticipated summit of the Arab League, scheduled to begin today in Tunis, was abruptly put off Saturday, and for a remarkable reason: The kings, emirs and presidents-for-life of the Arab Middle East are unable to agree on a common response to the Bush administration's new policy of promoting democracy in their region. The younger and brighter rulers, knowing the stagnant status quo is unsustainable, are pushing a strategy of co-option, offering half-way, half-baked "reform" programs they have hastily drawn up. The less enlightened insist on sticking to the excuses that Arab dictators have offered the world for the past half-century: a) the first priority must be Israel, and b) foreign tutelage is wrong, except when applied to Israel.

The summit may now never happen; if it does, it will probably settle on a murky mix of these two responses. Either way, critics of the pro-democracy policy—in Europe, in Washington and inside the Bush administration itself—will again proclaim that a neocon attempt to "impose" democracy on the Middle East "from the outside" has fundered. That this resistance to elected government comes from a group of kings, emirs and presidents-for-life doesn't seem to trouble the critics. The assumption seems to be that the autocrats' objections are those of their own people.

Yet, they are not. The most underreported and encouraging story in the Middle East in the past year has been the emergence in public of homegrown civic movements demanding political change. Two years ago they were nonexistent or in jail. Now they are out in the open even in the most politically backward places in the region: Egypt, Saudi Arabia, Syria. They are made up not only of intellectuals but of businessmen, women, students, teachers and journalists. Unlike their governments—and the old school of U.S. and European Arabists—they don't believe that change should be gradual, and they reject the dictators' claim that democracy would only empower Islamic extremists. The delay of change, they say, is the increasing danger.

These people weren't created by George W. Bush. They are the homegrown answer to a decadent political order, and they ride a powerful historical current. But they will tell you frankly:

As for Iraq, Spain will cease to have "occupation forces" there on June 30, whether it is because the U.N., at the request of a legitimate Iraqi government, assumes authority and constitutes a new international force, or simply because our troops will withdraw. The decision will be coordinated with the other countries present in Iraq, and will have the support of the Spanish parliament. This was our firm electoral promise, a contract with our citizens that no terrorist can make us breach. The international reaction to the impending withdrawal of our troops, which comprise a mere 0.4% of all those stationed in Iraq, is clear proof of the fragile situation in that country. It suggests, also, that the present parameters of the military presence there need to be modified substantially. This change will not be a panacea for the enormous problems there, of course, but will contribute to the creation of a better climate both inside Iraq and outside it. The feeling is shared by a growing number of countries that decided to send troops.

Europe will also be at the core of our government's action. The debate over "new" and "old" Europe is banal. There is only one Europe, which faces the future with vigor, aware of its left and of its global responsibilities in the creation of a more secure world.

Spain wishes to participate fully in the construction of Europe. That means we must abandon divisive policies and diplomacy by letter. We will defend Spanish interests to the utmost, but always in a constructive spirit, based on a desire to help make compromises, not to impede them. Spain's ambition in the European Union will be achieved only through solutions that satisfy each and every member state; and we will be at the very heart of Europe, making common cause with those who seek to deepen the process of European integration. We trust that the positive dynamic created by the change in government in Madrid will influence the completion of a historic agreement on a European constitution in the next few months, perhaps even before the end of the Irish Presidency in June.

Another priority of the new Spanish government will be to work toward a strengthened trans-Atlantic relationship. I am convinced that the best sort of ally for the U.S. is not a weak one that, blindly and unconditionally supports American policy, but one that is strong and capable of frank dialogue, with its loyalty based on mutual benefit. During previous Socialist governments, the inevitable disagreements between Madrid and Washington never got in the way of the closest cooperation. The Transatlantic Agenda, which Spain authored during its EU presidency in 1995, is the basis of ties between the U.S. and the EU that go well beyond defense arrangements. Spain and the U.S. also cooperated closely in the democratic transition in Central America.

Now, as NATO allies, we need to continue to deepen our bilateral relationship, as well to establish a stable basis for dialogue and cooperation between the EU and the U.S. Europeans and Americans share values and common interests. We also share enormous responsibilities in the cause of creating a safer and wealthier world.

Spain's Socialist government will promote—jointly with our partners and friends—both an effective multilateralism and a respect for international law. Those are two principles shared by all Europeans, and are fundamental to our security strategy. And with this clear strategy—which will serve to combat the world's many threats, from hunger and poverty to weapons of mass destruction—Europe and the U.S. need to make common ground, working hand in hand.

Mr. Moratinos is the foreign minister-designate of Spain.



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## Afghanistan Needs Capital Not Aid

By Don Ritter And Mahmood Karzai

There's freedom in the air and music in the streets in Afghanistan. Kites are flying. Rausc traffic careens through Kabul. Goods of all colors have returned and small shopkeepers and merchants are selling them. Big money and technical assistance are flowing from donor nations into Afghanistan. Buildings, roads, water projects, clinics and schools are all rising from the rubble.

But the donor community focuses on assistance for public endeavors, largely infrastructure, not on private enterprise. Governments and so-called nongovernmental organizations do not create sustainable markets, businesses or jobs. Infrastructure alone does not an economy make; how the infrastructure is used by millions of people will define an economy. Only private enterprise can provide the creativity and broad-based work effort that leads to new wealth and job opportunities that can substitute for participation in militias, banditry and drug trade.

Today in Berlin, a conference of donor nations will meet to discuss a \$28 billion-dollar, seven-year aid package for Afghanistan. To complete the task begun when the Taliban was thrown out of power, some of that money should be earmarked for investment in the small and medium-size businesses that are badly in need of capital.

Big projects requiring big investments pose big risks to investors. They are also big targets that demand lots of security. The good news is that the risks for small and mid-size private-sector investments are far less, and they are widely distributed. There are Afghan businessmen and women, indigenous and from Europe, America and literally all over the world, willing and able to take them.

Public-sector-oriented donor agencies can overwhelm a budding private sector. With comparatively vast amounts of money and influence at their disposal, they drive up the price of food, housing, goods and services making the international banks, donor nations, the U.N. and others the highest bidders for human and material resources. One look at the prices in Kabul today will prove as much.

Donors set up expensive in-house operations to handle everyday tasks often better managed by the private sector. It can result in the kind of top-down economy controlled by elites that has failed the people in so many other developing nations.

Case in point: A U.N. operated airline, (which charges more one-way for the key entry and exit flight than the Afghan airline, Ariana, charges for the round trip), won't even fly businessmen because they are not registered as members of a U.N. certified NGO. Of course they're not certified NGO employees, they're businessmen. All they really want to do is invest in the country.

Combine the high-end customers of the U.N. flights with the rest of those traveling on the bare-bones national airline, and you have a more valuable property, ripe for private investment, with the potential for far better service.

The private sector must replace the present charity- and NGO-based economy of Afghanistan for the Afghan people to move beyond subsistence over the long term. Economic growth will never be the priority of NGOs, but it is the primary source of better lives for the Afghan people.

To start filling the gaping hole where a market economy should be, a portion of donor-nation funds should be made immediately available to the private sector. Commercial bank lending, venture capital, revolving loan or trust funds should all be established. Seeding private enterprises now will lead to credit worthy businesses later. Seed funds would amount to perhaps 10%-20% of total aid, but they just might be the most important part of the donor pie.

Afghans for their part need to establish rules of the game that are fair and transparent. Corruption must be pulled out at the roots. Donors must insist on it.

The conference that begins today in Berlin is the place to start the dialogue and get the ball rolling. We will be there. We will urge the participants to consider putting a defined portion of the \$28 billion in donor assistance being discussed into creating and expanding the private sector.

The people of Afghanistan would prefer not to end up like many developing nations, where far too much financial assistance was corrupted and squandered by governments in league with traditional elites. In too many places, foreign assistance actually worsened the economic conditions.

Although there can be a market economy without democracy (see China), there are no democracies without the decentralized power that comes with free and open markets. Building a market economy is a lot less expensive than battling the Taliban, al Qaeda or aggressors from neighboring states.

Indeed, building market economies in places like Afghanistan may just turn out to be the most important weapon in the long-term war on terror.

Former U.S. Congressman Don Ritter is vice chairman of the Afghan-American Chamber of Commerce (AACC) with 25 years of experience in Afghanistan. Mahmood Karzai is an Afghan-American businessman and AACC chairman.

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