Statement for the Record
Re: Senate Finance Committee Hearing
on
U.S.-China Economic Relations
June 23, 2005

by
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Introduction. Mr. Chairman and members of the Committee, we are economists that propose (personally, not representing any organizations) a novel "compensated free trade" policy for the USA. This policy meets all, without any exception, economic concerns put forth on June 23 by both members of the Committee and such witnesses as Dr. Greenspan. It also can be viewed as "the third alternative" sought by Senator Schumer, vastly superior to both free trade and protectionism.

Moreover, in distinction from many "mainstream economists," we fully recognize that the trade policy of a country never ever -- and especially not in wartime -- should be based purely on economic and financial considerations. It must also be a most powerful geopolitical tool -- a weapon of diplomatic persuasion and, above all, a non-confrontational means of containment of China and other potential rivals and adversaries. Since economic and geopolitical aspects and considerations are here closely intertwined, the Committee cannot overlook the latter. It must analyze the USA trade policy in terms of a more comprehensive point of view.

The proposed system is very simple: the Congress sets an upper boundary on the aggregate trade deficit in consumer goods, and the President allocates that limit among our trading partners. A country could exceed its limit if its government paid a stipulated percentage of the excess deficit. (See a more detailed outline below.)

The existing situation and its requirements. Can we slow down the armament of China and persuade it to help us with North Korea? Can we prevent or minimize its expansionist ventures and make the 21st century an American, rather than a Chinese, century? Can we persuade France and Germany to support us in Iraq? Can we save trillions of dollars and millions of American jobs from going overseas? If we overhaul our current trade policy, we have a reasonable chance to achieve these goals. But we have no chance at all if we retain it.

Unconstrained ("orthodox") free trade brings great benefits. But it also involves most serious negative "externalities": it has brought to the USA unacceptable geopolitical and economic consequences.

The first duty of the government is to assure the security of the country and its citizens; raising their welfare is only a second-tier part of this task. In turn, welfare includes not only consumption, but also other factors, too -- such as psychological, where free trade brings strong negative connotations. To assume that consumption and growth are the most important determinants of a trade policy would be a wrong and harmful oversimplification.

In the entire history of mankind, the trade policy of a state had been used, whenever possible, as an instrument of diplomacy, of economic influence on behavior of other states. Studying 13,000 years of the history of mankind, J. Diamond establishes the existence of friendly trade partners as one of five main challenges that define whether a society fails or succeeds (Diamond, 2005). Free trade removes any possibility of selecting such partners.

In spite of enormous trade deficit and all its implications, *the geopolitical consequences* still are more important: we are stripped of economic levers of foreign policy. We are at war now, and we also have long-term strategic interests. But at a time of war and high uncertainty, we are left with no effective economic means of persuasion, stabilization, and defense in our international relations.

The United States has the most rewarding market in the world, and access to that market is highly valued. The country also has assumed the predominant role in the war on terror, but has not been compensated for these human and financial sacrifices. In spite of all that, our current rush to free trade has led our diplomacy to beg for favors, instead of demanding cooperation from a position of strength.

We are impotent, for instance, in our belated attempts, both diplomatic and economic, to slow down the ever-increasing threat to our strategic, long-term military interests. Based on the strong growth of its industrial and technical sector (16% in 2003) and on its trade surplus, China "assimilates and replicates the Western military technology ... with stress upon war in space, the oceans, and the ether" (Helprin, 2004). As it was with Japan before WWII, China's needs in energy and raw materials should unavoidably lead to an expansionist policy. Without any doubt, sooner or later, this new superpower will try to contain and overtake the United States.

The USA has therefore an indispensable need to obtain a powerful tool to contain China and, if necessary, other potential rivals and adversaries. Containing the Soviet Union was mostly a geopolitical operation and therefore relatively easy. We have now to contain China on both geopolitical and economic front lines, which is much more difficult. Using for that purpose confrontational methods would be counterproductive (Kissinger, 2005). This predicament was enormously aggravated by admitting China to WTO: we unilaterally and irrevocably disarmed ourselves and had no means left of economic containment. The current American free trade policy continually increases our relentless decline as an economic and military power, relative to China.

If we do not succeed in obtaining a superb containment tool, the 21st century will not remain American. That tool must be:

- Comprehensive, able to be effective in regard to any political, military, and economic event, and to be equally applicable to any country of the world;
- Long-lasting and enduring, not to be overturned or nullified;
- Of changeable impact, to be intensified or weakened at our will, as necessary under the circumstances;
- Above all, non-confrontational, non-provocative, and easily explainable in realistic and believable terms of economic survival of our country.

As to *the economic consequences* of "orthodox" free trade, these are a gigantic trade deficit, the demise of our industry, and the loss of millions of jobs. We have had 28 years of trade deficits, sharply increasing lately to unsustainable levels. During the last 10 years, we transferred abroad about $3 trillion. The projected borrowing from abroad for 2005 approaches another trillion dollars. Whole sectors of industry are disappearing, and we have lost millions of jobs.

In a few years, the U.S. external debt could reach 100% of GDP, "territory never visited by any large industrial country" (Blustering, 2005), and in 2010 the annual current account deficit would reach 12% of GDP (Eichengreen, 2004). Just the interest on such debt would exceed half a trillion dollars a year. How will we pay it during a recession?

True, we have a reasonably good growth rate of the economy, but this result is achieved at too high a price: our annual trade deficit grows at least five or six time faster and, as indicated above, is unsustainable. Besides, the growth and high consumption are short-term, transitory, and will disappear at the first whiff of a recession, while debts are forever.

Note that these are the good scenarios that assume "soft landing" – long-term continuation of the existing "export financing" policies of our trade counterparts and infinite tolerance of the financial markets. Moreover, the longer we live under good scenarios, the higher is the probability of the bad ones, and the worse these "hard landing" scenarios become. They envisage an uncontrollable financial disaster, triggered at any moment by any unfavorable event, big or small, from a terrorist act to a misunderstood statement of a prominent official. Because the current trade situation threatens to weaken or bankrupt many companies that have survived even the Great Depression (Jones, 2005), that is, the very foundation of the American industry, the crisis scenarios may be catastrophic.

Even if an industry sector wins because of buying cheaper components, outsourcing, and the offshore exodus of the US factories, the country as a whole loses. Trade between U.S. companies and their foreign affiliates accounts for about one-third of the total trade deficit (Blustein, 2005). The computer hardware industry, with an export surplus in the beginning of the 1990s, now contributes $25 billion to the country's trade deficit (Bernstein, 2004; Engardio and Roberts, 2004). In the area of highly advanced technology products (ATP), United States trade has gone from a surplus of $30 billion in 1998 to a deficit of $27 billion in 2003 (Stein, 2004). In 2004, this deficit increased to $37 billion. Now we mostly sell to China scrap metal, recyclable paper, lumber and other commodities.

The trade deficit with China (expected to top $200 billion in 2005) is especially worrisome. Congress is considering now the Senate Bill # 295, imposing tariffs on goods of that country. But the bill treats the symptoms, rather than the disease -- and only a small part of lesser symptoms, too. It is too narrow, addressing neither the geopolitical issues, nor the possibility of retaliation and a trade war, nor the predatory trade tricks other than "pegging" the currency, nor the structural crumbling of the total global market. The measure will not provide much relief. The bill may be counterproductive, too, leading to harmful destabilization of the Chinese currency and economy, without substantial positive effects for the USA. Finally, it is temporary, and it will be overturned by WTO. Chinese are patient people, and they will sit these tariffs out with a scornful smile.

Such measures are very far from sufficient; they only distract us from what is necessary. The whole global market system is broken. We need a permanent, comprehensive, and theoretically sound change of the trade policy and overhaul of that market, rather than a temporary, partial, and ineffective return to tariffs.

True, in some periods, such as after WWII, free trade may indeed have been beneficial for the USA from every point of view. During those periods, meeting the theoretical conditions did not matter. But the 21st century, full of troubles and uncertainty, is not one of these periods, and it will not be for many decades. Therefore let us consider the theoretical justification of free trade: "There is nothing more practical than a good theory."

The Emperor Has No Clothes. To summarize, it is our nation that pays for globalization. Free trade was supposed to pay for it. But the theory that free trade benefits every participating country is not applicable in the real world. The "law of comparative advantage," which is supposed to justify that assumption, works only under utopian conditions of no trade deficits, no capital movement, full employment, no excess capacity, a static economy, no technical progress, homogeneous workforce, and no uncertainty. Exchange rates, wages, and prices must be "appropriate" (that is, no great disparity in wages between the countries) and completely flexible (no minimum wage, either). The displaced workers should be re-employed by another industry immediately (hence no unemployment), without any training or transition or relocation cost -- otherwise, the "comparative advantage" would disappear. (Even worse -

- comparative advantage disappears if a country can undersell us in all products and has sufficient resources to manufacture them.) We can go on and on.

Every economist should know these conditions: almost all of them are listed even in the introductory textbooks, such as Samuelson (1976, 668, 671, 680) or Samuelson and Nordhaus (1998, 696, 704). In addition, Samuelson (2004) has shown that the law is invalid for a dynamic economy with technical progress. Instead, exaggerated, baseless, and wrong statements about the validity of that "law" in the real world are regularly presented as eternal and universal truths. This myth has obtained the status of being infallible and immaculate. But the emperor has no theoretical clothes.

Besides, the free trade advocates keep mum about several "factor price equalization theorems" which prove that, even under full employment, wages in all trading countries would be equalized at a sufficiently low level. Under a persistent unemployment, it will be much worse. (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. The average American wage is about $135 per day. China needs up to 20 million new jobs per year. What jobs and salary levels should be sacrificed to meet that requirement -- let alone similar large-scale requirements of India and the former Soviet bloc?)

By the end of the 1920s, John Maynard Keynes completely rejected the "law of comparative advantage," considering it invalid and irrelevant in the real world, that had unemployment and deficits (Milberg, 2002; Irwin, 1996, 189-206). Many preeminent economists were of the same point of view. Karl Marx was for free trade -- but only because he considered it destructive (Marx, 1982, 213).

The Keynes's dislike of dogmas was shared by Friedrich Hayek, who stated that "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." He implied that -- since only two imperfect alternatives were available, protectionism and free trade -- after choosing free trade, "the temptation to present it as a rule which knew no exceptions was too strong to be resisted" (Hayek, 1994, 21).

The supporters of free trade suppress extremely important principle formulated by John Stuart Mill (1848), that forever changed economics: 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. The economists have no say here, except for providing auxiliary analyses. After Mill, again and again, we unfailingly come to a conclusion that "Economic science could evaluate how certain courses of action differed in terms of achieving a desired end, but economic science could not judge those ends themselves." (Irwin, 1996, 186). The very fixation on purely economic goals of consumption and growth, mentioned above, is a serious violation of that principle.

The principle directly involves the end results of trade: even if a country as a whole gains from free trade, it still has winners and losers. To solve the arising difficulties, Mill (1825) proposed "the compensation principle": winners compensate losers. But the difficulties proved to be insoluble even in theory (Irwin, 1996, 183-188, 219), let alone in practical implementation of the principle. Since the winners do not voluntarily share their gains with the losers, society has to intervene. Societal determination should extend into the very decision about what form of trade to engage in -- even more so because, if a theory supporting free trade assumes full employment, it counts only consumption gains, but not job displacement losses, both material and psychological.

Myths and distortions could have been tolerated earlier, but now, with the current 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 and free trade are good examples. A Russian proverb says, "Make a fool pray, and he will get bumps on his forehead." (This is not about prayer – this is about fools.) Unfortunately, in the free trade case, it is the American economy that gets bumps.

The Proposed System. We cannot and should not completely back out of free trade. But its scope must be limited to the lower (micro) level of international trade. At the macro level, the undesirable side effects of free trade should be constrained by forbidding excessive trade deficits. Balancing the trade deficit at a reasonable level should be a prerequisite for free trade.

Deficit constraints should be aimed at both stability of the global market and the equitable sharing of the burden of economic adjustment between surplus and deficit countries. Keynes was against "the misplaced notion that the deficit country should bear the entire burden of adjustment" and therefore against devaluation of that country's currency, especially under fixed currency rates (Milberg, 2002, 242), which include "pegging". If our trading partners want to create jobs at our expense, especially by predatory trading, then let that country pay for the privilege.

This is an extremely important and undeservedly suppressed consideration, and the proposed "compensated free trade" system implements this view of Keynes and others, which, throughout the centuries, was implemented through tariffs.

The proposed system also represents a generalization of the "free market at the micro level, state policies at the macro level" approach of Keynes, Samuelson, and others, expanded from a single country with a "closed" economy to the global economy -- resulting in a comprehensive, orderly, consistent, and theoretically valid system of organizing the global market for our times.

This proposal can also be understood as a simple embodiment of common sense: it is equivalent to the behavior of parents, who do not deny the freedom of purchase choice to their kids, but still wisely set a limit on their overall spending.

This is how the proposed system would work:

- The United States sets an upper bound of the allowed annual trade deficit in consumer goods (and undesirable capital goods) for each country or group of countries.

- A country may exceed its limit if its government pays a stipulated percentage (up to the full amount) of the excess deficit.

- Congress sets annual limits on the overall trade deficit in consumer goods. (For instance, at the start of the system Congress approves year-by-year mandatory reductions of the deficit, 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 to bypassing the deficit limits, or demanding a Congress approval for any substantial increase of the deficit limit for a country.

- The President of the United States allocates the allowed deficit and stipulated percentage for each of our trading counterparts. (The deficit is added to our expected export to form an upper limit on imports from a country. It is adjusted by that country's tariffs, if any, on our goods; see Item 10 below.)

- 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 its Pacific imports could have to pass through one customs inspector located in San Francisco.)

To raise the money for deficit payments, our trade counterparts may use either export taxes (Lau and Stiglitz, 2005) or export certificate auctions (similar to the types described in Buffet, 2003 or Daly and Cobb, 1991). They may also pay from their financial reserves. But it would not require the appreciation of Chinese and other currencies, which might reward speculators and de-stabilize these economies.

In distinction from "soft" import limiting measures such as tariffs, which may or may not achieve their goal, the proposed system will assure meeting its trade deficit objectives.

The system uses the American separation of powers to limit the arbitrariness of the deficit limits: Congress sets the overall limits, while the President allocates them among our trading partners. That approach also decreases the capability of lobbyists to manipulate the system in their interests.

The proposed overhauling of our current trade policy probably is the only feasible way to eliminate the fallout of admitting China to WTO in a comprehensive, constructive, enduring and (extremely important) non-confrontational manner. Applying the system to sustain the financial well-being of the country is reasonable and non-provocative. It provides perhaps the sole reasonable chance to make the 21st century an American, rather than a Chinese, century. We might have no chance at all to achieve that goal if we retain the current policy.

As Hayek (1994) implied (see above), the liberals selected "orthodox" free trade because only two alternatives, free trade and protectionism, were available. The proposed "compensated free trade" system would be the third alternative, a compromise in many ways highly superior to the two extremes. It switches from trade to finance, thus escaping Lilliputian clutches of both WTO and the many trade agreements, entered into by many administrations. It differs from the "orthodox" free trade by imposing a macro control over that anarchic and shock-generating activity. And it differs from protectionism by: (a) offering a "compensated bypass" of any fixed import quotas ("We can take any of your exports, just pay for the privilege"), and (b) thus replacing our import tariffs by the export tariffs or their equivalents, self-imposed by the exporters (see above).

The proposed system can be implemented, even given the constraints imposed by ideological commitment 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. The war grants a more than sufficient cause for a much needed overhaul of a utopian and harmful orthodoxy. And it is high time for it. A later action may not suffice.

The System Objectives. This system will be a versatile instrument, designed to achieve four geopolitical and 16 economic objectives. It also has another large advantage: as a measure saving millions of jobs and trillions of dollars, it probably will be very popular politically.

A. *Geopolitical Objectives*

(1) The system will provide a comprehensive, constructive, enduring and (extremely important) perhaps the least confrontational way to contain the excessive economic and military development of China. The containment can be gradual, measured, and targeted against specific actions. It will stop our financing the growth of the gigantic, modern, and potentially hostile armed forces of that country.

(2) To win the war on terror, we need the cooperation of all countries. This system would be a powerful tool of persuasion. We can stop begging for favors and start demanding what support is due to our country for its human and economic sacrifices on world's behalf.

(3) Our "less deserving" trade counterparts, such as predatory traders, will have much tighter deficit limits than our allies and other "deserving" countries, such as the developing countries we want to help. This will re-direct our imports toward the "deserving" countries.

(4) The proposal may replace in part our current system of direct foreign aid and World Bank or IMF loans and grants to developing countries by increasing instead their allowed deficits. A new factory may bring more benefits than badly designed and corruption-prone grants and loans.

B. *Economic and Financial Objectives*

(5) The system will reduce our trade deficit and the current account deficit.

(6) Most importantly, it will implement the principle of sharing the burden of trade adjustment between surplus and deficit countries. Moreover, in distinction from tariffs, which might be set too high, the system will allocate these costs fairly and automatically, at a level compatible with the given deficit limit of each country.

(7) Most importantly, the system is very flexible. Most of its control parameters (country bounds and percentages) are easily changeable. Every year, it would hone the terms and limits anew, in light of current needs and events, both geopolitical and economic. In short, it is a superb risk management tool, reducing our need for knowledge about the future.

(8) The system will provide macro constraints to prevent and absorb economic shocks. In accordance with the risk management feature (of Item 7 above), we can move into deficit reduction gradually, testing the consequences as we proceed. To a certain degree, we will be able to control the market process at the macro level, instead of being its helpless plaything, while fully retaining free trade at the lower micro level of individual enterprises.

(9) The system will change the behavior of predatory trading countries that now use dirty tricks costing us hundreds of billions (such as pegging their currencies to the dollar at an undervalued rate, intervening in the currency markets, dumping, counterfeiting goods, violating patents, or subsidizing their export production}. Currently they are sure of their impunity because we have no effective weapons. Complaints to the WTO are lengthy and difficult, while WTO bureaucrats often have their own biases and agendas. The very emergence of the proposed system, where misbehaving could be punished, would have an immediate and strong effect, much stronger than the import tariffs currently being proposed in Congress and elsewhere.

(10) In distinction from such tariffs, we can protect our strategically important and socially desirable industries without fear of a trade war through retaliatory tariffs or quotas on American goods, since these tariffs and quotas would automatically lower the allowed upper bound of imports. (For instance, let our exports to a country equal $100B and we allow it to have a deficit of $20B. The upper limit on imports from that country thus equals $120B. If the country imposes a tariff of $5B on American goods, our revenues would decrease to $95B. The limit on imports would then automatically decrease to $95B + $20B = 115B.)

(11) We can protect a large number of our domestic companies from bankruptcy by eliminating the unfair "China price" (as they are called in industry) terms of competition, when "... [imported] finished goods ... cost less than the costs of the U. S. firms' raw materials" (Encardio and Roberts, 2004; Jones, 2005). In case of complaints to WTO about fettering free trade, we would easily neutralize any such

complaint by showing that nobody impedes it. ("Sure, sell till you drop. It is about the deficit, stupid.")

(12) In Items 10 and 11, the system will crush the major argument of American industries that sell finished goods on the American market but use in their production the imports of raw materials or semi-finished goods, that more costly imports make them to abandon the USA production and cut the USA jobs -- like the argument of steel users, that their workers outnumber "40-to-1" the workers in the steel industry. Under the proposed system, considering the export tax or similar surcharges, the import to the USA of finished goods will be more costly than production in the USA. (E.g., suppose that the imported raw material costs $30 per unit of finished product, while the other production costs -- both in the USA and in the alternative country -- equal $70 per unit. With an export tax of 20 percent on raw material only, the total cost per unit equals $30 + $70 + $6 = $106. If the industry wants to transfer the whole production abroad, the export tax would apply to the total amount of $100 and, instead of $6, would equal $20.)

(13) The system will save American jobs in many ways, such as reducing dumping and other means of unfair competition, reducing the volume and raising the prices of imports (thus re-directing consumers toward "made in America" goods), and protecting our industries.

(14) The system will stop our financing of the creation of Godzilla-strength competitors.

(15) Most importantly, by increasing the export prices of our trading partners, the system will automatically change the often-harmful behavior of American enterprises without any intrusion or control of their profit-seeking motivation. (For example, Wall-Mart would be able to continue its pursuit of profit, without hurting the American economy and without additional government control and interference.)

(16) The system would provide an additional incentive for the central banks of our trading counterparts to purchase dollars, since the dollar devaluation would automatically reduce the quantity of goods they could export to the USA, while the dollar appreciation would increase that quantity.

(17) The system will impose a proper financial discipline on domestic consumption. To some discomfort of our consumers, the system will limit our excessive consumption to the desired level. It will impose the deficit limits only on consumer and undesirable capital goods, thus reducing the consumption of "butter" to what we can afford after producing the necessary "guns" and making worthwhile investments.

(18) Higher prices of imported consumer goods may have any of the three possible outcomes or their combinations: (a) the population will buy less and thus increase private savings; (b) the payments for excess imports will decrease the external deficit; or (c) the population will buy domestic goods and thus increase the domestic employment. All three outcomes are beneficial to the USA.

(19) 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.

(20) As long as the trade policy is not corrected, our trade deficit and debt position will worsen at an ever-increasing rate. In turn, that will provoke an increasing pressure toward protectionism, as already demonstrated by Senate Bill #295

submitted by 14 senators. Similar measures are to come in the House. The proposed macro constraints may be our best chance to retain free trade at its proper micro level with the minimal necessary modifications.

But what about the negatives? Five 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; (b) reducing the purchasing power of the American consumers; (c) reducing profitability of American enterprises and other multinationals that use the low wage countries as sources of profit; (d) decreasing the rate of growth of our trade partners and of global GDP; (e) triggering an economic and financial meltdown.

Unfortunately, the same five phenomena will also unavoidably happen under any other future scenario, such as the dollar depreciation, irrespective of whether we have done anything or not to bring our deficits to a sustainable level, but without the advantages of this system. It is better to deal with such phenomena when we at least have a powerful weapon for fighting them, rather than otherwise. And "Addictions must be broken, the sooner the better" (Krugman, 2005).

Besides, some of these consequences may be desirable: compare (d) with Item 19. Most importantly, (c) is unavoidable if we want to reduce the deficit: as mentioned above, a substantial part of it is caused by imports of multinationals and other companies that have taken the US factories abroad.

<u>Conclusions</u>. We may draw 12 main conclusions from this statement.

(1) Granting access to lucrative American markets can be a powerful weapon in our diplomacy, in the war on terror, and in containing China in a non-confrontational way. Not using it cannot be morally justified. Also, the trade policy should reflect a complex interaction of military, geopolitical, economic, and financial factors and considerations. The proposed system provides that weapon and meets that requirement.

(2) The proposed system is the only way to save both free trade and globalization -- with modified rules. He who pays for globalization sets the rules.

(3) Over the long run, but starting immediately and on an impressive scale, the proposed system should save millions of American jobs and trillions of dollars of deficits and debt. Even the first year financial savings should be no less than an 11-digit dollar amount.

(4) Free trade is only as good as its set of constraints. "Compensated free trade" uses macro constraints that impede only harmful trade, while allowing free trade at the micro level.

(5) What is good for Wal-Mart may now be bad for the country. The proposed system would eliminate the dangerous dissonance between the larger criteria of the country as a whole and the local profit criteria of individual enterprises.

(6) If the USA wishes to extricate itself from the quicksand of trade deficit, the proposed system or something similar is absolutely necessary; changing currency rates or setting up import tariffs would not be even remotely sufficient. The proposed system is the simplest and most natural approach. It also implements the view of Keynes and others that the deficit country should not bear the entire burden of adjustment. As well, it generalizes the theoretically correct approach of Keynes, Samuelson, and others "free market at the micro level, state policies at the macro level" from one country with a "closed" economy to the global economy.

(7) This proposal does not urge any specific timing or size of deficits cuts. It merely provides an effective and versatile tool for helping to solve complicated multifaceted problems of the USA government.

(8) The very existence of that tool should stop predatory practices used by a number of our trade partners.

(10) The "compensated free trade" system can be supported by both sides of the theoretical and practical aisles: both committed free traders and committed deficit hawks can remain true to their principles, while the system, as an exceptionally good compromise, provides a "win-win-win" solution: "wins" for both sides and a victory for the country. If a reason is still needed for a much-needed overhaul of a harmful orthodoxy, the war grants a more than sufficient cause.

(11) The orthodox theory of free trade is abstract and utopian. It becomes invalid and irrelevant under a multitude of real world conditions, such as a persistent unemployment or unbalanced trade. Obviously, the cumulative impact of all these conditions makes this conclusion much stronger. The theory can be safely applied in practice only in a modified form, and the proposal allows doing that with minimal modifications, leaving free trade intact at the micro level.

(12) Both protectionism and orthodox free trade are outdated, and the latter is very dangerous: it involves most serious negative "externalities", both geopolitical and economic. "Compensated free trade" is a highly superior third alternative, a logical response to the conditions and needs of the twenty-first century, at a time of war and uncertainty.

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