How to Manage Globalization While Containing the Dragon

(Attachment
to
"A Radical Plan to Manage Globalization")

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This paper presents results obtained in joint work with the late Mark Perlman, the University Professor of Economics (Emeritus) at the University of Pittsburgh. These results were first introduced in our joint *Statement for the Record* in the Hearing before the Committee of Finance of the US Senate on June 23, 2005.

1. Introduction

The US is currently in a precarious position, one of the most dangerous in its history. In addition to geopolitical threats, we face a severe economic shock. The enormous wealth of this country is transferred abroad at a high and accelerating rate. To finance our voracious consumption, we borrow from potential adversaries. We lose important industries and millions of middle-class jobs. With the industrial base being destroyed, our security is compromised. The country has lost every important economic weapon that can be used in thorny geopolitical situations, which will prevail in this century.

All these devastating changes come from a blind following of an "orthodox" free trade policy, which the US currently employs in the global market. It brings great benefits to many consumers, corporate executives, and investors, as well as to many poor people around the world. But it may be very dangerous to the American society and to the world. Five questions arise. First, does the use of free trade correspond to the interests of both the American society and the global system as a whole? Second, is the use of free trade in the real world theoretically justified? Third, what can be done to improve the situation? Fourth, how risky will it be? Fifth, can the new policy be also used as a geopolitical tool?

This paper gives strongly negative answers to the first two questions. To the third question, the paper proposes a "compensated free trade" policy that promises substantial and multifaceted improvement. To the fourth question, the techniques of that policy will reduce risk and provide a superb risk management tool. As for the fifth question, the answer is extremely positive.

This means the following:

- An enormous, relentless and shameless propaganda machine tries to convince Americans that both unbridled free trade and uncontrolled globalization have theoretical justification, are unavoidable, and are good for the US and the world. Neither of these statements is true. Free trade and uncontrolled globalization are not good even for Big Business.
- Time has come for capping the trade deficits. Any currently proposed version of capping would be a step in the right direction. Our version includes both allocation of the overall deficit limits between this country's trading partners and intergovernmental payments. We believe that, though more complex, it is much more flexible, versatile, and promising. Most importantly, it is an excellent tool of the containment of our potential geopolitical and economic adversaries -- a must for the turmoil and upheaval of the 21st century.

2. The Current Situation

The US is currently in a precarious position, one of the most dangerous in its history. In addition to threats of nuclear or biological terrorist acts on American soil, the war in the Middle East, and the overall geopolitical turmoil, including Iran and N. Korea, the military advance of China and the resurgence of the Russia-China alliance -- we face a severe economic shock. During the past six years, the country lost more than 3 million of manufacturing jobs and transferred abroad, by different estimates, 4 to 6

percent of its enormous wealth. In 2006, its current account deficit will probably reach about $900B, or almost 7% of GDP, with its rise accelerating. In just one year, the deficit exceeded more than twice our expense on the Iraq war for four years. The notorious "bridge to nowhere" costs $222 million; in foreign trade, we lose that amount every two and a half hours. In 6 to 8 years, just our return payments on foreign holdings on US securities may reach half a trillion dollars a year. A large part of that debt is borrowed from China, our potential adversary; it holds now more than one trillion dollars of currency reserves, predominantly in the US debt securities, and expects to double that amount in four years. This is an ever-growing mortgage on our country, and the situation is unsustainable. Even President Bush, a religious devotee of free trade, says so.

The just completed draft of the Horizon Project, which is intended to be a Marshall-type Plan for America and has been authored by eleven eminent CEOs and policy innovators, comes to basically the same conclusions.

The Horizon Project talks about "a hollowing out of American productive and services capacity," about "the US international trade position ... being in free fall," about "many U.S. multinational corporations which ... seem tempted to off shore almost everything but consumption." Consequently, "The traditional U.S. trade surplus in agricultural products is nearing zero, in high-technology products it has turned negative, and in trade services it is small and declining as a proportion of total trade." Moreover, it considers emigration of such industries as chip manufacturing to China, Taiwan and South Korea as "very unwise," as these areas are threatened by potential geopolitical disturbance in the region that might "greatly diminish U.S. armed forces operations and effectiveness."

The present relatively low rates of inflation and unemployment and satisfactory rates of growth were bought at an enormous price of transferring our wealth and labor force abroad.[1] Besides, they are transitory and are about to end in either "hard" depression or – in the best Fed's scenario –- "soft landing" into possibly a recession, while debts (growing at almost a trillion dollars a year, and escalating) are forever.

But that is just for starters. As argued last spring in *Foreign Affairs* by a Princeton economist Alan Blinder, we are at the beginning of a great upheaval of the third industrial revolution. He says that out of about 140 million current US jobs, all 14 million jobs in manufacturing and between 28 and 42 million in the service sector could be moved offshore in the next decade or two. About three billion people will be waiting for these jobs in other countries, expecting just a fraction of US wages. Education and skills may not help, because these hordes will include scores of millions of scientists and engineers, medical professionals, accountants and even (non-divorce) lawyers. US wages will go down sharply. Our broadly shared middle-class prosperity of the post-WW II era will be dead. This is very dangerous, because a strong middle class is a must for long-term sustainability of any democratic society. Without it, the society will polarize, its democracy will be destroyed, and the country may turn sharply left. (We may already see such effect of globalization in other countries, too.)

First and foremost, we have to ask ourselves – is an industrial revolution likely to come? We think that the probability of its occurring is close to 1.0. Perhaps many would agree. Alan Blinder analyzed and spelled out the probable implications of that revolution. But Americans are not prepared for it in any sense.

Moreover, we must fully recognize that the trade policy of a country should never -– and especially not in wartime -- be based on purely economic and financial considerations. It also has to be a powerful geopolitical tool. We should be able to reward our friends and penalize our adversaries. The old Cold War is gone, but we have perhaps even worse and diverse challenges from new adversaries. Our country has presently lost, however, every important large-scale economic weapon that can be used in the thorny geopolitical situations, which are likely to prevail in this century. We speak loudly and carry a minuscule stick.

All these devastating changes come from a blind following of an "orthodox" free trade policy, which the US currently employs in the global market, and from allowing uncontrolled globalization, which greatly exceeds affordable levels. Both free trade and globalization bring great benefits to many consumers, corporations (more correctly, their top executives), and investors. They also raise the standards of living of many poor people abroad. But, as argued above, they may be very dangerous to the American society and to the world.

Conferring on China a permanent Normal Trade Relations status (2000) and admitting China to WTO (2001), in spite of such glaring flaws as absence of minimum wage, were two most terrible mistakes. They have changed everything, disarming us unilaterally and irreversibly.

This section gives an unambiguous answer to **the first question** about the current impact of the free trade policy. Free trade under present conditions and rules is too destructive and thus contradicts the vital interests of the US and of the world. This trade system cannot last and urgently needs an overhaul.

3. The Emperor Has No Theoretical Clothes

(a) Finally, Free Lunch – a Cost-Benefit Analysis with Cost Amputated

Is free trade at least justified theoretically? Answering **the second question**, we start with showing that it is not justified even if we make a simplistic assumption that the goal of a trade policy is just to maximize the standard of life. Then we proceed to a more realistic definition of trade policy.

Free trade does not correspond to the conditions of the 21st century and is greatly outdated. It was good for England in 1907, but too much is different now. (It is sufficient to mention just one change – abandoning of gold standard.) Nobody would try to install a 1907 carburetor in a 2007 car.

Under the simplistic assumption above, we submit that the presumed theoretical rationale of free trade, the "law of comparative advantage," is invalid, inapplicable, and irrelevant in the real world of trade imbalances, worker specialization, persistent unemployment, large wage-level gaps between countries, "sticky" prices and wages, technological progress, "learning curves," excess production capacity, geopolitical and economic instability, and unprecedented uncertainty. This list of forbidden by the theory but unavoidable conditions of the 21st century can be prolonged further. (And we do not even include here the "unfair-trade" conditions that maybe -– just maybe –- can be removed, such as predatory trading and currency manipulation.)

Among the best sayings of George Orwell, “There are some things only intellectuals are crazy enough to believe” takes a place of honor. One of these crazy things is the “law of comparative advantage,” formulated (without calling it a “law”) about 190 years ago by David Ricardo. The “law” basically states that, in the long run, country specialization combined with free trade benefits every participant.

For millenniums, humanity had been pursuing a beautiful “Dream of Free Lunch,” which is “You can get something for nothing.” Economists are in the best position to climb that pole, because they do not have to demonstrate a working model and therefore have a power of “assuming away” all unpleasant realities, calling that procedure “making the necessary abstractions.” Thus they have advantage over such less fortunate competitors as inventors of perpetual motion machines, who, try as they may, cannot “assume away” friction and other physical hindrances.

Under abstract conditions, the Ricardo’s concept is unassailable. Ricardo says that any country can increase its standard of life by importing those goods which that country makes less efficiently, and paying for the imports by exporting more efficiently produced goods. This increases overall production and consumption. So far, so good.

But here the power of “assuming away” becomes effective: Ricardo looks only at the benefits of such specialization, but not at its negative “externalities,” or adjustment costs. In effect, he assumes that such costs do not exist. But in the real world, these costs might easily bury “the advantage”. We might be penny-wise about benefits and pound-foolish about adjustment costs.

Every action of a living being affects a large system; the “butterfly effect” has been widely recognized. Economists are very quick to notice any such “externality,” any wisp of smoke rising out of a factory chimney, any emanation of methane gas from under a cow –- when it is convenient. How to explain their lack of vision for the past 190 years?

It would be very surprising, were Ricardo not to find any “advantage.” *A cost-benefit analysis with no costs; at long last, a veritable free lunch.* Cost-benefit analysis was developed just for the purpose of a comprehensive analysis and evaluation of positive and negative consequences of human decisions. The case of free trade is a serious violation of its strict and clear rules.

Because costs are forbidden, re-training, transition and relocation of workers are disallowed, as well as the social costs arising if they become unemployed.

At this point, to avoid the unemployment costs, full employment becomes necessary. To avoid transition costs, the displaced workers should be re-employed by the better industry at once; hence, we need full employment for that reason, too.

Adam Smith strived for efficiency by specialization of individual workers. Ricardo generalized the approach of Smith by specializing whole countries. *But he achieved that goal only by sacrificing the specialization of individuals.*[2] Because he cannot let re-training and other costs eat up the “comparative advantage” in consumption, he has to make a drastic assumption: *Ricardo’s laborers must be “homogeneous”* -- either unskilled roustabouts, or vehicle drivers identical for all industries, or “jacks-of-all-trades” that can, without re-training, start working in any industry.

(b) "The do-all paradox"

We call the need for that sacrifice *"the do-all paradox."* Maybe it was not so important two hundred or even one hundred years ago, and in a country where Manchester is just a step away from Liverpool, but in America of the 21st century this paradox nips Ricardo in the bud. Just try to imagine, for instance, the girls of the textile mills of South Carolina, who, next day after being displaced, start programming Windows at Microsoft or assembling planes at Boeing. Staying in South Carolina, too.

To avoid an unpleasant discussion of that paradox, economists needed to find the superwomen and supermen that met the necessary do-all skill requirements in manifold industrial fields of the international trade.

In a popular (16 editions) introductory *Economics* textbook by Campbell McConnell and Stanley Brue, a CPA is also a very good house painter, swifter than another painter.[3] She has though comparative advantage in tax preparation, which is paid better. So she prepares tax returns for the painter, while he paints her house.

A more advanced textbook (*International Economics* by Paul Krugman and Maurice Obstfeld, 7th edition) also provides no examples of "do-all" capability in industry –- unless batting and pitching can be ranked among industrial activities. (We learn from the book, however, that Babe Ruth was an outstanding pitcher, too.)

Disturbingly, even relatively balanced textbooks, such as *Economics* by Paul Samuelson and William Nordhaus, are not able to provide anything better than a "traditional" example of the best lawyer in town, who also is the best typist in town. She has comparative advantage in practicing higher-paid law; should she leave typing to a secretary?[4]

The cigar probably goes to Gregory Mankiw, an eloquent knight of outsourcing. A burning question is asked in his economics textbook about a situation of a vital, everyday importance in industry: should Michael Jordan mow his lawn himself or leave it to a girl next door? In distinction from other authors, Mankiw understood the need to improve his example. Three years later, in the second and third books of his three-textbook series, Tiger Woods replaces Michael Jordan, and the boy next door (Forrest Gump) -– the girl next door. The pivotal industrial activity of mowing grass remains, however, cast in stone.

Very cute, as it is usual for the textbooks in that exalted science, economics. But ...

Isn't it both irresponsible and cruel to close down whole industries, with so much at stake and enormous human cost for millions of people, on a basis of a theory that cannot find even a single appropriate and relevant example that would support its main assumption – the assumption about the homogeneity of the industrial workers?

Animal cops treat dogs and cats better than the American elite -– business, political, academic, media –- treats American workers. And, primarily, exactly those workers that, at any reasonable cost, should be retained in the country. In the whole history of mankind, has anyone seen a Great Power without an industrial base?

(c) The Final Nail in the Coffin

There are only three possible patterns of re-training and readjustment of workers of the contracting industry of the advanced country:

- The expanding industry cannot use them, either because they are not trainable for more complicated jobs, or because it can get better and cheaper workers from elsewhere, say -– from the ranks of unemployed.
- The expanding industry needs them and they are trainable, but their readjustment is difficult and costly.
- The expanding industry needs them, they are trainable, and their readjustment is easy and cheap.

In the first case, closing the less productive industry does not produce any "comparative advantage." The displaced workers become unemployed, and social costs arise. People, companies and communities are destroyed without any reason or justification, just because some economists have declared that, in this matter, costs do not count. This cost omission is due to either stupidity or deliberate deception.

In the second case, why haven't been the "externalities" of a difficult readjustment taken into account? Again, the same sin of omission.

In the third case, let us relax our requirements. Suppose that the theory is still applicable to the combinations of expanding industries that do not require special skills or have low enough re-training costs, and contracting industries whose workers are easily re-trainable. (Of course, the advanced country should also have full employment, and all the necessary conditions outlined below should be met.)

But do expanding industries with such characteristics exist in an advanced country, and (if they do) can their relative advantage be retained? If they exist, and even if they initially have a relatively higher productivity than the identical industries of the developing country, *this advantage can be quickly eradicated by the latter -– exactly because of the easiness and low cost of training*. (Of course, technology and capital do matter, too, but corporations are only too happy to transfer these to the low-wage countries.) This is exactly the point of a much-talked-of 2004 article in *The Journal of Economic Perspectives* by Paul Samuelson, where he considers the scenario of a technological progress in the developing trading country and admits the possibility of a long-term or a permanent harm from free trade to the more advanced US economy. William Baumol and Ralph Gomory (a member of the Horizon Project) came in their recent book to similar conclusions. (For that exercise in cruel logic, Samuelson was called "an apostate" in a letter published in a venerable but, alas, pro-free-trade newspaper, *Financial Times.*)

This very realistic threat of unfavorable dynamics drives the final nail in the coffin of the "law." The "law" argument has unavoidable contradictions; the "law" does not work in any of the three possible cases. There never was such a "law"; there was only a "Dream of Free Lunch," disguised by wily or dumb (your choice) economists.

(d) Further Nuisances

But that is not all; far from it. Up till now, we considered only three assumptions pertaining to the validity of the comparative advantage theory in the real world: full employment, "the do-all paradox," and no dynamics (specifically, no technical progress in the developing country). It turns out, however, that, to apply this concept in practice, we also need to meet a number of other utopian conditions, including: no trade deficits; no net capital movement between the countries; no excess production capacity; no big gaps between wage levels; instantly flexible currency rates, prices and wages; a homogeneous society (no losers); no uncertainty, and so on (see also the beginning of Section 3).

Exchange rates, wages, and prices must be completely and instantly flexible (no minimum wages or "sticky" wages and prices, either). As soon as countries begin to specialize, the prices of the traded goods and the currency rates are supposed to change automatically in such a way that the net trade revenue of each country equals zero and trade becomes balanced. Money is thus redundant; it merely plays a transitory, bookkeeping role, and trade, in effect, becomes barter. In reality, prices and especially wages are "sticky" (moreover, minimum wage exists in the US but not in China and many other countries), currencies are manipulated, and trade is neither barter nor balanced. Of course, this leads to gargantuan deficits.

Prices, exchange rates, and wages must be "appropriate" (that is, no great disparity in wages between the countries). "Comparative advantage" disappears and is replaced by an "overall absolute advantage," if one country not only can undersell another country in all products, but also has sufficient resources to manufacture all of them. We can continue the list of necessary conditions. Each of them is important; their cumulative effect is overwhelming and devastating.

Every older economist knew these conditions, warnings, qualifications, and reservations: all of them (except uncertainty, the Achilles' heel of economics) were listed in the mentioned above Economics by Samuelson and Nordhaus.[5]

I have not seen earlier editions of the McConnell and Brue, but both its latest edition and the three textbooks by Gregory Mankiw do not contain any of these warnings. That might dangerously misguide the future generations of economists and other students of Economics 101 and international economics.

(e) Equalization of Wages

Finally, it has been rigorously proven that, even under full employment, and even if all difficulties were "assumed away," wages in all free-trading countries would be equalized at a sufficiently low level.[6] Under persistent unemployment, and under the conditions of the new industrial revolution, it will be much worse: in every category of labor, excessive supply will overwhelm any possible growth of demand. And, as outlined by Alan Blinder in Section 2, education and skills may not help. (The average American wage is about $135 *per day*. The average Chinese wage is around $135 *per month*, for 14 to 16 hours of work a day, seven days a week, under very harsh sweatshop conditions; some factories pay $50 to $80 per month. Conditions begin to improve, but barely. For political stability, China needs at least 15 to 20 million new jobs per year, with about 700 million people standing in wait just in that country and about 2,300 million – in other countries around the world. Again,

compare that with the total of 140 million American jobs, about 50 million of which are transferable.)

As with other anti-free-trade arguments, economists keep mum about these conclusions. They are presented in any advanced handbook on international economics, but in none of textbooks on elementary economics that we've seen. Are they strictly confidential, for economists only?

(f) Great Economic Authorities Concur

What do the recognized economic authorities say about all that? In 1944, in his *The Road to Serfdom*, the iconic Friedrich Hayek explained raising the status of comparative advantage to an unshakable law as follows: the liberals selected "orthodox" free trade because only two alternatives, free trade and protectionism, were available. Since their motives (to protect the world from protectionism) were pure as snow, "the temptation to present it as a rule which knew no exceptions was too strong to be resisted". As a consequence, "Probably nothing has done so much harm to the liberal cause as the wooden insistence of some liberals on certain rough rules of thumb, above all the principle of laissez faire".

In 1987, a leading expert on international trade Paul Krugman expressed similar thoughts: "Yet the case for free trade is currently more in doubt than at any time since the 1817 publication of Ricardo's *Principles of Political Economy.* ... [F]ree trade is not passé, but it is an idea that has irretrievably lost its innocence. Its status has shifted from optimum to reasonable rule of thumb. There is still a case for free trade as a good policy, and as a useful target in the practical world of politics, but it can never again be asserted as a policy that economic theory tells us is always right".[7] (For instance, Krugman has shown that the "law" may apply only to some commodity-like products, where the "learning curve" doesn't matter.)

But we cannot even relegate "the law of comparative advantage" from a lofty "law" to a lowly "rough rule of thumb". As could be expected, any theory based on a "free lunch" hypothesis is simply wrong. That is not to deny that specialization of some countries may be beneficial; we are just saying that, in every specific case, pros and cons of an industry shake-up should be analyzed in depth on an individual basis, with no support from any theory or any rule.

We should do it using the standard economic approach of "cost-benefit analysis," with adjustment costs not excluded – even though the social costs (unemployment and re-training) are now somehow shifted to the state, while such actions as relocation are mainly left to the displaced persons themselves.

We will not expound here on the numerous opinions of John Maynard Keynes, who by the end of the 1920s completely rejected the "law of comparative advantage," deeming it invalid and irrelevant in a world that had unbalanced trade, persistent unemployment, and excess capacity.[8] (An economist in a class by himself, he is not properly appreciated in the US, because what is known here as his system is really, as labeled by a prominent British economist, a "bastard Keynesianism"; see also Section 4(a).)

It is necessary to emphasize, however, that Keynes was also against "the misplaced notion that the deficit country should bear the entire burden of adjustment" (William Milberg on Keynes) and therefore against currency devaluation, especially under fixed currency rates, which include "pegging". This is an extremely important consideration, undeservedly suppressed by economists. Absence of discussion of that issue may have cost the US trillions of dollars and millions of jobs.

(g) The Mill Principle

As we indicated in the beginning of Section 3, the discussion about free trade should be considered against a more general background of the role of economy in society. In his 1848 book *Principles of Political Economy,* John Stuart Mill, who was one of the greatest economists and philosophers and reputedly had the greatest IQ of all time, just in 31 years after Ricardo, invalidated a predominant part of Ricardo's approach, particularly, all "laws" related to the distribution of goods and wealth. He made a brilliant and self-evident observation that should have changed economics forever: *economic laws are relevant only for production, where we allocate limited resources to deal with nature's constraints. The distribution of goods and wealth obeys no laws but those set by society.* Economists have no say here, except for providing auxiliary analyses.[9] They stop being high priests of free market and become a service personnel of society. Perhaps that is why the Mill principle is not mentioned in any textbook I have seen.

It is easy to generalize the Mill principle: *The economy is a handmaiden of society, and economic policy should be based on the totality of societal and economic needs and desires. Efficient market is an important instrument, but not a goal of that policy.* In time of war that should become obvious beyond any doubt.

The approach of Mill is, of course, preferable to simplistic opinions of laissez-faire economists of the 19th century. For them, all later ideas of "managing" the economy to secure such "objectives" of the society as low unemployment, a sufficient growth rate, stable prices, and a healthy balance of payments would seem as "central planning."

These four already pursued "social objectives" mainly reflect the short-term perspective, while the main, crucial goal of a society is its sustainable long-term survival in an acceptable state. Not to ignore the latter goal, we must add three more "objectives": the preservation of the industrial base, the attainment of the geopolitical goals, and the preservation of the middle class.

Accordingly, in distinction from the free trade theory, our objective in international trade is neither to minimize the market prices nor to maximize consumption. It rather is to achieve, as much as possible, the societal goals listed above –- of course, with as low prices and as big consumption as possible. *The standard of life becomes a constraint, rather than an objective.*

The free-trade economists of today are mostly reconciled with the idea that the viewpoint of their predecessors is too narrow –- at least, as far as it involves the short-term "objectives." They still fail to understand or refuse to admit, however, that the free-trade approach to organizing international trade could be successful only under rare combinations of favorable conditions, which prevailed before WWI

and shortly after WWII. As mentioned above, conditions of this century are bad, will get much much worse, and free trade is now as outdated as the dodo.

(h) Summing Up

To sum up, both free traders and Marxists try to persuade gullible masses that science is on their side, that the iron laws of economics form an unavoidable strait jacket for society. Very politely speaking, that is untrue in both cases. (There was a difference though: nobody in the Soviet Union believed that nonsense. Neither the propagandists, nor the masses. Everybody but complete idiots was inoculated into automatically disbelieving anything told from above.) In the US, an enormous, relentless, and shameless propaganda machine brainwashes the country into believing that free trade and uncontrolled globalization are theoretically sound, remain the only rational or even inevitable options, and are good for the US.[10]

All three statements are untrue. *Free trade and globalization are not good even for Big Business; they are good only for its top executives and investors.*

There are no iron economic laws that inexorably push the US into free trade and globalization; this is a matter of free societal choice.

Other countries understand that: as stated recently in *Washington Post,* "Every other advanced country –- certainly, those of the Europeans and the Japanese –- has a conscious policy to keep its most highly skilled jobs at home. We have none." It is explained by a wish "to impress investors." And we do just that: according to Barney Frank, "corporate profits and pay for the top 2% of the US population have soared," while the real wages and benefits for an average worker have eroded. Well, as Arnold Toynbee used to say, civilizations are not killed -– they commit suicide. In this case –- we stratify and destabilize society and destroy its middle class, all for a *noble cause of maximizing corporate profits.*[11]

A democratic country that has no strong middle class will polarize and may turn sharply left, going the way of Venezuela. Is American elite so spoiled by individualistic egotism that it cannot see just a little beyond its today's self-interest?

The judgment about the desirable, acceptable, and affordable forms of trade and globalization has to be made by American society, considering the totality of economic and non-economic factors. It should be made after learning the truth about falsity of free traders' claims and about the cost of globalization in jobs and money.

Exaggerated, baseless, and plain wrong statements about the validity of the "law of comparative advantage" in the real world are regularly presented as eternal and universal truths. This myth has obtained the status of being immaculate and infallible. But the free-trade emperor has no theoretical clothes. None whatsoever.

Paraphrasing the Disraeli's saying about statistics, we can declare now that there are lies, damned lies, and free-trade propaganda.

As far as free trade is concerned, economics is not a science. True, it is a consistent theory, but it is relevant only in some utopian world, rather than under the real life

conditions. In the real world, that theory is vacuous, dogmatic, invalid, and inapplicable. This secret is guarded especially carefully.[12]

Utopian theories, myths, distortions, and shameless propaganda could have been tolerated earlier. But now, with the current almost trillion-dollar annual stakes, they must be stopped. We can unshakably rely on only one axiomatic canon: any absolute dogma is a bad bedfellow for the economy, be it sleeping on the left or on the right side of the bed. The Soviet Union (on the left) and free trade (on the right) are good examples. No society can prosper with extremism. A proverb says, "Make a fool pray, and he will get bumps on his forehead."

Unfortunately, in the free trade case, it is the American economy that gets bumps. Both fools and knaves of this "Washington consensus" disaster are cushioned by their positions or tenures.

4. The Proposed Trade System

(a) The Keynes Principles

In answering **the third question** (what can be done), we say that free trade has to be saved; the US cannot and should not completely back out of it. But the rules of trade must be modified: the present rules have created a danger that must be eliminated or mitigated. We can still have the free trade cake and eat it too, if we just remove some undesirable side effects of trade, such as excessive deficits.

Our proposal is a generalization of the approach of Keynes. Aside from his founding of macroeconomics, the most important true legacy of Keynes is, in our opinion, contained in three principles.

I. Economics is based on logic of choice, not under scarcity alone, but rather under both uncertainty and scarcity.

II. There is no "universal economics": different economic approaches should be applied under different states of the society.

III. Lower level market activities should be controlled and constrained, at a higher level, by a non-market entity.

Principle II confirms that, under the conditions of the 21st century, the free trade approach is not applicable. But we are most interested in Principle III, which Keynes considers very important –- in our opinion, as perhaps necessary to save capitalism. Principle III makes real horse sense. When kids go to a mall, prudent parents do not deny them certain freedom of choice in their purchases. But they impose a limit on their overall spending. Freedom at a lower (micro) level is combined with a constraint at a higher (macro) level. This is exactly the Keynesian approach to a managed "closed" economy of a free-enterprise country: be free, but stay within the limits of what is affordable.

This common-sense approach (a macro control of a micro-level free activity) is further strengthened by the generalized Mill principle: the will of society should be

imposed onto the market and should modify its activities. As will be seen below, we just extend the approach of Keynes/Mill from a single country to the global market.

(b) "Compensated Free Trade"

We propose a policy of ***"compensated free trade".*** This is how that policy would work:

- Congress sets annual limits (upper bounds) on the overall US trade deficit in consumer goods and undesirable capital goods; oil and gas excluded. (For instance, at the start of the system Congress approves year-by-year mandatory minimal reductions of the trade deficit, as a percentage of GNP, to be applied until its size is acceptable.) It also sets the rules of trade, such as: forbidding transshipping of goods between countries and similar techniques, aimed at bypassing the deficit limits; or demanding Congressional approval for any substantial increase or decrease of the overall deficit limit.

- The President of the United States allocates the allowed deficit for each of our trading counterparts –- countries or groups of countries.

- A country may exceed its limit if its government pays the US Treasury a stipulated percentage (up to the full amount) of the excess deficit, also approved for each country by the President of the US. The President can also cap the allowed amounts of intergovernmental payments.

- Both the number and zeal of customs inspectors dedicated to accepting goods from a country would depend directly on that country's relevant behavior. (For instance, if a country does not pony up, all imports from it could have to pass through a single customs inspector.)

Congress approves the budget and the debt limits now; similarly, it will approve the trade deficit limits, which may be even more important. Also, the system uses to advantage the American separation of powers to limit the arbitrariness of the limits, whenever one side, legislative or administrative, becomes too timid or too reckless.

Of course, we do not recommend immediate and complete balancing of US trade. Some residual deficit (perhaps about 2 to 3 percent of GDP) seems unavoidable, and movement to that level should be gradual, careful, and subject to a multitude of compromises. That goal may be feasible.

To raise the money for excess deficit payments, our trading counterparts may use either export taxes or export certificate auctions (similar to the type proposed for imports by Warren Buffett in *Fortune* in 2003). In distinction from the token export tariffs used now by China, the level of export taxes would be in effect determined by the US, and the taxes thus collected also would go to this country, rather than to the exporting country. The exporters may also pay from their financial reserves.

The proposed approach is a compromise between free trade and protectionism. It is ***the third alternative trade policy***, much better than both extremes. It differs from "orthodox" free trade by imposing macro control over that anarchic, shock-generating, and destructive activity. And it differs from protectionism by offering:

- A “compensated bypass” of any fixed import quotas (“We can take any of your exports, just pay for the privilege. This is about the deficit, stupid”), which, in distinction from “hard” import-limiting quotas, still allows flexibility in the quantity of imported goods and services.
- A replacement of our import tariffs by the export taxes or their equivalents, self-imposed by the exporting countries (see above).

Also, we avoid a mistake of too intrusive constraints of protecting individual products, when macromanagement is replaced by micromanagement.

While differing from protectionism, “compensated free trade” still combines the advantages of two its forms, “hard” quotas and “soft” tariffs. Economists usually recommend tariffs, which create more flexibility. One never knows with tariffs, however, whether or not they would provide the desired impact on import, whether they are too high or too low. On the contrary, a quota exactly achieves its goal. Our proposal is flexible in the quantity of imports, while exactly achieving its financial goal -– the desired reduction of the trade deficit.

We should point out here though that the flexibility of this policy is limited. As explained above, if some country wants, say, to sacrifice some of its currency reserves and increase its export to the US to a level that threatens too many American jobs, the President of the US can cap the allowed intergovernmental payment.

Now, what may be the potential impact of “compensated free trade”? A carburetor, by itself, does not accomplish much. But a proper 2007 carburetor, installed in a 2007 car, revives it from a dysfunctional chunk of metal into a marvelous working ensemble. Similarly, the proposed policy revives proper work of a now dysfunctional global economy, thus providing a multitude of benefits. It promises to become a powerful and versatile economic tool that would control globalization and kill quite a surprising number of plump birds with one stone. It seems to be a master key, a Swiss-army knife of economic levers. Among many others tasks, it would:

- Bring the trade deficit down to a sustainable level, while following Article XII of GATT (see Section 5) and avoiding violation of anti-protectionist clauses in existing trade agreements and WTO regulations;
- Allocate the burden of economic adjustment between the surplus countries and the US;
- Save American jobs;
- Prevent trade wars;
- Stop predatory trading;
- Make the profit motives of economic agents (industrial and service enterprises) consistent with goals and objectives of the state;
- Make every trading partner of the US our ally in protecting itself from transshipment of goods, which might eat up the country’s deficit limit;
- Impose financial discipline on the US as a whole –- on a Micawberish country that forgot the concept of “affordable”;
- Absorb shocks and stabilize both the US and global economies;
- Provide “precision bombing” of only the harmful areas of the global market -- in contrast to an indiscriminate impact of the sole control tool of the Fed (changing the interest rates), which may lead to damaging unintended consequences.

We will dwell here on only one least evident feature, preventing trade wars. We can protect our strategically important and socially desirable industries without fear of a trade war through retaliatory tariffs or quotas on American goods, because these tariffs and quotas would – automatically -- lower the allowed upper bound of imports; the other country would shoot itself in the foot. (Upper limit on import from a country = American export to the country + deficit limit.) Similarly, the system will stimulate our exports.

But what happens if any of our trading counterparts engage in another type of trade war, staying within its export limit and imposing, say, export taxes on its goods? In that case, it will shoot itself in another foot in a "dynamic" way. The first year the country will indeed get some windfall revenue. But that will raise prices of the exported goods, they will be more or less priced out of the market, and their sales will decline. In turn, that will diminish the demand for export certificates. In a few years, the country will find itself with decreased export and no additional revenues.[13]

The goal of limiting the trade deficit, with minimum harm to our society, is thus achieved at any behavior of out trading counterparts.

A very interesting situation would arise if the US enacts the proposed legislation, but sets the overall trade deficits limits high, not really fighting deficit growth. That will create a trade policy, completely **dominant** (as economists call it) over the current one: it will have no disadvantages compared with the current one, but will still provide some new major advantages. For instance, all countries that brazenly employ predatory trade techniques now, because we have no means to punish them, may rethink their behavior overnight.

This is not to say that we finally found a way "to get something for nothing." This is just to emphasize that *our current free-trade policy is so bad, that even one simple legislative act would substantially improve the situation without any negative side effects at all.*

5. Other Alternatives

Slow and indirect approaches, such as attempts to increase the US savings rate, will be insufficient: as indicated in Section 1, in a few years, just the annual returns on foreign holdings of US securities may reach half a trillion dollars. Of course, any such measures – as well as changes in corporate taxation laws -- would be highly desirable, but they can play only a secondary role. We have to take the bull by the horns, and to do it immediately.

There currently exist two types of legislative proposals to deal with the trade deficit directly. Senate Bill S.295, introduced in 2005 by Senators Charles Schumer (NY) and Lindsey Graham (SC), proposes setting tariffs of 27.5% on China products, unless China allows appreciation of its currency. The bill is a partial and temporary solution of the problem (tariffs will be applied only to China; and, as can be seen in the next paragraph, Chapter XII of GATT does not allow tariffs, so they will be quickly shot down by WTO).

The Balanced Trade Restoration Act (S.3899), introduced in 2006 by Senators Byron Dorgan (ND) and Russ Feingold (WI), goes much further in a correct direction. This

bill is the first, long overdue, radical correction of the outdated Reciprocal Trade Act of 1934. It requires setting caps on the annual trade deficits in accordance with Article XII of GATT, which states that any country "in order to safeguard its external financial position and its balance of payments, may restrict the quantity or value of merchandise permitted to be imported." (It says nothing about tariffs.)

Senator Dorgan proposes the same concept of capping the trade deficit and the accumulated trade debt in his 2006 book *Take This Job and Ship It*. Similarly to the annual reconsideration of the countries' deficit limits, proposed in "compensated free trade", he also proposes to re-establish an annual revision of our NTR (Normal Trade Relations) certification of China. (At the request of President Clinton, China was given a permanent NTR status in 2000.)

To implement the trade deficit caps, the Dorgan/Feingold bill relies on the import certificate auctions. The Horizon Project, mentioned in Section 2, endorsed the same bill and (initially) the same import certificate auctions. Unfortunately, as later noted by some experts, an import certificate auction policy, which cannot be differentiated by countries, strengthens the position of traders that cheat and thus can pay more for certificates; do we want to encourage predatory trading?

Such auctions will lead to two enormous extra advantages for China. Because its export prices are usually the lowest and it also has vast currency reserves, China could afford to make higher bids and buy up all import certificates issued by the US. *First. China will use all the certificates it needs to add import quotas advantages to its already existing export price advantages. Second, no less importantly, it could then re-sell the rest of certificates to countries and corporations at slightly lower prices, using these certificates as tools of blackmail.*

Our "compensated free trade" system meets the "no import tariff" requirement of Article XII of GATT. The system is more flexible and versatile. Even more important, it is the only one suitable to be used as a geopolitical tool for containing our adversaries (see Section 7). We hope that the additional beneficial features of our policy will be included in revised versions-to-be of these excellent proposals.

6. Risk Management

At least in its simplest implementations, the proposed system will need neither much input data nor complex information. The probability of making a serious error while using the system should be very low.

It will be a flexible "system for all seasons," good under any scenario of the future and compatible with any American foreign policy; just change the annual limits. Due to its flexibility, it also will be a *superb risk management tool*. To a certain degree, we will be able to control the global market.

This answers **the fourth question** (about the riskiness of the proposed system): risks should be reduced.

We will need this risk-reduction capability. The change of the American trade policy must be radical and therefore risky. We might have to implement it slowly and carefully, all the time thoroughly analyzing both the newly emerging and the potential long-term consequences.

7. A Geopolitical Tool

As to **the fifth question** (using trade policy as a geopolitical tool), the proposed system will be a powerful *weapon of diplomatic persuasion*, which again will give us a long-lost capability to "speak softly and carry a big stick." As a very desirable feature of any good trade policy, it will allow us to reward our friends and penalize our enemies.

Every responsible government uses its trade policy to pursue its geopolitical goals. For instance, during the "cold war," the US sacrificed several industries to prop up a strong and stable Japan. We are just restoring symmetry: in our proposal, both relaxing and tightening the trade rules serve this purpose.

But, above all and best of all, **it will be a tool of geopolitical containment, a la Kennan, of potential rivals and adversaries**, such as China. We need it badly, much more than we have needed the Marshall Plan and Bretton Woods II 60 years ago, because we are attacked both geopolitically and economically, and on many fronts, too. The system will provide an effective, comprehensive, constructive, enduring and (extremely important) perhaps *the least confrontational way* to contain the excessive economic and military development of China. It will –- again, automatically! –- limit its military expenses and possibly its geopolitical ambitions. It will stop or slow down our financing the growth of the gigantic, modern, and potentially hostile armed forces of that country. The containment can be gradual, measured, and targeted against specific actions. It can be used when China is a friend and when China is an adversary. One way or another, our trade deficit with China must be reduced; as mentioned in Section 2, even President Bush says it is unsustainable. If it indeed will be reduced, then, from China's point of view, this policy might even be preferable to a sharp appreciation of its currency.

8. Countering The Negatives

So much about the advantages. But what about the negatives? Eight major negatives of the proposed system are possible:

- (a) Raising our inflation and interest rates and decreasing our growth –- countered, however, by better growth because of reduced competition and return home of some of our exported factories.
- (b) Reducing the purchasing power of the American consumer.
- (c) Begetting another bureaucratic mess.
- (d) Redistributing monetary and real incomes between different groups of the American population.
- (e) Reducing profitability of American enterprises and multinationals that use the low-wage countries as a source of profit.
- (f) Decreasing the rates of growth of our trading partners.
- (g) Same, of global economy.
- (h) Above all, triggering an economic and financial meltdown by making our trading partners angry enough to sell their dollar assets.

Unfortunately, the same seven -– except (c) -- phenomena will also unavoidably happen under any other probable future scenario, such as a dollar depreciation, irrespective of whether we have done anything or not to bring our deficits down to a

sustainable level, but without the proposal's advantages. (A movement toward a substantial dollar depreciation and, at best, "soft" landing into a recession are already here.)

Indeed, it is better to deal with such phenomena when we at least have a powerful weapon for fighting them, rather than otherwise. Having the proposed tool, we will be able to offer our trade partners "the carrot option" of cooperation -- a gradual reduction of their deficit limits, with minimal possible pain for all sides, leading to a sustainable "soft landing." Truthfully and convincingly, we would tell them that they will lose the American market -– either by destroying the US economy or by begetting full-scale US protectionism. (As Henry Kissinger used to say, "This argument has an additional advantage of being true.") Hardball dissenters and proponents of (h) would also face "the stick option" of an immediate sharp reduction of their export limits.

Under present conditions, the surplus countries have the upper hand, and we have to rely on their mercy. (Just look at the zero results of the last trip of a high-level US delegation to China.) The biggest surplus country is China, with the 2006 surplus $230 billion. We should heed the warnings of the 2006 book *Death of an Empire* by Yegor Gaydar, the prime minister of Russia in the beginning of the 1990s (and recently poisoned in Ireland), which is making tsunami waves in Moscow. He said that *the Soviet Union disintegrated primarily because it had to borrow from its enemies.* **Caveat America!**

(May we remind you -- that happened because of cheap oil, because Saudi Arabia used its trade policy for geopolitical purposes.)[14]

Under the proposed system, the US will be in the driver's seat. We will also transfer to our partners many difficult decisions, otherwise to be made by this country. The surplus countries would have to go along -- access to the American market provides for them too many advantages, including the crucially needed employment and the resulting political stability.

As to (b), both any Micawberish family and any Micawberish country must learn to live within their means. Consumption is forgotten the next day, but the debts are forever. *When one buys a cheap Chinese goody, society pays the rest of its real price, getting in debt and losing jobs. Under present conditions, every such purchase is a start of a vicious cycle that -- sooner or later, in one form or another -- will come back to him, or his neighbor, or his descendants.*

As to (c), we have many bureaucratic messes. But not a single one of them costs the country almost a trillion dollars a year; none of them leads the country to an assured disaster. Is the beautiful simplicity of free trade worth the price?

We have to be very cautious about (d). The middle class will win in their monetary income. The monetary income of elite will probably decrease, but that is only fair, considering the income shifts from the middle class to the elite in our recent past. Prices will rise, and everybody will lose in his purchasing power. It is not clear what will happen to both monetary and real income of the lower-income group. But we should really make all comparisons here with the outcomes of the alternative strategies under the new industrial revolution, rather than with the today's status quo. In that sense, we think that everybody – maybe, except the elite -- will win. This issue needs additional analysis, but any possible conclusions in that direction

clearly will not overweigh the advantages of the proposed policy. Besides, the deficit limits can be set in a way that would protect the consumers, as much as possible.

Most importantly, (e) is unavoidable if we want to reduce the deficit: a substantial part of it (about 40%) is caused by imports of multinationals and other corporations that have exported American factories abroad. We also desperately need to restore the *risk management safeguards*, recklessly abandoned by many greedy corporations that scatter their supply chains around the globe, as if only balmy days are ahead. In the 21st century, full of dangers and unprecedented uncertainty!

Also, Big Business does not have the right to exploit the advantages of being American companies, while endangering the security needs of the US. The system will help here: greed will be channeled into a less dangerous form. (The earnings of top corporate executives and investors returns would suffer. Too bad.)

As to (f), to increase their rate of growth, our partners should finally abandon their "beggar thy neighbor" export policies and develop their domestic markets. The proposal would give a strong push in that direction, which was necessary long ago.

As to (g), the rate of growth of the global economy –- I can only repeat here the immortal words of Rhett Butler: *"Frankly, my dear, I do not give a damn."*

Critics can say to the US -– you "go it alone", are unilateral, and dictate too much. Well, does anyone object to the US "going it alone" in paying for globalization?[15] *He who pays for globalization sets its rules.*

Also, some of these "negative" consequences may even be desirable: the system will reduce the unsustainable rates of growth of some parts of the world economy, which threaten the environment and put excessive pressure on the supply and prices of oil and other commodities. This will help to conserve valuable global resources (and lower their prices, too). Our policy will also stop or slow China's buying up the producers of these resources, "colonizing Africa" and other continents.

9. Feasibility of Implementation

The proposed system can be implemented, even given the ideological commitments of both free traders and deficit hawks. Both can remain true to their principles, while the system, as an exceptionally good compromise, provides "wins" for both sides and a victory for the country. Both the Middle East war and the rise of China grant a more than sufficient cause for an urgently needed overhaul of an utopian and harmful, dinosaur orthodoxy. And it is high time for it.

For free traders, this proposal may be acceptable for three reasons. First, it retains free trade at the micro level. Nobody encroaches here on decision freedom of individuals, both producers and consumers. True, market prices shift somewhat. But that happens even when Fed changes the interest rate, not to speak of our interventions in the market to achieve any of the "social objectives" listed in section 3(g). Second, as shown above, something clearly has to be done. *Time of trade deficit caps has come; they will be imposed, in one form or another.* "Compensated free trade" may be the most flexible, least intrusive, and least error-prone way to do anything –- and most promising in many directions, too. From the free traders' point

of view, protectionism should be much worse. Third, it doesn't call into question their cardinal assumption about the self-regulating power of free trade and free markets. If markets indeed have that power, the system would be redundant, because there would be no deficits. But it will do no harm; no Hippocratic oath will be violated. If and when, however, the power is lacking (and there are some tiny indications that this might indeed happen sometimes, such as the Great Depression or the current dysfunctionality of the global economy), the proposed system becomes a complementary regulatory mechanism that would save the day.

Of course, one should expect furious attacks from the special interests. (A minority of them, I hope against hope. The results of the 2006 elections and the conclusions of the Horizon Project might change some minds, too.) But a predominant number of rank-and-file Americans either suffer from the current situation or worry about it -– and many realize that we are at a tipping point. "Staying the course" in the trade policy would be even more a disaster for the US than doing it in the foreign policy, and "surge" might only mean an increase of imports. I believe that supporters of this proposal should eventually be much more numerous than its opponents. Many times more. Sometimes that counts in a democracy.

10. Conclusions

To conclude, unbridled free trade and non-affordable globalization are very dangerous: they involve serious negative "externalities", both geopolitical and economic. *Both free trade and globalization have to be controlled; both are only as good as their sets of constraints*. If we do not replace both of them by a better policy, the US will either become strongly protectionist, or:

- We will lose most of our middle class.
- We will get too polarized and our political system will be damaged, with the country moving sharply left (it may also happen to other countries).
- A substantial part of American wealth will be transferred abroad.
- A substantial part of the American economy will be destroyed.
- Manufacturing, absolutely necessary for security and survival of any society, will be destroyed.
- This country will lose much of its geopolitical and economic clout.
- The 21st century will be a Chinese century.

The proposed "*compensated free trade*" system is the third alternative trade policy, different from both "orthodox" free trade and protectionism, and complementary to them. It *dominates* the existing trade policy and therefore is, without any doubt, better than it. The system is also seems to be more flexible than any alternative policy conceived at this time. It promises to become a powerful and surprisingly versatile geopolitical, economic, and risk management tool.

I hope that this paper provides a long overdue one-two punch, both debunking the myths and providing a reasonably good alternative policy -- perhaps exactly what the US society needs now. **The proposed "compensated free trade" system may help us to live in the 21st century, while working in the 1950s, when jobs were safer (and the America's clout was greater, too).**

Yet everything can be improved, and I invite constructive comments. If readers disagree with this paper, with its analysis, conclusions and proposal, I would greatly appreciate it if they precisely (and concisely) specify their objections and suggestions.

Appendix A

Notes

1. Japan manipulates yen to make its goods more competitive and thus obtains big surplus in its trade with the US. In 2003, to retain a low inflation rate during the last years of his watch (and to stimulate unaffordable consumption, with "Americans buying things they do not need with money they do not have"), Alan Greenspan sent Ben Bernanke to Japan, to ask the Japanese to buy American securities. The Japanese gladly obliged; they bought an enormous amount ($320 billion) of them, printing a lot of yens. Everybody was happy. Now Japan has $900 billion of currency reserves, predominantly in American debt securities.

2. Ricardo analyzed trade under an international gold standard. Also, he considered specialization based on geographical and climatological endowments, factors of great importance at that time. These endowments, rather than the skills of workers, largely determined the "comparative advantage." Maybe that is why he so easily sacrificed specialization of labor. On the other hand, were he to admit the adjustment costs, there would be no "law."

3. In writing for their colleagues, free-trade economists have to keep close to professional standards. But in dealing with masses, claims for a status of science for their theory and other self-interest considerations require losing and loosing some scruples; thus my focus on textbooks.

4. This example was retained through the 16th edition (1998) of the textbook; it was dropped in the two latest editions, published in 2001 and 2005. No replacement was offered.

5. That was done only earlier, up to the 16th edition; in two latest editions these conditions and warnings were abridged and weakened. This is understandable. In the 1970s, for instance, the US trade balances were almost zero, so the author was able to define, without sounding utopian, barter (or no-deficit) as being a condition necessary for free trade.

6. There are three so-called "factor price equalization theorems," formulated with different assumptions and proven more than 60 years ago by three independent teams of prominent economists, founders of the modern theory of international trade. Labor is one of production factors, and wages are its price.

7. I may have missed it, but I haven't seen anything like this 1987 critical statement in the cited textbook of Krugman and Obstfeld. Instead, it approvingly quotes an admiring opinion about the "law of comparative advantage" and "debunks myths" opposed to it.

8. A free-trade academic, Douglas Irwin, published two books on controversies surrounding the free trade doctrine, *Against the Tide* (1996) and *Free Trade*

Under Fire (2002). In the first book, a whole chapter was devoted to the negative opinions of Keynes, plus he was mentioned several times in other parts of the book. In the second book, Keynes is not even mentioned in the Index. Such self-censorship of anti-free-trade arguments seems to be on the rise lately. It looks like the more dangerous free trade becomes, the more we see circling of economic wagons.

9. I say, "should have changed" rather than "changed," because the Mill principle would have changed economics, as well as the attitude of society to economics -- if only the economists didn't keep it highly confidential.

   James Mill, the father of John Stuart, was a proponent of an early education. Born in 1806, John started to learn Greek at 3, and so on. (John thought that his early training gave him "an advantage of a quarter of a century over my contemporaries.") James was a prominent economist and a friend of Ricardo, who wrote his *Principles of Political Economy* (1817) mainly because of insistent pressure from James Mill. After publication of that book, James daily lectured his son on Ricardo's economics; every evening, John had to write a summary of what he learned from the lecture. James then collected these notes and published them as a book, almost without change. So, by 14, John was indeed nursed on Ricardo.

   Nevertheless, at the ripe age of 24, John had already understood that *the subject of political economy was production, rather than distribution, of wealth*. That opinion, canceling a predominant part of Ricardo's legacy and first expressed in a John's 1830 essay on political economy, was crystallized in his 1848 *magnum opus*.

10. In his book *The Structure of Scientific Revolutions*, Thomas Kuhn observes: "Almost always the men who achieve these fundamental inventions of a new paradigm have been either very young or very new to the field whose paradigm they change."

    Perhaps that might explain why people, ostensibly clever and of high integrity, support an obviously wrong theory, where gross errors are seen immediately and with naked eye. But there is a simple test –- what does a person do when shown the error of his thinking? Does he repent or resist?

    I sincerely apologize to all concerned for the unflattering remarks made in the article and the Attachment -– provided they pass this test and it is clearly seen that their temporary delusion was caused by naiveté or misinformation, rather than by a pursuit of self-interest.

11. Stability is one of the main factors of a society's sustainable survival. Two perhaps the most profound and very different social thinkers of the last century, George Orwell and Aldous Huxley, wrote two books about the future (*1984* and *Brave New World*). The books contrast as day and night. And yet they have the same main theme – the quest for stability. Both Big Brother and soma are just details of implementation. (Orwell also thought that high consumption is bad for stability. That's why he needed wars between the three Great Powers -- to redirect the production of goods to non-consumer products, such as military equipment.)

12. Moreover, I think that a lofty name of "science" cannot be claimed for a body of knowledge if it uses censorship and self-censorship, if it is afraid of open discussion of facts and ideas and tries to silence its opponents. I do not know whether Charles Darwin explained the cake or just the frosting on the cake, but I do know that he was a true scientist. One sixth of his book, *On the Origin of Species*, is devoted to his constructing and discussing possible counter-arguments against his theory.

    Our (my and Professor Perlman's) proposal of "compensated free trade" may be good or bad, but it certainly is an important new idea and deserves a broad discussion. In a clear display of undisguised censorship, its publication was however prevented several times since 2004, without any explanation or argumentation. That makes me sad but proud: perhaps we have done something right, something to be strongly afraid of.

    Up till now, we managed to publish it only as a *Statement for the Record* in Senate's Hearings (see p. i), because the censors had no say there. During these two and a half years of hushing our proposal up, the foreign debt of the US increased by around $2 trillion, at a rate of about $2.5 billion a day. The price of suppressing new ideas and freedom of speech seems to shoot up dramatically. Of course, it's not the censors who pay the price.

    I would like to express here my gratitude to *Business Week*, which also published a one-paragraph description of "compensated free trade" in December of 2004.

    (Thomas Kuhn is of different opinion. He considers suppression of ideas and facts a normal pre-revolutionary part of progress of a science. If so, let the revolution begin! To arms, citizens!

13. It the so-called "Symmetry Theorem" it was proven that import tariffs (which are forbidden) are equivalent to export tariffs of an exporting country (which are not). One of the objectives of "compensated free trade" is to avoid using forbidden means. As stated in Section 8, the resulting rise of prices is unavoidable under any probable scenario of the future, with or without the proposed system.

14. Sheik Yamani was a clever man -– with the same stone, he killed for more than 20 years the US alternative-fuel industry. Beware of Sheiks bringing gifts; that may happen again soon, with Iran as a target. Start a combined "market-cum-central planning" strategy.

15. Attitude of shifting the burden of globalization onto the US and other marks can be best demonstrated by a quotation from the 2005 book *Why Globalization Works* (does it, indeed?) by Martin Wolf, an associate editor and chief economic commentator of Financial Times. The author, a product of Oxford education and a 10-year toil at the World Bank, writes about migration: "Yet the US could fit in another billion people. There is much empty space in Europe, too. This is not a recommendation. It is an observation of human hypocrisy." Amen.

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