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2017 Global Agenda for Economic Freedom

James M. Roberts and William T. Wilson, PhD, eds.

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2017 Global Agenda for Economic Freedom

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Foreword

The promotion of economic freedom at home and abroad is essential not only for a genuine and sustained revitalization of the U.S. economy, but also to strengthen U.S. national security. In 2010, the United States fell from the highest category of economically free countries (those with overall scores above 80) in the *Index of Economic Freedom*. It has been stuck in the ranks of the "mostly free," second-tier economic freedom category ever since.

In the 2016 edition of the *Index*, the U.S. came in at No. 11 on the list of 178 nations evaluated with a score of 75.4, down 0.8 points from 2015. The U.S. trails behind Hong Kong, Singapore, New Zealand, Switzerland, Australia, Canada, Chile, Ireland, Estonia, and the United Kingdom. Although it edged up slightly from its No. 12 ranking in the past two editions, America remains outside the Top Ten list of freest economies in the world.

Why? Mainly because of the size—and growing expense—of government. More than any other reason, America's decreasing economic freedom in the past decade is due to less fiscal freedom and more government regulation. For a country founded on the idea of limited government, this is an irony with tragic consequences.

Other factors have derailed American economic freedom, too, and my expert colleagues at The Heritage Foundation delve deeply into many of them in this collection of essays.

The message for Americans is to support policies—and policymakers who advocate them—that will avoid further decline, and create conditions for more economic freedom at home and abroad.

This edition of The Heritage Foundation's annual "Global Agenda for Economic Freedom" lays out a comprehensive series of actions for the U.S. government to take, mostly at home but also overseas, and offers Washington a blueprint for a practical and effective strategy to end stagnation and restart meaningful economic growth.

For example, American leadership can be decisive in promoting property rights and anti-corruption measures in other countries by taking high-profile steps at home to strengthen them. In addition, the 2017 Global Agenda urges the U.S. government to pursue more vigorously such agreements with countries around the world that will *reduce* barriers to trade and investment, as opposed to those that might only create additional regulatory hurdles to doing business. It also stresses the importance for all governments (including in the U.S.) to liberalize energy markets, revitalize bilateral and multilateral development assistance, and identify and reduce subsidies for state-owned enterprises that are especially toxic breeding grounds for cronyism and favoritism.

One of the highest priorities for the President of the United States who takes office on January 20, 2017, must be to put America back onto the path toward economic growth and greater shared prosperity by following the roadmap of recommendations contained in this Global Agenda.

—Ambassador Terry Miller

Introduction

The *Index of Economic Freedom* has been published annually by The Heritage Foundation since 1995. In the decades since, the world has witnessed profound advances in the cause of freedom. Open economies have led the world in a startling burst of innovation and economic growth, and political authorities have found themselves increasingly held accountable by those they govern.

Unfortunately, even before the 2008 financial crisis, the United States began to drift downward in the *Index* rankings—propelled by reckless government spending that spiraled out of control and led to unprecedented budget deficits.

The long U.S. slide has been marked by stagnant economic expansion and extremely sluggish employment growth. As Heritage Foundation Research Fellow in Labor Economics **James Sherk** has reported, more than seven years after the Great Recession officially ended, the U.S. economy is not out of the woods. Hundreds of thousands of Americans have *stopped looking* for work.

So, in this important election year, The Heritage Foundation is dedicating this edition of its annual "Global Agenda for Economic Freedom" to a detailed examination of the causes of the decline in Americans' freedom to start a business or earn a paycheck—and what the next Administration can do about it in 2017.

Drawing on the core principles of the *Index of Economic Freedom*, the "2017 Global Agenda for Economic Freedom" contains essays that analyze obstacles to the free flow of capital, goods, services, and ideas in the U.S. and around the world. It proposes a series of revitalizing policy measures essential to creating good new jobs for Americans. It also explains that it remains vital to promote economic freedom abroad, because U.S. companies and workers increasingly rely on international trade and finance to improve productivity and to build markets.

More American Jobs in a World with More Trade and Investment Freedom

International trade plays an increasingly significant role in the economies of the United States and other countries around the world. Thanks to U.S. leadership in the Uruguay Round trade talks, 123 countries collectively implemented the largest global tax cut in history and created the World Trade Organization in 1995 to mediate trade disputes. Trade disagreements that could have escalated into trade wars in the past are now moderated by impartial referees. With first the U.S.–Canada free trade agreement (FTA) in the 1980s, and then the North American Free Trade Agreement (NAFTA) in the 1990s, the United States initiated a healthy global trend toward freer trade.

As documented in the 2016 *Index of Economic Freedom*, however, the world is still plagued by protectionist measures, industry-specific subsidies, and excessive "enforcement" actions, such as antidumping and countervailing-duty regulatory measures, that reduce efficiency and competitiveness and diminish the prosperity of all nations.

All countries should resist these counterproductive policies. In this Global Agenda, Heritage Senior Analyst in Trade Policy **Bryan Riley** explains specifically how FTAs can reduce trade barriers and open new markets for American goods and services, while giving U.S. manufacturers access to high-quality inputs so they can produce more competitive products at lower cost. **William Wilson, PhD**, Heritage economist and Senior Research Fellow, examines in detail the challenges that now confront one of the world's largest trading economies—China.

Herbert and Joyce Morgan Fellow **Nicolas D. Loris** examines one of the most important of those imported production inputs—energy—and stresses the benefits of further liberalization of global energy markets.

In analyzing a growing threat to global trade, Heritage Senior Research Fellow for Regulatory Policy **Diane Katz** explains why export-financing subsidies, such as those provided by the U.S. Export–Import Bank, are unnecessary and distort the American and international economies.

In an economically free country, there are no constraints on the flow of investment capital. Individuals and firms are allowed to move their resources to and from specific activities without restriction, both internally and across the country's borders. To encourage investors, the U.S. government should refocus its development policy on trade and investment and vigorously pursue an expanded commercial agenda that makes investment in developing countries more attractive to investors, such as by establishing a broader network of bilateral

investment treaties or trade and investment framework agreements, and by negotiating double-taxation treaties that remove fiscal burdens from investment-oriented capital flows.

Efforts by the next Administration to pursue these goals will be enhanced by U.S.-led international policy coordination. An essay by **this author** explains how that can be achieved, in part, by downgrading the G-20 process, which has proven ineffective.

Another essay by this author discusses international financial system coordination and balance-of-payments supports—topics of vital importance to the maintenance of a global economy open to trade and investment—and argues that the International Monetary Fund (IMF) must return to basics by promoting rules-based monetary policies instead of bailing out countries that fail to follow that advice.

Needed for Economic Growth: Less Corruption, More Property Rights

Economists from Adam Smith to Milton Friedman have noted the crucial role of property rights as an engine of economic growth, on which the equally important development of a middle class depends. Establishing those property rights is step one for economic freedom.

For nearly every country on the globe, the *Index of Economic Freedom*'s "freedom from corruption" score is the lowest of the 10 indicators measured. Corruption is a perennial and difficult problem to address, yet it must be a top priority for governments hoping to create conditions favorable to economic growth and prosperity. The degree of corruption in a country is a good barometer of the strength of its judicial institutions and rule of law, both of which are strongly tied to how effectively a country protects private property.

Many countries' economic freedom scores would be substantially higher if not for the prevalence of government corruption. Yet the solution lies not in passing more anti-corruption laws, which can be corrupted in practice. In fact, too much regulation can reduce respect for the law, creating an environment for predatory behavior by the government or its favored cronies. Policy Analyst for Africa and the Middle East **Joshua Meservey** examines all of these issues in his essay on the impact of corruption on economic development in sub-Saharan Africa.

Lack of reliable property rights is a worldwide problem. The starting point for economic development, especially in lower-income countries, is greater agricultural productivity, which depends on secure property rights to land. These are absent in much of the world.

This *Special Report* includes several essays covering various dimensions of economic development challenges. **Brett D. Schaefer**, Jay Kingham Senior Research Fellow in International Regulatory Affairs, outlines a bold plan to review and update America's foreign aid programs.

Senior Policy Analyst **Anthony B. Kim**, Research Manager of the *Index of Economic Freedom*, makes the case for overhauling and refocusing the lending practices of the World Bank and its five sister Multilateral Development Banks. Finally, this *Special Report* includes an essay by this author describing how well-intentioned but poorly thought-out corporate social responsibility policies have made economic development harder instead of easier.

A World with Less Crony Corporatism and Fewer State-Owned Enterprises

The fact that a full chapter on state-owned enterprises (SOEs) is included in the proposed Trans-Pacific Partnership treaty is not an accident. Massively subsidized SOEs have been an issue in the United States and are an international issue that is steadily growing in importance, not least because of their dominance of the Chinese economy. Brazil has been backsliding in this area for several years. India has a set of poorly performing state firms associated with harmful government intervention in the economy, such as price controls. In Vietnam, underperforming SOEs are the main factor restraining development.

Diane Katz analyzes the global problems caused by SOEs in detail and calls for the next Administration to pursue a policy of retrenchment from SOEs at home and abroad.

When nations or rogue states pursue policies that are deliberately harmful, to themselves and to international security and commerce, they must be confronted. Senior Research Fellow for Northeast Asia **Bruce Klingner** outlines a sanctions strategy for the new Administration that can actually succeed by reining-in the troublemakers and enhancing global economic freedom.

Climate-change policies are another area where government decisions have created opportunities

for cronyism and rent-seeking that have harmed economic growth. Senior Research Fellow for Energy Economics and Climate Change **David W. Kreutzer, PhD**, recommends that the next Administration take immediate action to withdraw from the redistributionist and ineffective United Nations Framework Convention on Climate Change (UNFCCC). He also calls for the cessation of U.S. contributions to the U.N. Green Climate Fund.

An Agenda for Economic Freedom, at Home and Abroad

History teaches that the human spirit thrives on fairness, opportunity, transparency, and liberty. The downfall of the Soviet Union and the liberation of Eastern Europe are vivid reminders of this truth. The human spirit is the real wellspring of economic prosperity and enduring development, and that spirit is at its most inspired when it is unleashed from the chains that have bound it.

The fight for freedom necessitates perpetual vigilance. The false idols of socialism and collectivism in the name of social justice and equality are never short of deceptive emotional appeal. If they become touchstones of government policy, the unavoidable economic and social results are stagnation, deprivation, coercion, and even the gradual erosion of the rule of law.

The "2017 Global Agenda for Economic Freedom" offers the next President and the 115th Congress a blueprint—a global agenda—for a practical and effective strategy to promote economic freedom around the world and restart growth at home. Surely there can be few higher priorities.

—James M. Roberts

Reduce Trade Barriers and Open New Markets

Since the end of World War II, government-erected barriers to global commerce have been reduced significantly. Today, the average worldwide tariff rate is less than 3 percent, and it has fallen by one-third since the turn of the millennium alone. Thirty-eight countries have an average tariff rate of 1 percent or less. Unfortunately, global barriers to the free flow of trade and investment—such as non-tariff barriers and non-transparent investment regimes—grew during the Obama years. In particular, politicians here and elsewhere promoted shortsighted policies to restrict imports. The next Administration must correct these mistakes and open new markets.

Free Trade *Is* Fair Trade

Free trade can take place when governments do not limit or subsidize imports or exports. That means, for example, that Americans may spend their dollars on goods and services regardless of their country of origin and are free to engage without restriction in voluntary and mutually beneficial transactions, both as buyers and sellers, with people in other countries. In a time of concern about inequality and social fairness, it is worth pointing out that the freedom to trade leads to the fairest outcomes for producers (bigger markets) and consumers (lower prices).

As the results of the 2016 *Index of Economic Freedom* demonstrate, citizens of countries that embrace free trade are materially better off than those in countries that do not. The *Index* data show a strong correlation between trade freedom and a variety of positive indicators, including greater wealth, lower poverty rates, and cleaner environments.

Countries with low tariffs and fewer non-tariff barriers also benefit from stronger economic growth. Free trade policies do not just promote economic growth, however. They encourage personal freedom—including protection of private property rights and the freedom of average people to buy what they think is best for their families, regardless of attempts by special-interest groups to restrict those freedoms.

Polls consistently show near-unanimous support from economists for free trade. According to a 2014 survey by the Chicago Council on Global Affairs, 65 percent of Americans believe that "globalization, especially the increasing connections of our economy with others around the world, is mostly good for the United States." A 2014 Pew Research Center survey found that 68 percent of Americans believe that expanding trade and business ties with other countries is "a good thing." A 2015 Pew survey found that 58 percent of Americans believe that trade agreements have been "a good thing" for the United States.

Opening New Markets

Free trade agreements, such as the North American Free Trade Agreement (NAFTA), reduce barriers to trade between the United States and trade partners abroad. The advice of Ronald Reagan is as valid today as when he was President. Responding to calls for the U.S. to get tough on foreign governments by increasing U.S. trade barriers, President Reagan said: "When you hear talk about a tough trade bill, remember that being tough on trade and commerce, the lifeblood of the economy, will have the worst possible consequences for the consumer and the American worker."

Good trade agreements also encourage trading partners to play by the rules, provide a way for mediating trade and investment disputes, and avoid costly trade wars. In short, trade agreements increase individual autonomy for Americans by reducing U.S. and foreign trade barriers. The next President will inherit several proposed trade agreements, including the:

- **Trans-Pacific Partnership (TPP).** Current TPP participants are the United States, Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, and Vietnam. TPP negotiations were completed in October 2015, and member countries are currently reviewing the final product.

- **Transatlantic Trade and Investment Partnership (TTIP).** Negotiations for this agreement between the United States and the European Union are ongoing. A TTIP agreement that reduces barriers to trade and investment between the United States and the EU, thereby boosting trade freedom, would give individuals on both continents more purchasing choices. To be successful, negotiators must resist the temptation to create

new regulatory barriers to trade under the guise of "harmonization" that would in effect protect EU companies by increasing regulatory burdens on their U.S. competitors.

- **Trade in Services Agreement (TISA).** Service industries account for nearly 80 percent of the U.S. economy. In 2013, countries representing a majority of the world's services market launched the TISA negotiations, covering industries such as transportation, travel, communications services, construction, insurance, banking, and computer services. Numerous barriers currently interfere with the free flow of trade in services. For example, state-owned enterprises often restrict competition from foreign companies; many government policies are biased against foreign service providers; local ownership requirements require service providers to collaborate with local businesses; and data storage requirements force companies to store their data locally.

- **Information Technology Agreement (ITA).** In 2015, World Trade Organization members agreed to eliminate tariffs on more than 200 products that account for over $1 trillion in annual trade. Tariffs to be eliminated include those on semiconductors, GPS navigation systems, magnetic resonance imaging machines, telecommunications satellites, and touch screens.

- **Environmental Goods Agreement (EGA).** Australia, Canada, China, Costa Rica, the EU, Hong Kong, Iceland, Israel, Japan, Korea, New Zealand, Norway, Singapore, Switzerland, Taiwan, Turkey, and the United States are in negotiations to reduce trade barriers for environmental goods ranging from carbon-dioxide scrubbers to solar panels.

Free trade is a vital pillar of America's economic strength. As President Reagan reminded Americans:

> The winds and waters of commerce carry opportunities that help nations grow and bring citizens of the world closer together. Put simply, increased trade spells more jobs, higher earnings, better products, less inflation, and cooperation over confrontation. The freer the flow of world trade, the stronger the tides for economic progress and peace among nations.

Recommendations

The next Administration and the 115th Congress should pursue trade policies and agreements that promote economic freedom by reducing barriers to international trade and investment. They should also reduce self-imposed and destructive barriers to imports. Imports benefit U.S. consumers and businesses.

—Bryan G. Riley

Is the Chinese Model Past Its Expiration Date?

For the past three decades, China has rung up historic and record-breaking economic growth that placed it just behind the United States in terms of absolute gross domestic product (GDP).

During the financial and economic crisis of 2008 and 2009, Beijing implemented a $600 billion stimulus package (equating to 13 percent of GDP). That allowed China to breeze through the global contraction with 10 percent growth. With the U.S. mired in Depression-like conditions, some believed that the Beijing Consensus of state-led capitalism was set to eclipse the 1990s Washington Consensus of market capitalism. Now, with the great contraction seven years old, it is time to evaluate whether the Beijing model has had staying power.

China's Economic Model Today Resembles 1980s Japan

Both inside and outside China, there is great skepticism about the accuracy of many of Chinese macroeconomic indicators. There are significant reasons for this perception. First, it is highly likely that any government exercising such a significant role in managing the direction of an economy is manipulating official statistics. In a nation of almost 1.4 billion people, quarterly GDP figures are often released just 14 days after the end of the quarter— with no subsequent revisions being announced. In the U.S., by comparison, GDP figures undergo two revisions, sometimes significant, that span out 90 days after the first release. Meanwhile, the headline economic figures in China often conveniently match Beijing's political targets. That is because the reporting by the Communist Party of more accurate figures (thus admitting that the economy grew at only a 4 percent pace) could have caused a loss in confidence relatively early in the tenure of Xi Jinping.

Second, there are plenty of other inconsistencies. While GDP was reported to have grown at a rate of 6.9 percent in 2015, according to a report by Nick Butler in February 2016 in the *Financial Times*, electricity consumption rose by only 0.5 percent. These two figures are simply not compatible—either actual GDP growth was much lower, or electricity use was much higher. Moreover, customs receipts for commodity exporters in Australia, Africa, and Latin America show serious drops in their exports to China, and lower prices received for them.

In any case, the elevated level of fixed investments stemming from Beijing's 2009 stimulus package has by now long passed its expiration date. Many industries—such as steel, cement, rare earth minerals, energy refining, and housing—are currently operating at just three-quarters capacity. That is precisely why wholesale prices in China have fallen for three consecutive years, a deflationary trend that has had global ramifications.

Stock Market Down, Capital Flight Up

Going forward, then, a large drop in fixed-asset investment (as a share of GDP) will be a necessity for two distinct reasons. First, the return on these investments has been rapidly declining. The amount of capital needed to generate an extra dollar of income from them has roughly doubled over the past decade. The lower returns on investment have been recently reflected in stock prices. As of March 2016, the Shanghai stock index is down roughly 50 percent from its June 2015 peak. The sharp fall in stocks reflects deterioration in Chinese economic fundamentals.

Second, investment spending, particularly since the beginning of the global recession, has also severely indebted the Chinse economy. According to McKinsey, total debt (government, corporate, and household) increased from $7 trillion to $28 trillion from 2008 through the end of 2014. Also, according to *The Wall Street Journal* and ratings firm Standard & Poor's, corporate debt now amounts to 160 percent of GDP, up from 98 percent in 2008 (compared to a current U.S. level of 70 percent). These are unprecedented and unsustainable debt increases.

There are many similarities of China's economy of today to that of Japan's during the 1980s. Japan's mistake in creating and handling the bubble economy during that decade obviously had long-term consequences. The same can be said of the credit bubble in the West in the first decade of the 21st century.

Perhaps the most significant economic development in China over the past year has been the exodus of capital, despite stringent capital controls. According to data compiled by Bloomberg, capital outflows jumped to $1 trillion last year. In short, what is occurring is the greatest episode of capital flight in history. That capital movement has been hidden in plain sight, from real estate purchases to buy-outs

of Western businesses, such as movie theaters and hotel chains.

There are a number of important factors behind this epic exodus. Outward-bound investment by Chinese companies has sharply increased in recent years. (In fact, outward investment will likely exceed inward-bound direct investment for the first time in 2016.) More Chinese than ever are also sending their children to American schools and colleges—another source of long-term capital outflows. But the greatest source of the recent surge has been driven by the lack of confidence in the Chinese economy and capital markets. The government is also cracking down on capital flight, which merely encourages the increasing desire of wealthy Chinese to get their money out of the country while they still can. (Chinese citizens are currently restricted to moving $50,000 a year offshore.)

The surge in capital flight is causing China to hemorrhage reserves in an attempt to prevent the yuan from falling even more sharply. China's foreign-exchange reserves fell by an astonishing $700 billion in 2015. In January 2016 alone, they fell by almost $100 billion, dropping total reserves to $3.23 trillion, the lowest level in more than three years.

The central bank finds itself in a vicious cycle: The more it draws on foreign reserves to defend the yuan, the more it fuels skepticism about its ability to maintain its foreign exchange value, increasing the impetus for capital to leave the country. This scenario seemed unimaginable only a short time ago.

Another Failure of Centrally Planned Economics

It seems clear that China's economic prospects are not favorable in the short-to-medium term. The economy is currently experiencing the slowest growth in at least 25 years. Equity markets are often a leading economic indicator, and China has had two bear markets in the past year. The Chinese authorities injected $20 billion in the equity markets in an attempt to stabilize the market. It amounted to a vast waste of capital but highlighted an essential (and deeply flawed) feature of China's command economy.

China central planners continue to defend more fixed-asset investment. Some economists state that China's need for capital accumulation is essential since it is still in the developmental stage and that the ratio of capital-to-GDP is not a problem. This argument is seriously flawed. With a per capita income of less than $10,000, China's ratio of capital-to-labor is historically high. Developed countries are "capital intensive." China is still a developing country. Furthermore, most of the economy's primary industrial engines are operating at significant levels of overcapacity. The return on invested capital has been sharply dropping in recent years. This is *prime facie* evidence of excess capital.

Conclusions

So is the Chinese economic model past its expiration date? It looks increasingly likely. Economic growth in China is now probably growing closer to between 4 percent and 5 percent; the elevated growth rates of the past came at an enormous cost. Excess industrial, commercial, and residential capacity appears to be growing, not shrinking. Aggregate debt levels have skyrocketed. Pollution is rampant in most large cities, and income-inequality metrics are some of the worst in the world. In a word, China does *not* have the economic model of the future.

In recognition of these realities, the next U.S. Administration and Congress should:

- **Prepare for a Chinese "hard landing."** Much slower Chinese growth could cause the Chinese Communist Party to become more aggressive in foreign policy in order to retain authority at home. The U.S. must more forcibly counter Chinese aggressive behavior in the South and East China Seas and beyond.

- **Communicate to the American public the serious flaws of command economies.** The 2008–2009 recession caused many Americans to question the free-market system. The next President and Congress should boldly proclaim the message that that system is alive and well and worth expanding both at home and abroad.

- **Acknowledge that slower growth will weaken China's hand in foreign institutions.** At the World Bank, the International Monetary Fund, and G-20 summits, China displayed the "upper hand" during the Obama years. As recommended in other essays in this *Special Report*, the next Administration should take the lead to downgrade G-20 summit meetings (back to the finance-minister level) and to create a new, less-formal "G9" consultative mechanism whereby

heads of state of the world's nine largest economies meet on the margins of other international gatherings (such as that of the U.N. General Assembly) for informal exchanges of views. The U.S. should also make the principles of economic freedom the guiding light at the World Bank and the Asian Development Bank.

- **Allow more Chinese foreign direct investment (FDI).** The Chinese have recently increased their FDI in the U.S. economy. This is distinctly healthy for the U.S. economy and also forces more transparency in China, as was demonstrated by calls in the U.S. for disclosure of the true ownership of the Chinese insurance company Anbang during its attempt in 2016 to buy a U.S. hotel chain. The U.S. should encourage Chinese FDI, but also insist on transparency.

- **Ask China to make "doing business in China" easier.** Over the past four to five years, Western business firms have complained that doing business in China has become increasingly difficult. The Chinese authorities should ease red tape and the harassment and finings of foreign corporations—and the next U.S. President should make a point of asking about it during meetings with Chinese counterparts.

- **Sign a U.S. bilateral investment agreement (BIA) with China.** While discussed for years, a BIA could possibly ease geopolitical tensions, but more important, increase bilateral direct investment between the world's two largest economies.

—William T. Wilson, Ph.D.

The Importance of Liberalizing Global Energy Markets

Unleashing free enterprise in global energy markets will provide abundant supplies at competitive prices, stimulate innovation, and grow the world economy. Liberalization provides *more* choice and will eliminate reliance on taxpayer-funded subsidies. Free trade in energy bolsters national security by increasing supply diversity, reducing the effects of supply shocks, and increasing supplies that are readily available for national security needs. Congress should open domestic markets, eliminate favoritism, remove restrictions on energy exports and imports, and encourage other countries to do the same. The next U.S. President should, too.

Start by Lifting Restrictions on Production at Home

Opening access to energy markets begins with providing the opportunity for companies to develop America's abundant resources. With its plentiful reserves, the U.S. is already a global leader in energy production. Regrettably, the federal government prohibits resource development in many parts of the country and off its coasts. A large part of the problem concerns ownership: Much of the growth in energy production is occurring on private and state-owned lands, while oil and gas output on lands owned or controlled by the federal government has been in decline.

Fortunately, companies in the U.S. energy sector are mostly privately owned. That is an inherently good and important fact. The next President must ensure that the American energy sector remains largely in private hands. One need not look far for confirmation of the wisdom of that policy. Government ownership of the energy sector in other countries is problematic because those governments do not make decisions under true market conditions. Their state-owned oil and gas companies suffer from economic inefficiencies, higher rates of pollution, wasteful spending, less technological innovation, and aging infrastructure. Further, by relying on their state oil companies' profits to fund other government operations, those governments divert resources that otherwise would be available to invest in new energy technologies or potential new areas of energy exploration and development.

Both in America and abroad, opening markets to domestic private investment and foreign investment is crucial to developing energy resources and increasing economic growth. In countries where private actors own mineral rights and reap rewards from risk-taking energy development ventures, energy-producing companies typically have more efficient, economically competitive outcomes than do countries where the proceeds from energy production funnel back to the government or to corrupt special interests allied with it.

Unshackle Companies from Government Dependence

Global liberalization in energy markets cannot be achieved unless energy companies are liberated from dependence on government subsidies. Given the different uses of resources and changing demands, future energy markets are entirely too complex for politicians seeking to pick winners and losers. Yet, time and time again, policymakers in the U.S. and around the world attempt to force technologies into the marketplace at great cost to taxpayers and energy-consuming families and businesses. The government-forced shift and emphasis on more expensive, intermittent, renewable green-energy sources, for example, has created "energy-fuel poverty" in countries as rich as Germany and the United Kingdom. Moreover, the West's imposition of first-world, politically correct "green opprobrium" in turn also has hampered development of mineral wealth resources in developing countries that desperately need access to affordable, dependable energy.

Prices are the mechanism governments should rely on to drive innovation, exploration, discovery, and development of energy. Government favoritism distorts market signals considerably and provides market opportunities for companies that would likely otherwise not exist. Companies then rely on the subsidies to remain market viable rather than identifying ways to lower their costs without political favoritism. When a firm minimizes costs, that company not only maximizes profit but maximizes value to its customers. The market, not government officials, can allocate resources to meet consumer demand.

Free Trade in Energy Provides Economic and Geopolitical Benefits

Freely importing and exporting energy and energy technologies would yield tremendous economic

benefits, providing Americans with more opportunities to sell products to more customers and to buy cheaper goods and services from abroad. Further, increasing global energy supplies from a diversity of producers will provide important geopolitical benefits to the rest of the world by reducing the ability of any one nation or organization to use its control of energy resources for strategic purposes. More choices in an open market will significantly reduce the leverage of those countries or organizations that want to choke off supplies or manipulate prices in a restricted market.

Congress lifted the crude oil export ban last year, and companies have begun shipping the product abroad, mostly to European markets. Cheniere Energy shipped liquefied natural gas (LNG) from its plant in Louisiana to Brazil in February; several other LNG export facilities are under construction. Other companies have requested and await Department of Energy (DOE) approval. Currently, companies must obtain approval from both the Federal Energy Regulatory Commission and the DOE before exporting natural gas. A facility is automatically authorized if the recipient country has an FTA with the U.S. In the absence of an FTA, the DOE can arbitrarily deny a permit if it believes the volume of natural gas exports is not in the public's interest.

The U.S. government is also making renewable power more expensive by placing high tariffs on imported solar parts to protect U.S. manufacturers from foreign competition. Protecting domestic manufacturers will only keep prices higher, ensuring that the technology is less competitive and reducing the incentives for domestic manufacturers to innovate and lower their costs.

Actions for Congress and the Next Administration

Congress and the next Administration should:

- **Open access to federal waters and federal lands that are not part of the national park system or congressionally designated areas to exploration and production for all of America's natural resources.**

- **Eliminate energy subsidies and political favoritism for all sources and technologies.**

- **Remove the DOE from the decision-making equation in approving LNG projects.** The U.S. trades regularly with a number of non-FTA countries, and natural gas should be treated like any other globally traded good.

- **Modernize anti-dumping laws to allow Americans to take full advantage of the increasingly interconnected global economy.**

Open global energy markets free from government meddling will best serve the people of the world by providing more choice and affordable supplies. Liberalized energy markets will foster innovation in new energy technologies more effectively than any government-controlled plan. Eliminating restrictions on domestic and international access and eradicating favoritism in energy markets will enable a robust world energy economy to flourish.

—*Nicolas D. Loris*

Eliminate Export-Financing Subsidies

Government financing of exports through export-credit agencies (ECAs) has risen dramatically in recent years, driven by growth in both global trade and emerging markets. Economists have long understood that such subsidies are not only unnecessary but distort domestic and international economies. The United States and its allies should work aggressively to eliminate government financing of exports, at home and around the world.

An Old, Bad Idea

The central purpose of an ECA is to provide loans and loan guarantees as well as capital and credit insurance to "facilitate" exports. ECA financing may be provided directly to a domestic firm, or awarded to an overseas enterprise or government to foster the purchase of goods and services from the country providing the financing.

Great Britain is credited with (or blamed for) establishing the first official ECA in 1919. Similar programs subsequently appeared elsewhere in Europe. The Export–Import Bank of the United States (Ex–Im) was incorporated in February 1934 through a decree (Executive Order 6581) issued by President Franklin D. Roosevelt to finance trade with the Soviet Union. The following month, FDR approved another decree (Executive Order 6638) to promote trade with Cuba. Both were subsequently codified when Congress passed the Export–Import Bank Act of 1945. Ironically, in the decades since, Ex–Im has made billions in loans around the world but never did make any loans to the USSR.

Advocates of ECAs claim that the subsidies are necessary to fill gaps in private financing, increase competitiveness, and promote economic growth and job creation. However, ECA financing actually subverts free trade, disadvantages non-exporters (and thus domestic markets), and imposes undue risks on taxpayers.

Virtually all ECA financing once adhered to the so-called Organization for Economic Co-operation and Development (OECD) Arrangement of 1978 (the Arrangement), which remains in effect and consists of uniform lending terms and conditions designed to prevent an escalation of subsidies among member nations. Additionally, the World Trade Organization's Subsidies Agreement provides a "safe harbor" for some ECA financing if governments comply with the OECD standards.

Today, however, just 34 percent of the estimated $280 billion in annual government export financing (medium-term and long-term) is conducted under the aegis of the OECD. China's ECA support alone exceeded $100 billion in 2014 according to Ex–Im's annual Competitiveness Report. In fact, the government-export financing provided by the "Asian giants"—China, Japan, and Korea—constitutes an estimated two-thirds of total trade-related support worldwide.

The dramatic increase in non-OECD financing has prompted member nations to likewise expand their support beyond the conventional financial instruments subject to the Arrangement. Thus, the OECD standards have largely been rendered obsolete.

Governments no longer confine financing subsidies to domestic goods and services—formerly the *raison d'être* of ECA. A variety of other political and economic imperatives, such as securing natural resources or establishing strategic alliances, also trigger export subsidies.

Unfair Competition

Advocates often insist that subsidized export financing only generates positive returns. In fact, there are a plethora of disadvantages for taxpayers, unsubsidized firms, and economies.

U.S. firms that do not receive Ex–Im financing are sometimes left to compete against foreign firms that *are* receiving subsidies from the U.S. government. For example, and notwithstanding staggering losses that prompted a $5.8 billion bailout from the Indian government in 2012, Air India received some $4 billion in Ex–Im subsidies to purchase Boeing products. The subsidies provided the airline a cost advantage of about $2 million per plane, leading to route expansions and other upgrades that put some U.S. carriers at a competitive disadvantage—and resulted in the estimated loss of some 7,500 U.S. jobs.

In many instances, political considerations trump economic merits in ECA-financing decisions. That results in higher returns for less-worthy products—the very opposite outcome of the benefits that consumers reap from market competition.

There is also no meaningful evidence that Ex–Im subsidies create jobs. Export subsidies do redistribute labor from unsubsidized firms to subsidized ones, thereby imposing higher labor costs on the firms that get by without preferential treatment. As the

Congressional Research Service concluded in a 2014 report, "Ex–Im Bank's credit and insurance programs…draw from the capital and labor resources within the economy that would be available for other uses, such as alternative exports and employment."

To the extent that ECAs finance deals that the private sector supposedly snubs, taxpayers are justified in questioning whether they should be saddled with risk that private investors deem unacceptable. Export subsidies also entail financial and political risks, including changes in interest rates, currency fluctuations, political unrest, and international conflicts. So, it is difficult to reconcile the assertions of ECA officials that they alone assist higher-risk exporters but still manage to offer competitive rates and generate profits.

Moral Hazard

There is a morally hazardous dimension to export subsidies, too, which is often overlooked: They encourage poor countries to take on debt for purchases of otherwise unaffordable products. For example, Ex–Im encouraged Ethiopia to purchase a new fleet of Boeing planes (with GE engines) for a population that mostly lives on $2 a day. As economist Veronique de Rugy trenchantly observed, "Bad credit, no credit? No problem! The Ex-Im Bank's creative financing options will allow any country to put shiny new Boeing planes in their national airports—no matter how dire their fiscal position."

Government officials also claim that they are forced to offer export subsidies to compete with other countries, but finance costs are only one among a variety of factors that affect a foreign purchaser's choice of supplier. Availability, reliability, and stability all play significant parts in purchase decisions.

Many ECAs operate in relative obscurity, and the lack of transparency invites corruption. Inadequate management controls of borrowers' eligibility and insufficient analyses of lending risk also increase fraud. The reality is that ECA officials are not putting their own money at risk and thus have less of a stake in the outcome. It is an inevitable aspect of government intrusion into private enterprise.

Recommendations for the Next Administration and the 115th Congress

In decades past, political and economic turmoil around the world did present export risks, but global trade is now firmly entrenched. In countries where private financing is difficult to come by, governments should focus on reducing tax and regulatory barriers in order to increase the competitiveness of their exports.

A great many influential special interests are aligned with ECAs. It should be no surprise that the beneficiaries of subsidies want the subsidies to continue. It is crucial to recognize, however, the many unseen costs of this form of government largesse, including market distortions, resource misallocation, and competitive disadvantages imposed on domestic businesses that do not enjoy privileged access to corporate welfare.

Surging ECA activity is evidence of a global escalation of subsidies that threatens free trade and fuels trade disputes among nations, but the remedy to that problem is not more ECA financing.

The U.S. Congress caved in to the forces of cronyism in December 2015 when it re-authorized Ex–Im's charter through 2019 (after several temporary extensions due to opposition by conservatives in Congress that resulted in the bank being prohibited from transacting new deals for nearly six months in 2015).

The next President and new Congress should:

- **End decades of cronyism by repealing reauthorization of the Ex–Im charter.** The supposed reforms included in the 2015 re-authorization are largely a regurgitation of others previously mandated by lawmakers—without appreciable effect. There is no shortage of private capital to finance exports, and Ex–Im repeal could serve as a powerful example for other countries. If nothing else, the U.S. would be freed from all the problems associated with subsidies.

- **Work with U.S. allies and trading partners to negotiate ECA-retrenchment provisions in all new and existing trade agreements to protect global trade from even more subsidy escalation.**

Finally, if governments around the world are sincere about expanding opportunities for exports, they can refer to The Heritage Foundation's *Index of Economic Freedom* to identify a host of tax and regulatory barriers to trade that can be eliminated. Subsidies can never match economic freedom when it comes to nurturing growth.

—Diane Katz

Downgrade G-20 Meetings and Create an Informal G-9

The Cold War–era "Group of Seven" (G-7) global coordination mechanism must be revitalized and made more effective in a manner that enhances U.S. national security and economic interests in the 21st century. Heads-of-state-level summit meetings of the G-20, however, have proven to be time-wasting distractions. They should be downgraded.

The G-7 Model Must Be Revamped

The G-7, an informal bloc of the principal World War II combatant countries (excluding the USSR), was created at the height of the Cold War in 1975 as a mechanism for the leading market-based Western democratic economies to increase economic freedom, promote global trade and investment, and coordinate action on shared security concerns. By then the value to the U.S. of the United Nations as a forum for achieving American foreign policy goals had greatly diminished; often it was a serious obstacle. The U.N. Security Council certainly did not function—as originally envisioned—as the de facto political and economic policy coordination arm of NATO. So the U.S. led an effort to create the G-7. The Marshall Plan–era Organization for Economic Co-operation and Development in Paris served as its informal secretariat.

Effective policy coordination by leaders of Canada, France, Germany, Italy, Japan, the U.K., and the U.S. (the G-7), plus representatives of the European Union, certainly helped the West to defeat its common enemy—communism.

In the heady days after the collapse of the USSR, a hopeful G-7 extended an olive branch to its former enemy, but by 2014 it had the good sense to support Ukraine's sovereignty and expel Vladimir Putin's Russia from what had been called the G-8 (G7+1). The G-8 was not created to give diplomatic and public relations cover to corrupt regimes such as Putin's.

The membership of the G-7 as currently constituted, however, no longer reflects 21st-century economic realities. It must be updated, but its effectiveness and usefulness to the United States must be maintained.

The advantage of the streamlined G-7 process has been to adopt and implement mutually beneficial policies. The manageable size of the G-7, its informal structure, and the fact that it accounted for a large share of global GDP were all important factors in its success. Those features must be retained when it is re-constituted. Most important, the new G-7 mechanism must remain faithful to the values of market-based Western democracy and economic freedom.

G-20 Bureaucratic Superstructure: Bigger Government, Endless Meetings

The G-20 was established after the 1997 Asian financial crisis, but before the Putin era, as an annual forum for finance ministers (the Treasury Secretary in the U.S.) and central-bank governors to advance economic cooperation and help bring stability to global financial markets.

At the time of the 2008 financial crisis, when it was elevated to head-of-state-summit status, the G-20 represented the 19 largest advanced and emerging economies from all regions of the globe, including the G-7 countries and Russia, plus the European Union. India and Indonesia represent developing Asia, alongside China and South Korea; Saudi Arabia and Turkey standing for the Middle East; South Africa representing Africa; and Argentina, Brazil, and Mexico speaking for Latin America. U.S. ally Australia rounded out the group.

The Big Five developing countries—Brazil, China, India, Indonesia, and Russia—and their impact on the world economy was a conceptual grouping often cited by the World Bank and others in the 1990s as a sort of shorthand when discussing emerging-market countries. Since then, the commodities-based, export-oriented economies of most "BRIC" countries have stagnated. Putin's retrograde economic policies in Russia have been especially toxic. Those factors alone are good reasons to demote the prominence of the G-20. And there are many others.

G-20 tax policy meetings could focus on minimizing the inevitable economic distortions that are caused by all taxes. Yet rather than concentrating on reducing the need for more taxation by cutting government spending, G-20 leaders usually seem to concentrate on policies to fight tax avoidance, "base erosion and profit shifting." In other words, G-20 leaders think about creative new ways to tax so they can continue spending.

G-20 meetings generate word clouds of government-centric buzzwords (such as "financial safety nets," "rebalancing global demand," "global infrastructure gaps," "financial inclusion," and "inequality") that seem to cry out for more spending.

The names alone of other G-20 working groups are dead giveaways that achievement of their goals will be through coercive big-government programs:

- G-20 Investment and Infrastructure Working Group
- G-20 Employment Working Group
- G-20 Green Finance Working Group
- G-20 Climate Finance Working Group
- G-20 Energy Sustainability Working Group
- G-20 Development Working Group

When the G-20 is downgraded, all of these groups should be eliminated so that finance ministers and central-bank governors can return to the core mission of the G-20 by focusing only on the remaining working groups that concentrate solely on germane topics.

Cronyism, G-20 Style

Along with the many working groups peopled with government civil servants, other G-20 groupings meeting on the margins of the summits have created new opportunities for cronyism and rent-seeking:

- B-20: Business 20, representative of the international business community
- L-20: Labour 20, representatives of trade unions from G-20 countries
- T-20: Think 20, representatives of leading think tanks
- C-20: Civil Society 20, representatives of civil society
- Y-20: Youth 20, meetings of young participants from G-20 and other countries

G-20 organizers decide, in a non-transparent manner, which companies, unions, think tanks, civil society groups, and young leaders are invited to participate. What about the hundreds of millions around the world who are not invited to share their views? Who speaks for them? And, do those few from the groups who are privileged to attend the G-20 thereby gain an unfair advantage through access to those world leaders? That is practically a definition of cronyism.

It is all the more ironic since one of the many subjects covered in the G-20 process is corruption. According to the charter of the G-20 Anti-Corruption Working Group, it "covers a broad range of issues, including impact of corruption on economic growth; measures against foreign bribery and solicitation; combating money laundering and recovery of proceeds of corruption; whistleblowers protection; asset disclosure and conflict of interest regulation; cooperation with private sector and civil society in fighting corruption."

Economic freedom rests on the empowerment of the individual, nondiscrimination, and open competition. None of these requirements can exist in a society that lacks effective rule of law. That rule of law, however, can be undermined by the cronyism engendered by these G-20 groups. They should be eliminated. Recommendations for the Next Administration and the 115th Congress

The annual G-20 summits have evolved into unwieldy mini U.N. meetings that waste resources and the time of heads of state with an ever-expanding list of issues, many of them nearly insoluble in the near term and far beyond the G-20's original financial and monetary stability mandate. G-20 membership also confers more prestige upon Russia than it currently merits.

The next Administration should immediately lead a global effort to revamp the G-7 by creating a G-9 that would be composed of the nine largest economies in the world (United States, China, Japan, Germany, the United Kingdom, France, Brazil, Italy, and India).

Meetings of the G-9 would occur only on the fringes of other summit meetings—the annual meeting of the U.N. General Assembly, for example. No need for any notetaking or preparation of volumes of official papers, draft communiques, self-serving photo-ops, and press releases. Just an honest exchange of views among the heads of state of the world's nine largest economies. The world's tenth-largest economy, Russia, could be invited from time to time—depending upon the behavior of its government.

There would be no need for any G-9 "sherpas" (senior bureaucratic event planners), no more

working groups, and no more host-country worries about imaginative "deliverables" and how to fund the burdensome costs of security at stand-alone summit meetings. There would be no more secretariats staffed by international civil servants pursuing their own interests, either.

One of the most compelling arguments deployed during the 2008 financial crisis to elevate the G-20 to the head-of-state level was that, by doing so, China would be included. China was never *in* the G-7. With the creation of a G-9 that argument will become moot and, for the reasons outlined above, future G-20 meetings can revert to the finance-minister and central-bank level.

—James M. Roberts

IMF Should Promote Rules-Based Monetary Policies, Not Bailouts

The International Monetary Fund's (IMF's) "Exceptional Access Framework" was reinstated at the insistence of Congress in exchange for its 2015 approval of the IMF Reform Package. The framework re-imposes a rule that prohibits new IMF lending to a country that has unsustainable debt and no realistic plan to get out of it. Its abandonment by the IMF in 2010, at the beginning of the Greek debt crisis, cleared the way for a fresh round of morally hazardous loans that bailed out big European banks but left Greece even further in debt and still in need of debt restructuring and fundamental economic and political reforms.

The next Administration and the 115th U.S. Congress should insist that this rules-based "Framework" approach be strengthened and expanded. It should become the IMF's default setting for policy advice to all IMF member countries.

Rules-Based vs. Discretionary Monetary Policies

The fight over the appropriate role of the IMF goes all the way back to its creation at the Bretton Woods conference in 1944. Although World War II was still raging, world leaders were planning for the post-war period and sought to avoid a return to the chaotic post–World War I economic policies (protectionism and beggar-thy-neighbor competitive currency devaluations) that had, in part, led to the second war.

The liberal and progressive view then in the U.K. and on the Continent, pushed by John Maynard Keynes and others, envisioned the IMF as an international clearinghouse based on a single world currency—a sort of global Treasury Department/Federal Reserve Bank. IMF member countries could then be free to pursue expansionary tax-and-spend social welfare programs, and the IMF would be there to underwrite them with endless (and potentially morally hazardous) bailouts when those policies failed to produce the hoped-for results. These policies were rooted in the same Keynesian philosophy that drove the New Deal in the U.S. in the 1930s.

Fortunately for the prosperity of the post-war world, the more realistic approach of the U.S. delegation at Bretton Woods prevailed. The IMF was confined to a more limited role, and the U.S. dollar replaced the pound sterling as the world's reserve currency. IMF member nations would maintain their own monetary policies and currencies. The IMF would ensure that its member states adhered to the new rules of the post-war, fixed-exchange-rate system, making fundamental adjustments to a country's currency exchange rate as needed, and making short-term loans to countries if they encountered balance-of-payments problems. The system worked well, for the first few years.

As Carnegie-Mellon economics professor Allen Meltzer pointed out in *The Independent Review* in 1999, however, if the original IMF mandate had been observed faithfully, the IMF would have ceased to exist in 1973, when the fixed-but-adjustable rate system officially ended and the world went completely off the gold standard. "The Bretton Woods system left capital-account lending to the World Bank, so the Fund no longer had a reason for being," wrote Meltzer.

Instead, the IMF began a program of aggressive capital lending to help the global economy absorb the first oil shock in the early 1970s and it continued to ramp up lending through subsequent economic crises. While, to their credit, IMF advisers did always try to insist that member countries fulfill a loan's conditionality—by adopting fiscally conservative and sustainable economic policies before they could borrow any new funds—IMF bureaucrats were frequently undercut. As professor Meltzer pointed out (consistent with public choice theory), the international civil servants at the IMF knew that if their lending programs failed it would be bad news for their careers. Cynical officials in the borrowing governments knew it, too.

Unfortunately, the struggle between Keynesian expansionists and fiscal conservatives continues. The latest skirmish was over the 2010 IMF "reform package," which reduced U.S. control over tens of billions of U.S. taxpayer dollars in the IMF's "New Arrangements to Borrow" (NAB) account that had been reserved for IMF lending only in extreme emergencies. Now that the reform package has been approved by Congress, those NAB funds have been transferred to regular IMF "quota" lending procedures—nearly doubling them in the process.

The IMF: The World's Lender of First Resort

As Heritage Foundation co-founder Edwin Feulner put it back in 1998 during the Clinton Administration

when the IMF (then led by French socialist Michel Camdessus) proposed one of several dramatic increases it has received in its lending resources over the years, the U.S. government should oppose the IMF's "self-styled role of international rescuer of failed economies and insurer of poor international investments." Those words still ring true today. As Feulner explained,

> IMF bailouts are more likely to cause financial crises than prevent or cure them. Bailouts send signals to governments that they will not have to bear the costs of failing to reform their economies: The IMF will be there to pay the price of their inaction. Thus, the IMF's actions will neither prevent nor cure financial crises—they will encourage them.

This is almost the perfect definition of moral hazard.

It is a fact that highly subsidized interest rates on IMF bailouts and structural adjustment loans provide massive subsidies to borrowing countries. IMF policies lead developing countries to economic stagnation and recession, and foster dependence on foreign aid. At last count, 79 of the IMF's 188 member countries were in debt to the IMF. That means, contrary to calls by some of its defenders that it be tasked with that role, the IMF is not functioning as a lender of last resort. Instead, it has been acting as a lender of first resort. In the process, the IMF has in some cases actually increased political instability by bailing out and thus preserving the power of ruling elites.

Taylor's Rules-Based Policy Advice for the IMF

Instead of laying the groundwork for more IMF bailouts, Stanford University economics professor John Taylor has been a leading voice in calling for a return to a strict rules-based international monetary system that would prevent the need for bailouts. He persistently (and successfully) promoted the re-adoption of the IMF's Exceptional Access Framework.

In a May 2016 keynote address to the International Conference on Macroeconomic Analysis and International Finance, and in his other recent writings and speeches, professor Taylor also urged central banks to commit publicly and transparently to a monetary policy rule or a strategy for setting policy instruments to ensure predictability and increase investor confidence. These instruments could include a specific inflation target, an estimate of the equilibrium interest rate, and a list of key variables to react to in certain specified ways. The process need not impinge on other countries' monetary strategies and could include a flexible exchange rate system tied to a global hard currency (such as the dollar or the euro) or a regional currency zone (such as the West African CFA franc zone).

Recommendations for the Next Administration and the 115th Congress

The market is far more effective in enforcing conditions, promoting reform, and minimizing the risk of a crisis spreading in the near term or far into the future. For example, the presence in a country of developed-country private banks—and their best practices—is the best way to instill those practices in the local banks that have to compete with them.

The United States government should encourage other major IMF donor nations to join it in sending strong and unwavering signals to the world that the IMF's resources are not, in fact, unlimited, the huge increase in regular quota lending from the NAB funds transfer notwithstanding.

The IMF should be viewed by its developing country members as a firebreak to support and stabilize the economy in the short term, not the ultimate solution for financial crises—and definitely not as a "first responder." To prevent those future crises from arising and spinning out of control, Congress and the next Administration should push the IMF bureaucracy—hard—to follow rules-based prescriptions.

—James M. Roberts

The Impact of Corruption on Economic Development in Sub-Saharan Africa

People understand intuitively that government corruption is bad. The extent of the damage it causes is less well understood, but new scholarship is illuminating the impact. These studies show that corruption robs people across the world of opportunity, freedom, and sometimes even their lives.

Corruption and violence have strong links. Even small increases in institutional venality can significantly decrease the levels of peace inside a country, particularly when corruption damages the rule of law: Countries with the highest levels of police and judicial corruption often have among the highest homicide rates in their regions.

The violence caused by corruption goes beyond increased homicide rates, however. Sleaze strains the social compact between governments and their citizens, resulting in a strong correlation between deeply corrupt countries and state failure and conflict, ranging from insurgency to terrorism to social upheaval. When the so-called Arab Spring exploded across North Africa and into the Middle East beginning in 2011, one of the primary complaints of protesters was the corruption that riddled their governments. The demonstrations eventually brought down some of the region's most entrenched and seemingly stable regimes, a powerful warning about the anger that corruption can stir among those who suffer from it.

Economic Costs of Corruption

Venality has a wide range of direct and indirect economic costs as well. Pak Hung Mo, an economist at Hong Kong Baptist University, quantified the former, finding that a 1 percent rise in a country's corruption levels diminished growth by approximately 0.72 percent, which can translate into billions of dollars a year lost.

Much of that damage is done in countries that can least afford it. None of the 30 worst-ranked countries in Transparency International's *2015 Corruption Perceptions Index* are included in the U.N.'s *2015 Human Development Index*'s "very high human development" category, but two-thirds are in the "low" bracket. In keeping with the trend, the world's poorest region, according to the *Human Development Index*, sub-Saharan Africa, has many of the world's most corrupt countries—Transparency International notes that 43 of sub-Saharan Africa's 49 countries have a serious corruption perception problem.

Recent economic developments mean that Africa can afford corruption even less today than in the past. Many of its countries have enjoyed impressive growth over the past decade, but sinking global demand for commodities, exacerbated by a slowing Chinese economy, has brought economic pain to the many African countries that have become overly reliant on commodity exports. The World Bank estimates that average economic growth in sub-Saharan Africa fell from 4.6 percent in 2014 to 3.4 percent in 2015, the region's worst performance since 2009.

A tremendous amount of investment will be needed to help African countries diversify their economies and build a range of industries better able to weather global shocks. Foreign direct investment is fleeing the continent, however, down by nearly a third in 2015 from 2014, according to the U.N. Conference on Trade and Development. The corruption that plagues so much of Africa will make it harder to win back the lost, and entice new, investment, as corruption injects an investment-repelling element of uncertainty into business transactions.

…Especially High in West Africa

The continent's largest economy, Nigeria, is a microcosm of the African corruption problem. Nigeria derives around 70 percent of government revenues from the sale of oil, and has been one of the casualties of falling oil prices. According to Nigerian government statistics, economic growth in the second quarter of 2015 was its worst in 10 years, and the country is seeking loans worth $3.5 billion from the World Bank and the African Development Bank to plug its budget gaps. Yet such a loan would not be necessary, or a much smaller one would suffice, if the country still had the tens of billions of dollars in oil revenue it has lost to corruption over the years. In May 2015, the former central bank governor of Nigeria estimated that $12.5 billion in revenues from the state-owned oil company were "diverted" in one 19-month period alone.

The indirect economic damage of corruption is harder to quantify, but similarly severe. For instance, corruption often weakens public health systems. Many developing countries battle public health crises, such as HIV/AIDS and malaria, which,

in the case of the former, likely reduce affected African countries' growth rates by an average 2 percent to 4 percent or higher, according to an IMF study. A National Institute of Health report found that malaria, too, has a large negative effect on economic growth. Corruption makes it more difficult for countries to fight these menaces, costing lives and depressing the economic well-being of millions.

The 2014 Ebola outbreak in West Africa is a gripping example of this phenomenon. The three hardest-hit countries—Liberia, Guinea, and Sierra Leone—all rank in the lower half of the *2015 Corruption Perceptions Index*. The weak health infrastructure in those countries was quickly overwhelmed by the crisis, and more than 11,000 people eventually died from the outbreak. World Bank data show that the countries' GDPs plummeted in 2014, representing hundreds of millions of dollars' worth of losses that will continue for the next several years. A portion of that lost potential economic growth can never be recouped. The outbreak was going to be costly no matter what, but less corrupt countries would likely have had stronger health infrastructures better able to contain the damage.

Education systems also suffer in corrupt countries due to underfunding. Money is not the only way to improve educational quality, but wise infrastructure outlays by the state to help create a high-quality education system is one of the best ways to develop the cognitive skill set in citizens needed to propel economic growth. Education experts Eric Hanushek and Ludger Woessmann found that boosting student outcomes would result in a dramatic, long-term enhancement to a country's GDP, yet corruption robs countries of those windfalls.

Finally, corruption is often part of a toxic package deal with other government failures, such as excessive bureaucracy and weak legislative and judicial systems. These factors are likely mutually reinforcing, amplifying the malign effect of each.

Policy Recommendations

All countries struggle with corruption. The societal and economic damage in the most corrupt states, however, is a slow-moving and politically destabilizing disaster that sacrifices well-being and costs lives. For humanitarian reasons and to advance the national interest, the next Administration should:

- **Elevate the fight against corruption as part of its economic development assistance.** The United States should assign the fight against corruption the same importance as any other reform, and focus more of its aid on helping countries make appropriate institutional changes. Automating or streamlining some government tasks that currently involve the participation of potentially corrupt bureaucrats is just one possible opportunity for reform.

- **Help countries strengthen their civil societies.** Private-sector and NGO watchdog groups focused on detecting and exposing corruption help citizens hold their leaders accountable and push for reform. Also, civic organizations can often deliver certain services more responsively and efficiently than can government, which reduces opportunities for corrupt officials to prey on citizens. A number of African countries have recently enacted laws designed to gut civil society, and the U.S. should pressure those countries to amend or repeal them.

- **Promote economic freedom.** According to the 2016 *Index of Economic Freedom*, the world has seen an encouraging uptick in levels of economic freedom. There is still much room for improvement, however. Several of the core components of economic freedom, such as rule of law and limited government, are inimical to corruption, and enhancing economic freedom around the globe will necessarily bring down levels of corruption as well.

- **Leverage technology and the power of crowds.** The greatest potential check on corruption is the general population, which, as the foremost victim of graft, is heavily incentivized to eradicate it. The use of social media and other technologies is booming across Africa, and the United States should help civil society organizations create tools to track and publicize corruption using extant technology. Apps similar to Waze, which uses crowdsourced information to monitor traffic, could track corruption, and even create heat maps and lists of particularly corrupt government offices, similar to the "I Paid a Bribe" website popular in India.

—Joshua Meservey

Review and Update of America's Foreign Assistance Programs a Must

The next Administration should conduct a thorough review and update of America's foreign assistance programs in order to advance U.S. national security and economic interests more effectively.

The Structure of U.S. Assistance

While the U.S. provides assistance for a wide variety of purposes, they can be broadly sorted into three main categories:

1. **Humanitarian assistance.** Humanitarian assistance is provided to address sudden major natural disasters, tragedies, or ongoing suffering. Although annual appropriations are made for humanitarian assistance, distribution is generally irregular, unpredictable, and of relatively short duration. Humanitarian assistance is not intended to advance other foreign policy objectives, but it can serve to bolster America's reputation and increase international goodwill.

2. **Security assistance.** Support for U.S. security and foreign policy interests is at the forefront of providing security assistance, which is primarily used to provide equipment, training, and other support to U.S. allies and other nations deemed vital to advancing or defending American interests. America's security concerns often involve unstable areas of the world and require cooperation with governments that are less than ideal partners.

3. **Development assistance.** Development assistance is intended to reduce poverty and encourage economic growth in recipient countries by funding programs dedicated to improving agriculture, education, health, and democracy and advancing other initiatives. As such, there are numerous metrics for ascertaining the success of this effort. If development assistance contributes to higher standards of living in poor nations, it would support U.S. interests. Wealthier nations are generally more stable, more democratic, and more likely to become economic partners with America.

America is not getting the most that it can from its assistance programs. Humanitarian assistance can be slow to deploy and inefficiently employed, particularly food assistance, which is burdened with costly mandates requiring much of it to be bought in the U.S. and transported on U.S. ships. U.S. security assistance is not distributed to maximum effect and can be hindered by historical practice and political earmarks. The record of development assistance in facilitating economic growth and development is inconclusive at best and counterproductive at worst.

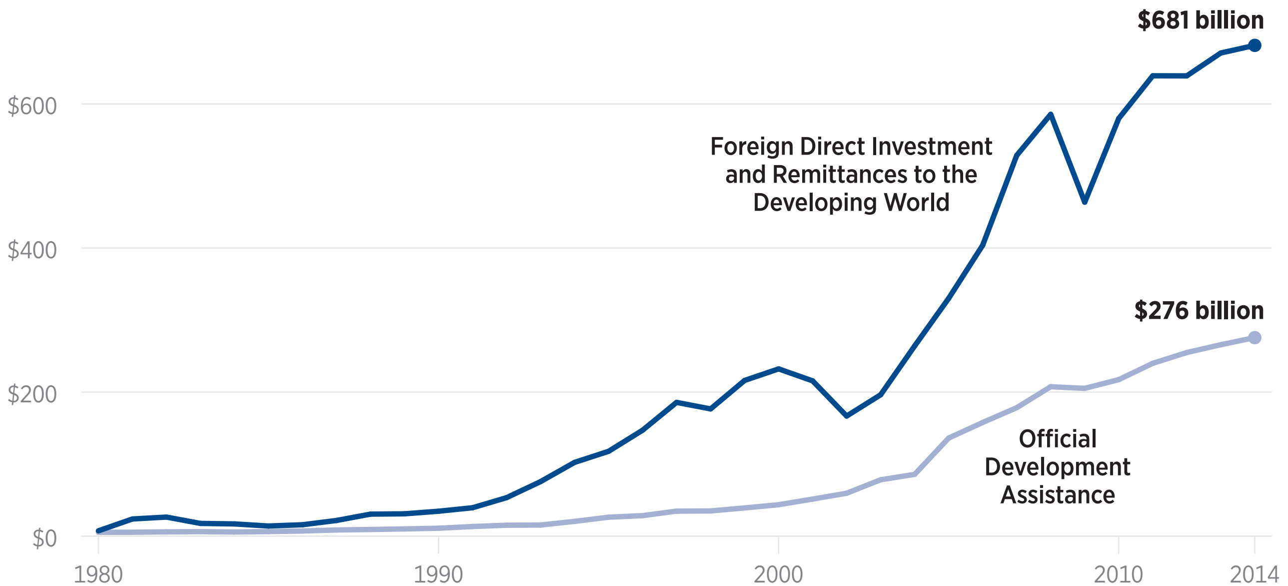
Moreover, the current structure for approving the use and distribution of these funds is complex, which undermines efficiency, clarity of purpose, and lines of accountability. As observed by the U.S. Commission on National Security/21st Century (Hart–Rudman Commission) in 2001:

> Foreign assistance is a valuable instrument of U.S. foreign policy, but its present organizational structure, too, is a bureaucratic morass. Congress has larded the Foreign Assistance Act with so many earmarks and tasks for the U.S. Agency for International Development (AID) that it lacks a coherent purpose. Responsibility today for crisis prevention and responses is dispersed in multiple AID and State bureaus, and among State's Under Secretaries and the AID Administrator. In practice, therefore, *no one is in charge*.... Neither the Secretary of State nor the AID Administrator is able to coordinate these foreign assistance activities or avoid duplication among them. More important, no one is responsible for integrating these programs into broader preventive strategies or for redeploying them quickly in response to crises.

The Hart–Rudman Commission called for significant structural changes to U.S. foreign assistance, including consolidating USAID into the State Department and requiring closer coordination with broader U.S. foreign policy priorities. This restructuring has not been fully adopted. USAID is now required to operate "under the direct authority and foreign policy guidance of the Secretary of State." However, USAID remains insulated from State Department priorities, coordination is lacking, and the problem of overly restrictive and sometimes contradictory or outdated congressional earmarks and instructions remain largely unaddressed.

CHART 1

Private Financial Flows to Developing Countries Far Outpace Official Assistance



SOURCES: United Nations Conference on Trade and Development, "Foreign Direct Investment," http://unctadstat.unctad.org/wds/TableViewer/tableView.aspx?ReportId=96740 (accessed August 24, 2016); United Nations Conference on Trade and Development, "Personal Remittances," http://unctadstat.unctad.org/wds/TableViewer/tableView.aspx?ReportId=86 (accessed August 24, 2016); and OECD, "Official and Private Flows," http://www.oecd-ilibrary.org/development/data/oecd-international-development-statistics/official-and-private-flows_data-00072-en (accessed August 24, 2016).

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Worse, the structure has become more complex, with a significant increase in the number of foreign assistance spigots created over the past dozen years, notably the establishment of the Millennium Challenge Corporation (MCC) in 2004 and creation of large, discrete initiatives, such as the President's Emergency Plan for AIDS Relief (PEPFAR) in 2003 and the President's Malaria Initiative (PMI) in 2005. Regardless of the results of such programs, this proliferation of programs indicates that America's foreign assistance initiatives are becoming more fractured, not less. A State Department and USAID authorization bill, under which fundamental restructuring would normally take place, has not been enacted for years, and the current bills before Congress do not contemplate the fundamental changes required.

The good news is that developing countries are far less dependent on Official Development Assistance (ODA) today than they were in the past. As the Hudson Institute's *Index of Global Philanthropy and Remittances* explains, private financial flows (philanthropy, remittances, and private investment throughout the world) now far surpass ODA from donor governments. This stark and growing gap is illustrated in Chart 1.

As stewards of American taxpayer dollars, Congress and the Administration have a responsibility to ensure that those humanitarian, security, and development assistance dollars are not squandered. They must endeavor to ensure that assistance is effectively and efficiently achieving its intended purpose, whether it is augmenting economic development, alleviating suffering during a crisis, or supporting America's national interests. Congress and the Administration should regularly assess U.S. aid programs to determine whether they are performing

well or are in need of reform. Similarly, as the world and America's interests change, so should U.S. assistance allocations change.

U.S. Policy Recommendations

To address these issues, the next Administration should:

- **Conduct an independent evaluation of all U.S. assistance programs.** As a matter of due diligence, Congress and the Administration should evaluate all U.S. assistance programs to determine whether they are doing what America needs them to do and, if not, implement changes to address those failings.

- **Lead an effort to replace or comprehensively update the 1961 Foreign Assistance Act.** This act, which is the legislative foundation of America's foreign assistance programs, is antiquated and burdened with 55 years of various instructions, reporting requirements, mandates, and tweaks added over time. Congressional earmarks (mandates requiring that certain funds be spent in certain countries or on specific purposes) number in the scores. They can exceed total available funds, can be contradictory, and undermine effective use of U.S. assistance.

- **Bring USAID directly under the control of the State Department to better coordinate its activities with U.S. policy priorities.** As noted by the Hart–Rudman Commission, "Development aid is not an end in itself, nor can it be successful if pursued independently of other U.S. programs and activities.... Only a coordinated diplomatic and assistance effort will advance the nation's goals abroad, whether they be economic growth and stability, democracy, human rights, or environmental protection." Previous reforms require USAID to operate "under the direct authority and foreign policy guidance of the Secretary of State," but it still functions as an independent agency largely insulated from the State Department and its policy priorities. The next Administration should place the Under Secretary for the Bureau of Economic and Business Affairs, possibly renamed the Bureau for Economic Development, directly in charge of USAID, and incorporate the agency into the State Department where the other priorities of the department can more directly influence foreign assistance policy and allocation decisions.

- **Eliminate unnecessary U.S. assistance agencies.** Programs such as the Complex Crises Fund, the Development Credit Authority, and the Overseas Private Investment Corporation are unnecessary, outdated, or should not be separate from existing aid programs.

- **Emphasize economic freedom and the rule of law in development assistance.** The MCC model encourages the rule of law and economic freedom so that the poor empower themselves rather than remaining dependent on inefficient or even corrupt government bureaucracies.

- **Reform America's food assistance programs.** The U.S. should eliminate costly legal requirements for the use of U.S. food and shipping, end monetization programs, and trim the food assistance budget to reflect the greater reach enabled by these efficiency reforms.

—Brett D. Schaefer

Advancing Economic Freedom: Job No. 1 for Multilateral Development Banks

Development assistance through the multilateral development banks (MDBs)—banks consisting of both donor and borrower countries—has been an important part of America's economic engagement with the world. Exercising strong leadership in improving the effectiveness of multilateral development assistance and holding the MDBs accountable for their development practices is clearly in the U.S. interest. In its endeavors to transform the MDBs into more effective and performance-based institutions, the next Administration should unequivocally stress that promoting policies and projects that advance economic freedom is the core of the development banks' mission and the foundation of America's engagement with them.

The MDBs Can and Must Do a Better Job

Over the past decades, the MDBs have provided financial, technical, and other forms of assistance to developing countries in the hope of helping them catalyze necessary reforms, economic growth, and broad-based development. The United States has been a founding member of and significant donor to the five MDBs, which are the World Bank and four regional development banks: the African Development Bank, the Asian Development Bank, the European Bank for Reconstruction and Development, and the Inter-American Development Bank.

These institutions have funded large infrastructure and other development projects in areas such as health, education, and environment by offering concessional financing, grants, and other types of assistance. Not all development assistance projects by the MDBs have failed, but the overall track record for multilateral development assistance has been mixed at best.

Not surprisingly, then, the effectiveness of these development banks has long been debated. The Heritage Foundation and other critics have called for reform measures at the MDB project, country, and institutional levels to enhance their transparency and accountability so that they can remain relevant in a rapidly changing global economic environment.

Advancing Economic Freedom: Proven Path to Economic Development

At the heart of development and poverty reduction must be the mission of advancing economic freedom so that ordinary people are empowered to improve their standards of living. Public policies based on economic freedom have been proven to generate the broader-based entrepreneurial dynamism that brings more opportunities and greater overall well-being.

This multidimensional relationship between economic freedom and development has been empirically documented in The Heritage Foundation's *Index of Economic Freedom* and other studies. Not only are high levels of economic freedom clearly correlated with greater levels of prosperity, but economic freedom also facilitates progress in overall human development including better health, longer lives, greater education, and cleaner environments. Economically freer countries have a much better record at reducing poverty than less-free countries.

As indicated by the findings of the *Index,* sustaining dynamic and broadly shared economic expansion is in fact about putting into practice three fundamental principles of economic freedom: empowerment of the individual, non-discrimination, and open competition. This is not a dogmatic ideology or development strategy. In fact, it represents the rejection of dogmatism of the statist, top-down development approach that has often resulted in trapping poor countries in vicious cycles of poverty, aid dependence, and debt.

Policies that promote economic freedom, whether through improvements in the rule of law, the promotion of efficiency and openness, or suitable restraints on the size and reach of government, provide the environment that can best empower people to cultivate practical solutions to reducing poverty and installing measurable progress in development. In other words, economic freedom paves the way for lasting development. Recent history shows that through the advancement of economic freedom, increasing numbers of people have gained access to knowledge and opportunities unheard of even a generation ago. Although not all countries start from the same place in the competitive environment of the global economic system, with economic freedom all have the opportunity to progress toward greater prosperity.

Recommendations for the Next Administration

A crucial aspect of sharpening America's global economic strategy should involve taking a more proactive role in transforming the MDBs into more effective and accountable institutions that advance economic freedom in the developing world. Determining whether they are performing well is not only owed the people who rely on these multilateral development institutions, but also the American taxpayers. The next Administration should:

- **Conduct a comprehensive review of America's engagement with each of the five major MDBs.** In prioritizing the role of the U.S. in enhancing the effectiveness of the MDBs, such a review process will be critical, particularly in terms of ensuring that U.S. financial contributions to the MDBs serve America's national interest and international economic strategy of advancing economic freedom around the world.

- **Urge the MDBs to place the advancement of economic freedom firmly at the core of the banks' development mission.** As The Heritage Foundation's *Index of Economic Freedom* documents, the expansion of economic freedom over time is key to laying the groundwork for long-term economic growth and development, which is the principal task of the MDBs. Greater development assistance should be given to countries with sound policies and demonstrable commitments to economic freedom.

- **Encourage the MDBs to adopt a more result-based, private-sector-driven development approach** by emphasizing rigor in evaluating successes and failures of their operation at the country and project level. As long as the development banks perform well, they should retain America's strong support. If the MDBs fail to perform as envisioned, the U.S. should reconsider its funding level to them. Market discipline should be applied to the development practice of the MDBs.

- **Broaden and deepen measures to fight corruption in the administration and operation of the MDBs.** At the institutional level, U.S. efforts to enhance internal auditing processes, independent investigative mechanisms on corruption cases, and the accountability and integrity of MDB management must be continued and strengthened.

- **Insist on measurable results of development assistance, expansion of private-sector development, and productivity growth in negotiations for the 18th replenishment of the International Development Association (IDA)** that will be finalized in 2017, just a few months after the next U.S. President takes office. Prior to renewing U.S. funding for the IDA, a stronger emphasis should be placed on strengthening the IDA's country-driven approach, with policy dialogues and project diagnostics supported by a more robust monitoring system, and leveraging effective partnerships with the private sector in order to generate more effective development outcomes.

America's long engagement with the MDBs has been multifaceted. They have been useful institutions for addressing development challenges, and as a leading member and donor, the U.S. has steadfastly supported them. It is clearly in America's interest to take a leading role to enhance their effectiveness. The next Administration should pursue reforms that will focus the MDBs on promoting economic freedom.

—Anthony B. Kim

The Danger of Corporate Socialist Cronyism

The success of the Obama Administration's socially engineered assault on the concept of American exceptionalism was due, in part, to cronyist alliances with corporate America—from too-big-to-fail giants to politically well-connected venture-capital start-ups.

Whether stoking alarmism about climate change, demanding a higher minimum wage, or restructuring traditional morality by judicial and regulatory fiat, President Obama collaborated with U.S. businesses that increasingly are managed and, in some cases, led by like-minded progressive groupthinkers. Daily run-ins with the aggressive "Hope and Change" agenda of the Left are now the norm; even advertisements for goods and services often seem to exact a political buy-in from consumers—such as "femvertising," advertisements that push the feminist agenda along with everyday products, such as skin lotion; or a Silicon Valley powerhouse pushing acceptance of a redefinition of marriage along with its electronic books. The result has been a toxic politicization of everyday life in America.

Companies pushing Obama's socialist agenda had much at stake: regulatory approval, subsidies, tax credits, government bailouts, lucrative "public-private partnerships," a wink and a nod from the government to anti-competitive but politically correct oligopolies, or perhaps access to well-trained but low-wage foreign workers with H-1B visas.

Even companies traditionally averse to advocating the positions of the far Left capitulated and did so during the Obama years. As Maggie Gallagher noted in April 2016 in *National Review,* while corporations were eager to avoid public controversy in the past, the "massive expansion of vague regulations under the Obama administration means that virtually every major corporation in America has some interest in keeping Washington off of their backs," and so the corporations waded "directly into the culture wars" as "a cheap strategy to curry favor."

Why would firms engaged in the production of good or services—activities that benefit everyone and should be non-political—choose to stake out extremely partisan positions and risk alienating many of their customers? Maybe they felt they had no choice. Maybe they concluded there was just too much risk from free-wheeling progressive bureaucrats wielding regulatory mandates that could damage their image and cost them big money—even put them out of business—if they did not toe the radical line.

In any case, the cronyist and clientalistic collusion of businesses with the government spawned economic distortions and weakened the body politic. The next President must act immediately to sever these linkages, must ask Congress to terminate the many pernicious statutory incentives that feed them, and must explain to the American people how corrosive and counterproductive this entire "pay-for-play" system has become.

From Responsible Corporate Citizenship to Corporate Socialist Cronyism

In the 1970s, United Nations efforts to regulate "transnational corporations," and other heavy-handed political pressure campaigns to demonize the free market, in general, and private businesses in particular, flopped. So, in the 1980s, progressive activists began promoting the more benign-sounding but vague standards of corporate social responsibility (CSR), billing them as strictly voluntary. CSR proponents promised that private companies that adopted these standards would earn their blessing as good stewards of community resources. Many companies, eager to protect shareholder equity and shield their brands from tarnish, were all too happy to sign on to CSR as a public relations strategy to offset the ever-growing demands on them by government bureaucrats and NGOs claiming to act on behalf of "multi-stakeholder" consumers and ordinary citizens.

Grove City College business professor Andrew Markley has warned that CSR poses a threat to the entire private enterprise system. It does so by redefining the essential concept and purpose of business through a model that ostensibly recognizes the existence of firms within a market economy but undermines firms and markets in an effort to usher in an age of socialism. In addition to CSR activism globally and at the federal level, Markley has spotlighted CSR activism at the U.S. state level to get laws passed to authorize new forms of incorporation. "Benefit" corporations (B Corps) are required to include environmental, social, and community goals in their basic business models. The costs of doing so are then passed on to consumers in the form of higher prices.

Today's CSR activists—self-proclaimed social justice warriors, whose ultimate goal is heavy taxation or outright expropriation of private capital to increase the size and scope of redistributive government—have moved far beyond the days of CSR voluntary standards. In fact, mimicking their counterparts in Europe, they have moved deep inside corporate America. Their strategies are now being analyzed—and improved—by academic researchers.

For example, in a February 2016 paper, "The Link Between Social Movements and Corporate Social Initiatives," University of Michigan business professor Panayiotis Georgallis acknowledges that American businesses still prioritize profits; but he concludes that ideologically motivated and "multilevel" social movements are increasingly able to influence firms' behavior. He includes advice on how to improve "the efficacy of insider activism."

Indeed, some former NGO activists now serve as CSR compliance officers in the executive suites of major U.S. corporations. These "insider activists," sometimes using federal "public-private partnership" cash, have created a network of powerful and wealthy corporations intertwined with counterpart CSR liaison offices that the Obama Administration opened in more than a dozen federal government agencies, including the State Department, the Overseas Private Investment Corporation, the Export–Import Bank, the Department of Labor, USAID, the Environmental Protection Agency, the Department of Agriculture, the Department of Energy, the Department of Commerce, and the Consumer Financial Protection Bureau.

The Many Faces of CSR

CSR has morphed into a wide variety of groups and movements, such as the Coalition for Environmentally Responsible Economies, founded after the Exxon Valdez oil spill in Alaska in 1989; business and social responsibility; business and human rights; the U.N. Global Compact; the National Association for Environmental Management, a group of corporate executives implementing models of sustainability in the "circular economy"; the Natural Resources Defense Council; the Global Initiative for Sustainability Ratings; and the Global Reporting Initiative.

At their core, however, all of these entities and philosophies are committed to the same goal: aligning private businesses to CSR's "triple-bottom-line" obligations of companies to deliver (1) economic, (2) social, and (3) environmental "returns" to justify a theoretical "license to operate" granted to them by society. Moreover, advocates of the new forms of CSR are pushing for mandated standards instead of voluntary initiatives, asserting comprehensive obligations in place of targeted projects, and requiring structured reporting in place of flexible communications.

A Plethora of Public-Private Partnerships. It will take the next President an entire term of office to disentangle the vast web of cronyist "public-private partnerships" created during the Obama years. Its vast size and scope cannot be described adequately in a short essay, but a few examples suffice to illustrate it:

- More than 1,400 bureaucrats in more than a hundred U.S. cities and more than 75 countries work for the U.S. Commercial Service, the trade promotion arm of the Department of Commerce. While U.S. companies might have needed that help in global markets when the service was established nearly 50 years ago, today countless private-sector consulting firms can provide that know-how more efficiently for less money. So, now the Commercial Service is just another potential conduit for cronyism. It should be shut down.

- The same can be said for a smaller, and redundant, operation at the State Department—the Office of Commercial and Business Affairs—the stated mission of which is "to engage U.S. government resources to assist and advocate for U.S. business interests abroad, strengthen intellectual property enforcement, promote a vibrant ecosystem for entrepreneurship and innovation, and ensure U.S. private sector concerns are integrated into our foreign and economic policy." To avoid creating additional opportunities for cronyism, the State Department should be doing just the opposite—and ensuring that the U.S. private sector is not integrated into what should be an arms-length relationship with the federal government.

- Billions in wasteful Department of Energy subsidies were awarded to politically connected biofuel, wind, and solar energy firms, such as Solyndra (that later went bankrupt), but public-private "green" partnerships have extended far beyond them. For example, the Commerce Department's

"Natural Capital" program website takes credit for environmental clean-up efforts by several major U.S. corporations (working with the Nature Conservancy) that were required under the Clean Water Act. The federal government should enforce the law, but not fund an entire bureaucracy to direct private-sector compliance efforts.

Cronyist, Obama-era public-private partnerships should be terminated. The federal government should resume its limited and constitutional role merely to ensure a level regulatory and judicial playing field for business at home, and advocate open markets and the rule of law overseas.

Corporate Cultural Cronyism. Today, the dominance of progressive activists in many major corporations is such that business school professors Aaron K. Chatterji of Duke University and Michael W. Toffel of Harvard University were able to publish a case study in 2016 assessing their effectiveness. In "Do CEO Activists Make a Difference? Evidence from a Field Experiment," they concluded that, yes indeed, they do. For example, the study reported that public statements and social media tirades, such as those by Apple CEO Tim Cook, Salesforce.com CEO Marc Benioff, and Angie's List CEO Bill Oesterle, did frame the issue and swayed public opinion against the State of Indiana's Religious Freedom Restoration Act (RFRA). Americans saw similar tactics deployed during President Obama's tenure, especially against RFRAs and similar conservative legislation in Arizona, Georgia, Mississippi, North Carolina, and Mississippi. Often, large companies also leveraged their sponsorship of major sporting events to encourage the NFL, NBA, and NCAA to take similar positions.

Dr. Ryan Anderson of The Heritage Foundation has called these heavy-handed tactics "cultural cronyism." But did these CEOs also have a hidden agenda?

Surely it is no coincidence that bursts of activism by Silicon Valley CEOs earned a big push for a "2016 Global Entrepreneurship Summit" at Stanford University, hosted by President Obama with more than 1,000 delegates from around the world. Likewise, it was probably not just serendipity that that many of these same giant companies underwent fewer audits by Obama's IRS. According to Pepperdine law professor Paul Caron's taxprof.com blog on March 24, 2016, "enforcement information obtained from the Internal Revenue Service show that total revenue agent audit hours aimed at larger corporations—those with $250 million or more in assets—dropped by more than one third (34 percent) from FY 2010 to FY 2015."

Recommendations for the Next Administration and the 115th Congress

Jay Cost recalled in his 2015 book *A Republic No More* the warning from Benjamin Franklin that the USA is "A Republic—if you can keep it." In a February 16, 2015, interview on Nationalreview.com, Cost said that political corruption—the triumph of special interests over the common interest that the prescient James Madison called factionalism—"is so widespread that our government is not so much a republic, but rather a special interest democracy. Everybody may participate, yes, but the contours of public policy depend not so much on the common good, but rather the push-and-pull of the various interest groups encamped in Washington, DC."

Together, the next President and the 115th Congress must tackle the endemic and deep problem of corporate socialist cronyism—which is the antithesis of corporate social responsibility. The many necessary steps they must take include:

- **Appointing**, on January 20, 2017, a presidential commission to survey the entire federal government and prepare an assessment of all risks of cronyism-related CSR;
- **Immediately closing** CSR-related liaison offices in all federal agencies and **ending** any federal grants to U.S. states for similar offices;
- **Ending** federal "corporate excellence" awards;
- **Ending** "green" tax credits;
- **Ending** corporate welfare programs, such as for the Export–Import Bank (subject of the companion essay "Eliminate Export-Financing Subsidies" by Diane Katz in the 2017 Global Agenda) and other federal corporate subsidies;
- **Ending** all public-private partnerships between federal agencies and private companies; and
- **Ensuring** that the IRS conducts audits of large companies at the same rate as other companies.

Conclusion

CSR in its many forms poses a toxic threat to American business and the entire free enterprise system. CSR is an attractive-looking concoction that appears to be a tonic for corporate public relations' strategies, with no risk. However, the "voluntary" but very radical CSR standards, principles, and strategies are increasingly being embraced by the corporate world. Pushed by leftist CSR proponents (special interest NGOs and intrusive government bureaucrats), their goal is to redefine the very purpose of business, weighing down private companies with ever greater burdens and constraints, and giving self-identified corporate "stakeholders" a free ride at the expense of responsibility to shareholders and customers.

American corporations have been the backbone of economic freedom. Their goods and services, efficiently produced and affordably priced, have made the American Dream possible. It is the genius of the capitalist system, with collective social benefits resulting from discrete microeconomic firms making the best widget or performing the best service they can. Now they are being pressured by the leftist-controlled regulatory administrative state to promote and enforce delivery of political goods that are far beyond their business models. Not every business should be involved in every issue. It is costly and increases politicization of the society.

Ultimately, CSR is a stratagem by progressive leftists to subsume the private sector under de facto government control. The next Administration should stop them.

—James M. Roberts

Eliminate State-Owned Enterprises to Maximize Global Well-Being

State-owned enterprises (SOEs) are increasing in both number and size, distorting markets and inhibiting economic growth across the globe. Government ownership and control of commercial enterprise entails significant costs and illusory benefits. Going forward, retrenchment from SOEs should be a priority in trade negotiations.

What differentiates SOEs from private corporations is the coupling of financial goals and social-political objectives such as job creation, economic development, or a domestic grip on natural resources. Varying degrees of corporate social responsibility (CSR) exist throughout the private sector, but SOEs specifically operate with a "double bottom line." (For more about CSR obligations, please see the companion essay "The Danger of Corporate Socialist Cronyism" by James M. Roberts in the 2017 Global Agenda.)

This dual pursuit of economic and social/political benefits is often cited as justification for the competitive advantages inherent in state ownership, including direct and indirect subsidies, discount financing, and regulatory favor. Inevitably, those non-business purposes conflict with efficiency and productivity. When governments attempt to compensate for the trade-offs, they misallocate labor and capital, and economic distortion ensues.

No matter the form, government interference in commercial activity undermines free and open trade and foreign investment—essential elements of all nations' well-being. The politicized nature of SOEs also breeds cronyism and corruption, while the lack of transparency undermines accountability.

Advantages and Drawbacks

Enterprises are typically classified as "state-owned" if the government (at any level, directly or indirectly) owns at least 50.01 percent of the shares. By this definition, 10 percent of the world's largest firms are SOEs, according to research by the Organization for Economic Co-operation and Development (OECD). The combined market value of these enterprises—an estimated $4.9 trillion—equates to about 11 percent of the market capitalization of the Forbes Global 2000.

SOEs are most common among emerging economies, with the top five being China, India, Russia, the United Arab Emirates (UAE), and Malaysia. According to OECD data, 96 percent of the shares of China's Top 10 firms belong to the state, followed by the UAE (88 percent); Russia (81 percent); Indonesia (69 percent); and Malaysia (68 percent).

The ownership structure of SOEs changed markedly under the market liberalizations in many former communist countries. It is not uncommon these days for minority shares of SOEs to be traded on stock exchanges or held by banks.

SOEs tend to be concentrated in highly capitalized industries, such as natural resource extraction, railways, telecommunications, and defense, as well as essential products and services (energy, health care, and postal services). OECD researchers found that SOEs controlled 43 percent of the shares in mining; 34 percent of crude oil and natural gas extraction; and 27 percent of electricity, gas, and steam.

Although seemingly sheltered from market tumult, SOEs' exposure to domestic and special interest political forces constrains their ability to innovate and to adapt to changing market conditions—both of which would otherwise maximize economic and social benefits.

Whatever the proportion of ownership, a government stake in any given sector of the economy automatically disadvantages private-sector competitors. For every commercial input, be it labor or capital, the government will always enjoy greater access and control. Thus, the continued expansion of SOEs reduces export and investment opportunities, which in turn diminishes economic and social progress for most everyone—with the exception of those who profit from cronyism and corruption.

Just as big government diminishes transparency and accountability, the politicization of commerce weakens the market forces that otherwise impose discipline on corporate behavior. Under such conditions, unethical employment, financing, and procurement practices can thrive.

Whatever social benefits consumers might gain from SOEs, such as subsidized prices, must be measured against the inherent drawbacks when bureaucrats displace entrepreneurs. Government enterprises are largely insulated from consumers' demands for quality and choice, as well as from the constant pressure in the for-profit corporate sector to contain costs and increase efficiency. For SOE bureaucrats, risk avoidance is paramount.

Enterprises Chartered and Owned by the U.S. government

- Commodity Credit Corporation
- Corporation for National and Community Service (Americorps)
- Corporation for Public Broadcasting
- Export-Import Bank of the United States
- Farm Credit Banks
- Federal Agricultural Mortgage Corporation
- Federal Crop Insurance Corporation
- Federal Deposit Insurance Corporation
- Federal Financing Bank
- Federal Home Loan Banks
- Federal Prison Industries
- The Financing Corporation
- Gallaudet University
- Government National Mortgage Association
- Legal Services Corporation
- Millennium Challenge Corporation
- National Consumer Cooperative Bank
- National Corporation for Housing Partnerships
- National Credit Union Administration Central Liquidity Facility
- National Endowment for Democracy
- National Fish and Wildlife Foundation
- National Park Foundation
- National Railroad Passenger Corporation (Amtrak)
- Neighborhood Reinvestment Corporation
- Overseas Private Investment Corporation
- Panama Canal Commission
- Pennsylvania Avenue Development Corporation
- Pension Benefit Guaranty Corportation
- St. Lawrence Seaway Development Corporation
- Securities Investor Protection Corporation
- Tennessee Valley Authority

CHART 2

Large Non-U.S. State-Owned Enterprises

Country	Company	Sector	2014 Revenue (billions)
China	Sinopec	Oil and Gas	$446.8
Saudi Arabia	Saudi Aramco	Oil and Gas	$378.0
Russia	Rosneft	Oil and Gas	$97.4
Brazil	Bank of Brazil	Banking	$58.2
UAE	Emirates	Airline	$26.3
Britain	BBC	Broadcasting	$7.5
Indonesia	Telkom	Telecommunications	$6.7

SOURCE: Heritage Foundation research.

Few Remedies to Date

The World Trade Organization (WTO) has thus far proven ineffective in preventing the growth of SOEs. Part of the problem is the lack of transparency of states' commercial activities. WTO rules that date to 1947 require that parties notify the organization of SOEs, but compliance has been very poor. Consequently, a significant number of anti-competitive practices are escaping WTO scrutiny.

The OECD, for its part, has issued "guidelines" on the corporate governance of SOEs. First released in 2005, and updated in 2015, the guidelines are recommendations to governments on how to ensure that SOEs operate efficiently, transparently, and with accountability.

SOEs undermine free trade and economic growth, and invite corruption. Eliminating this form of economic protectionism should be a top priority for all international trade deals and policies. However, that is easier said than done. Realistically, reform will have to be incremental and hard won. Negotiating the privatization of smaller SOEs is the obvious first step to reform. For larger enterprises, a gradual shift in ownership would avoid the disruptions experienced by Russia in the 1990s.

Recommendations for the Next Administration and the 115th Congress

One strategy that would definitely not work for the United States and its trading partners would be to craft protectionist policies in the name of "leveling the playing field." As Ronald Reagan once said: "We're in the same boat with our trading partners. If one partner shoots a hole in the boat, does it make sense for the other one to shoot another hole in the boat? Some say, yes, and call that getting tough. Well, I call it stupid. We shouldn't be shooting holes; we should be working together to plug them up."

The benefits of limited government and open markets are undeniable. As The Heritage Foundation's *Index of Economic Freedom* documents every year, these and other core conservative principles generate greater prosperity for all. That prosperity, in turn, creates virtuous circles of rising public support for expanded international trade and investment.

The best place to start, however, is at home. To set an example and send a signal around the world, Congress and the next President should take a close look at the SOEs in the United States that appear in Chart 2, with a view to removing the U.S. government from activities best left to the private sector.

—Diane Katz

Sanctions: An Important Component of U.S. Foreign Policy

Sanctions are punitive measures intended to deter, coerce, and compel changes in another country's policy and behavior. The debate over the utility of sanctions in foreign policy is usually depicted in binary fashion, that is, whether the U.S. should use pressure or engagement.

The reality, of course, is that sanctions *and* engagement—along with economic assistance, military deterrence, alliances, and public diplomacy—are all diplomatic tools to influence the negotiating behavior of other nations.

Rather than being used in isolation, these tools are most effective when integrated into a comprehensive strategy utilizing all the instruments of national power. These tools can be employed in a range of options and combinations. Not fully employing any element of national power reduces the effectiveness of U.S. foreign policy.

Critics of coercive financial pressure often question its effectiveness, overlooking that it is usually imposed after repeated attempts at diplomatic engagement and negotiations already failed. No tool is meant to be used in isolation, so statements such as "sanctions by themselves won't be effective" and "sanctions are not a silver bullet" reflect a misunderstanding of the requisite broader policy strategy.

Sanctions Have Many Objectives. Adopting such a narrow viewpoint as above overlooks the multifaceted utility of sanctions, which:

1. Show resolve for enforcing international agreements, and send a strong signal to other potential violators. If laws are not enforced and defended, they cease to have value.

2. Impose a heavy penalty on violators and demonstrate that there are consequences for defying international agreements and transgressing the law.

3. Constrain a violator's ability to acquire the components, technology, and finances to augment and expand its arsenal.

4. Impede nuclear, missile, and conventional arms proliferation. Targeted financial and regulatory measures increase both the risk and the operating costs of a violator's violations of United Nations Security Council resolutions and international law.

5. In conjunction with other policy tools, seek to modify a violator's behavior.

Unlike broader trade sanctions, targeted financial measures are directed against entities that violate U.S. laws by exploiting their need to access the global financial network. Even the most isolated regime, criminal organization, or terrorist group is tied to the global financial order. Dirty money eventually has to flow across borders and—given that the U.S. dollar serves as the global reserve currency—the vast majority of all international financial transactions are denominated in dollars.

As such, virtually all international transactions must pass through a U.S. Treasury Department–controlled bank account in the United States, which gives tremendous leverage to Washington. For banks and businesses, there are catastrophic risks to facilitating—even unknowingly—illicit transactions. The British bank HSBC was fined $1.9 billion for money-laundering and sanctions violations, including financial dealings with Iran, and the French bank BNP Paribas was fined $8.97 billion for processing banned transactions with Sudan, Iran, and Cuba.

Beyond having to pay fines and having assets frozen or seized, financial institutions can be denied access to the U.S. financial system—and thus shunned internationally as a pariah—if labeled a "money-laundering concern."

The events following the implementation of U.S. targeted sanctions against Venezuelan government officials prove their efficacy. During anti-government uprisings in 2014, the Venezuelan government violently cracked down on activists, killing upwards of 40. After numerous failed attempts at resolving the crisis, the U.S. government blocked travel for, and froze the U.S. assets of, seven high-ranking security and intelligence officials that oversaw the persecution.

Shortly thereafter, numerous defectors, including the former security chief of the ruling party's legislative chief and suspected drug cartel leader, began collaborating with U.S. authorities. The U.S. Treasury Department's Office of Foreign Assets Control had designated former and current cabinet

level officials as "Significant Foreign Narcotics Traffickers" pursuant to the Drug Kingpin Act.

Tougher Measures Effective When Applied. In 2005, the U.S. designated the Macau-based bank Banco Delta Asia as a money-laundering concern for facilitating North Korean illicit activities. North Korea was shunned by the international financial system due to the cumulative effect of the action—the clear signal that Washington would belatedly begin enforcing its laws—and a series of private meetings by U.S. officials throughout Asia.

Under Secretary of Treasury Stuart Levey stated, "Two dozen financial institutions voluntarily cut back or terminated their business with North Korea." A North Korean negotiator admitted to a senior White House official, "You finally found a way to hurt us." The Bush Administration subsequently removed the pressure in a failed attempt to improve the atmosphere for the Six-Party Talks. Years later, Obama Administration officials declared that the Banco Delta Asia action was "very effective" and it was "a mistake" for the Bush Administration to have rescinded it. In June 2016, the United States designated the North Korean government as a primary money-laundering concern.

The targeted financial measures against Iran were a critical factor in Tehran's return to the negotiating table. While successive U.S. Administrations had for decades imposed sanctions on Iran for a variety of transgressions, only since 2010 had Washington, the EU, and the U.N. adopted steadily stricter and more comprehensive measures.

Unilateral U.S. actions, combined with diplomatic pressure, led other nations to impose their own financial and regulatory measures against Iran, including an EU ban on purchasing Iranian oil. Collectively, the international sanctions isolated Iran from the international banking system, targeted critical Iranian economic sectors, and forced countries to restrict purchases of Iranian oil and gas, Tehran's largest export.

Sanctions Not the Cause of Lack of Economic Freedom. Targets of U.S. and multilateral sanctions often blame their country's dire economic condition on the punitive measures rather than on their own restrictive economic policies. Trade sanctions and targeted financial measures are imposed on nations that operate outside the norms of international behavior or in direct violation of laws or U.N. resolutions. Such abhorrent behavior is usually reflective of closed, authoritarian regimes.

The Heritage Foundation's *Index of Economic Freedom* provides strong evidence that economic freedom is a prerequisite for sustainable human and societal development. Nations with higher degrees of economic freedom have flourished economically. Put simply, the freer the economy, the more productive and prosperous its citizens are likely to be.

Nations with high economic freedom consistently empower individuals, improve living standards, promote human development, and facilitate democratization. None of those attributes is reflective of authoritarian regimes implementing policies that result in sanctions being imposed upon them. As such, the subsequent removal of U.S. and multilateral sanctions on such regimes will not, in and of itself, engender economic freedom or dramatically improve living standards.

Opponents of sanctions, particularly the trade embargo on Cuba, inaccurately portray the U.S. statutes as the cause of Cuba's poor economic conditions and advocate their premature removal. They fail to recognize that over 190 countries worldwide have long maintained unrestricted economic and political exchanges with Cuba. In fact, Cuba's abysmal economic situation is due primarily to the government's total control of the economy and the widespread public corruption that absolute power feeds.

Likewise, proponents of Obama's opening to Cuba conveniently forget that the U.S. trade embargo was implemented following the illegal expropriation of many properties owned by American citizens and companies. These expropriation cases remain unresolved and have never been compensated by the Cuban government. The U.S. trade embargo should not be lifted until they are.

Don't Hit the Snooze Bar on Sanctions

The Obama Administration pursued a sanctions policy of timid incrementalism in which strong vows to act resolutely "the next time" were not backed up by strong actions. By pulling its legal punches, Washington squandered the opportunity to more effectively impede progress on, for example, North Korea's nuclear and missile programs, and coerce compliance with U.N. resolutions.

This mild-mannered American approach has also extended to Cuba and Venezuela. The Obama Administration's decision to normalize relations with Cuba and to call for a unilateral lifting of the U.S. trade embargo has undermined American leverage

over the hostile regime in Havana. As for Venezuela, the Obama Administration's strategy of supporting targeted sanctions while simultaneously attempting diplomatic overtures sends the wrong message.

The collective international finger-wagging and promises to be "tougher the next time" have granted recalcitrant nations additional years to continue their prohibited behavior. Resolute imposition of sanctions had achieved ripple effects by altering the cost-benefit analysis of violators, as well as inducing other nations to duplicate American law enforcement actions. Those substantial gains have been squandered by the Obama Administration.

When confronted with violations of U.S. law or U.N. resolutions, the next President should not hold imposition of sanctions in abeyance, to be rolled out only after the next transgression or provocation. There will be little change in behavior until the opponent feels pain over the consequences of its actions.

—Bruce Klingner

U.S. Must Withdraw from UNFCCC and Revoke Disastrous Climate Action Pledge

The United Nations Framework Convention on Climate Change (UNFCCC), which was sold to the American people as an essential international collaborative effort to avert global warming, has instead become a mechanism to redistribute wealth and to dramatically rework and centralize the world economy with little or no impact on climate. Promises made by the Obama Administration at the December 2015 climate meeting in Paris are part of an unratified treaty and, in the absence of such ratification, the next Administration should announce that those promises are null and void. This climate treaty should be explicitly rejected.

The U.S. should also eliminate any U.S. contributions to the U.N. Green Climate Fund and eliminate U.S. contributions to, and withdraw from, the UNFCCC.

Intergovernmental Panel on Climate Change: An Abysmal Failure

The ostensible reason for creating the UNFCCC was to provide an international response to the supposedly impending climate crisis. The proffered source of the crisis was global warming due to man-made emissions of carbon dioxide, primarily from carbon-based energy sources—coal, natural gas, and petroleum.

The 2009 "Climategate" scandal exposed the unconscionable biases in the climate research underlying the UNFCCC's reason for existence. The abysmal performance of the Intergovernmental Panel on Climate Change's (IPCC) climate models, when compared to actual observed data, further undermines the scientific predicate for costly carbon policies.

Even more problematic for the climate agenda is the ineffectiveness of proposed climate policies. Even if the IPCC models were accurate, total elimination of carbon-dioxide emissions in the developed world would have a trivial impact on any global warming.

However, it appears that the means for "solving" the climate crisis are more attractive to leftists than the solution's efficacy. For example, at a 2000 U.N. climate conference in The Hague, then-president of France Jacques Chirac noted: "For the first time, humanity is instituting a genuine instrument of global governance, one that should find a place within the World Environmental Organization." More recently, Christiana Figueres, executive secretary of the UNFCCC, stated, "This is probably the most difficult task we have ever given ourselves, which is to intentionally transform the economic development model, for the first time in human history."

The flow of energy is the jugular vein of the world economy. With a chokehold on energy, the UNFCCC would gain extraordinary leverage over the whole economy. Total world carbon-dioxide emissions, if priced at the level suggested by the Environmental Protection Agency, could potentially generate over $1 trillion per year in the early years and greater amounts in subsequent years.

As a last-gasp attempt to salvage the 2009 U.N. Climate Change Conference in Copenhagen, the representatives established (but did not fund) a $100 billion per year Green Climate Fund. The fund is supposed to compensate the developing world for the damages from climate change—and, implicitly, for the damage of the draconian obstacles that U.N. climate policies would erect to economic development.

However, $100 billion would fall woefully short of compensating the developing world for hobbling their economies with growth-killing climate policies. India announced that it alone would need $2.5 trillion by 2030 to cut its carbon-dioxide emissions.

$100 Billion per Year for Climate Change Platitudes. Though too little to offset the economic damage of developing world energy privation, the promise of $100 billion per year is more than enough to get the leaders of the developing nations to pay lip service to the agenda and to offer themselves as props for the whole charade. The fund creates competition to claim the maximum home-country climate damages in order to qualify for the largest share of the pot. For example, the summary for policymakers (whose final form is vetted by political appointees) of the most recent IPCC report was so twisted that it purports to document sea-level-rise damage in landlocked countries.

Though not appropriated by Congress, the Obama Administration recently reprogrammed money to make an initial contribution of $500 million to the U.N. Green Climate Fund. The Administration is on record promising to contribute $3 billion per year as

a start. The expectation at the UNFCCC is that the U.S. contribution would eventually be in proportion to U.S. carbon-dioxide emissions. This would boost America's obligation to more than $20 billion per year.

U.S. Policy Recommendations

The next Administration should withdraw from the UNFCCC and eliminate any financial contribution by the United States to the UNFCCC and to the U.N. Green Climate Fund.

In addition, the next Administration should abandon the unratified carbon-reduction targets of the 2015 Paris climate agreement and repudiate all carbon-reduction targets made in any international agreement that was not ratified by the U.S. Senate.

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