Tablet

The Strange Career of Paul Krugman

How a trash-talking neoliberal economist harmed America by vilifying strategic trade and industrial policy

Michael Lind

November 22nd, 2021

Strategic trade and national industrial policy are back. Growing U.S. military and economic competition with China, along with the COVID-19 pandemic, have revealed the dependence of the United States on manufacturing supply chains in China and other foreign sources. The neoliberal consensus in favor of indiscriminate trade liberalization and against government support for strategic industries is evaporating: The Biden administration, in a more nuanced way, has continued many of Donald Trump's nationalist economic policies, including some tariffs and programs to promote reshoring. In an era of extreme polarization, there is a high degree of bipartisan support for measures like the CHIPS for America Act, which seeks to reduce U.S. reliance for semiconductors on a few Asian sources like the Taiwan Semiconductor Manufacturing Company (TSMC) and South Korea's Samsung Electronics.

The last time these issues were at the center of public debate was during the 1980s and early 1990s. At that time, both the industrial revival of Japan and West Germany after the devastation of World War II and the increasing offshoring of production to low-wage countries by U.S. corporations were challenging America's manufacturing sector and its workers.

Then as now, America's university-based economics profession was dominated by the otherworldly neoclassical school, which, having purged the empirical and realistic institutional school of economics after 1945, specializes in using mathematics to model unrealistic assumptions. Even so, a generation ago the debate over whether the U.S. should adopt a strategic trade and industrial policy—favoring some industries over others and including selective protectionism or export promotion—was causing a few bold academic economists to rethink the discipline's creed that free trade is always and everywhere good for everyone.

One was a promising young economist named Paul Krugman. In a 1987 paper for *The Journal of Economic Perspectives*, "Is Free Trade Passe?" Krugman noted:

If there were an Economist's Creed, it would surely contain the affirmations "I understand the Principle of Comparative Advantage" and "I advocate Free Trade." ... 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* ... because of the changes that have recently taken place in the theory of international trade itself. ... 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 the policy that economic theory tells us is always right.

Only a few years later, however, Krugman had become one of the most vehement critics of scholars, public servants, and journalists who questioned free trade, doing his best to destroy their reputations in the eyes of the trans-Atlantic media and business and academic establishments. He and other intellectual vigilantes like Martin Wolf of the *Financial Times* and the economist Jagdish Bhagwati who policed the borders of acceptable discourse about trade in general and offshoring to China in particular were all too successful. It might have happened anyway, but Krugman's prestige and skill as a polemicist helped persuade elite media outlets, think tanks, government agencies, and business institutions that they could ignore the experts from varied backgrounds who were raising alarms about the consequences that offshoring U.S. manufacturing would have for supply chain fragility, domestic jobs, and U.S. military power. By the time Krugman confessed that he and others had been wrong to minimize the problems involved in globalization for a quarter of a century, the damage to the United States had been done.

In 1991 Krugman won the prestigious John Bates Clark Award, often viewed as a major step in the *cursus honorum* that leads to the Sverige Riksbank Prize in Economic Sciences in Memory of Alfred Nobel (often wrongly described as the Nobel Prize in Economics, which does not exist). If some speculated that the young maverick had checked his heterodox questioning of free trade in order to protect his future career within the orthodox U.S. economics guild, Krugman himself attributed his volte-face to his view that governments were too incompetent and corrupt to apply strategic trade policies successfully—a view that presumably should have led him, a self-described liberal Democrat, to join libertarians in rejecting most complex government policies, not merely those related to trade and industrial policy.

Krugman began distancing himself from his own past work and viciously attacking anyone who claimed that it justified a strategic trade policy for the United States.

Whatever his motive may have been, in the early 1990s Krugman began distancing himself from his own past work and viciously attacking anyone who claimed that it justified a strategic trade policy for the United States. According to Steven Pearlstein, writing in *The Washington Post* in 1994, "Krugman even went so far as to recommend, in a speech last year to the American Economic Association, that his own New Trade theories be stricken from undergraduate economic curricula so that students would have no qualms about the unambiguous value of free trade."

A supporter of Bill Clinton in 1992, Krugman was passed over when the administration chose economic advisers and appointees. He subsequently went postal, attacking Clinton administration experts who supported industrial policy like Laura Tyson and Robert Reich, and denouncing Clinton himself for economic heresy. Krugman spent the rest of the decade in the political wilderness, trashing progressives and populists for the small but influential elite audience of center-right neoliberals and libertarians who read his columns in Slate *(*titled "The Dismal Science") and other middlebrow publications. He repeated ad hominem attacks on free trade heretics in vituperative book-length pasquinades like *Peddling Prosperity: Economic Sense and Nonsense in an Age of Diminished Expectations* (1994). In "Competitiveness: A Dangerous Obsession" (*Foreign Affairs*, 1994) and "In Praise of Cheap Labor" (Slate, 1997), Krugman recycled familiar right-wing libertarian talking points. But his status as an MIT economist with prestigious credentials and his political identity as a nominal Democrat lent credibility to arguments that would have been dismissed had they been made, say, by a junior research associate at the libertarian Cato Institute.

Krugman's efforts to retain his standing in the orthodox academic economics profession by distancing himself from his own heretical strategic trade theory marginalized him in Democratic politics in the 1990s but paid off in academic politics in 2008, when he won the Sverige Riksbank prize. It was widely assumed at the time that the Swedish Academy gave him the prize not only as a reward for excellence in economics but for regularly denouncing George W. Bush in the *New York Times* column he'd been writing since 1999, just as a year later they awarded the 2009 Nobel Peace Prize (a real Nobel prize) to Barack Obama for not being George W. Bush.

The Swedes claimed that the award was in recognition of Krugman's work in "new trade theory" and "new economic geography." As such, it was the first time the prize was awarded to an economist for work the prizewinner had already repudiated as a trivial thought experiment irrelevant to public policy and dangerously misleading if taught to undergraduates.

Like most economists, and most people in general, Krugman will soon be forgotten. His only significant legacy will have been his role in shutting down the debate in the 1990s about strategic trade and offshoring, to the benefit of the state-capitalist Chinese dictatorship and U.S. multinationals engaged in global labor arbitrage strategies.

In his 1994 *Washington Post* article, Pearlstein observed that Krugman's hit list of free trade apostates was headed by Bill Clinton, whose economic ideas Krugman compared to anti-Darwinian creationism. Also on the list were "a number of what Krugman calls 'pop internationalists,' whose writings have helped shape administration thinking. This list includes Krugman's MIT colleague Lester Thurow; journalists James Fallows and Robert Kuttner; Labor Secretary Robert B. Reich; Undersecretary of Commerce Jeffrey Garten, and White House policy adviser Ira Magaziner … Laura D'Andrea Tyson, the chairman of the Council of Economic Advisers; Lawrence Summers, the undersecretary of the treasury; and Lawrence Katz, the Labor Department's chief economist … Krugman's hit list also includes corporate executives …"

Not since the days of the Nixon White House's enemies list was inclusion on a hit list so coveted as an honor by prominent Washingtonians. I was therefore pleased as well as surprised in 1995 to find myself denounced in a speech by Krugman, "Ricardo's Difficult Idea," along with malefactors as distinguished as the Anglo-French financier Sir James Goldsmith, James Fallows, the Washington editor of the *Atlantic* who was an expert on the Japanese economy, the great 19th-century German-American economist Friedrich List, and Labor Secretary Reich. According to Krugman, all of us were drooling idiots who would have flunked an undergraduate course in economics.

I had attracted the wrath of Krugman for an article in which I pointed out in passing that the use by multinational corporations of global labor arbitrage was one factor in the divergence between productivity increases and compensation in the United States, which began around the time of the large-scale offshoring of U.S. industry to other countries. Krugman pounced on this sentence of mine: “No matter how much productivity increases, wages will fall if there is an abundance of workers competing for a scarcity of jobs—an abundance of the sort created by the globalization of the labor pool for U.S.-based corporations.”

At the time I’d been one of the harshest and most visible critics of Patrick Buchanan in venues like *The New York Times*, but in a characteristic move, Krugman began his criticism of my writing by trying to smear me as a primitive nativist and protectionist: “the passage could almost have come out of a campaign speech by Patrick Buchanan.” (Two can deploy the *argumentum ad Hitlerum*: “Like Confederate President Jefferson Davis and the rest of the antebellum Southern slaveholder class, Paul Krugman fervently supports free trade ...”)

Krugman went on to impugn my motives: “Mr. Lind, who is always looking for ways to enhance his enfant terrible status, saw this as a perfect opportunity.” I am certainly not opposed to enhancing my enfant terrible status, but in that passage I was merely alluding to the obvious fact that global labor arbitrage strategies of corporations can lower the wages not only of former steelworkers if their new jobs paid less, but also of various service sector workers who had benefited indirectly from the presence of a steel mill that had closed. As the economist David Autor and his colleagues have demonstrated in the American case, the population of an entire region—the U.S. Midwest, the British Midlands and north, the former East Germany—could suffer widespread economic losses from the closure of factories as a result of import competition or offshoring regardless of productivity gains. Those losses in turn could contribute to the epidemic of “deaths of despair” documented by Angus Deaton and Anne Case.

So intent was Krugman on blowing raspberries and bombing me and other targets with water balloons, however, that he forgot to recite one of the standard talking points of libertarian and neoliberal apologists for corporate offshoring: *Of course there are always losers from trade who should be financially compensated by transfers from those who benefit from it.* Krugman’s audience might infer his apparent belief that in trade there are no losers at all.

Having compared me to Pat Buchanan and claimed that a cynical lust for glory inspired my critique of corporate offshoring, the insult comic of the econ department then veered off into a rambling digression about the Harvard paleontologist Stephen Jay Gould, asserting that Gould and Robert Reich were both frauds in their respective fields. He then circled back to me, Fallows, Goldsmith, List and various other infidels and heretics, whom he said had all failed to comprehend Ricardo's theory of comparative advantage.

Like the others on Krugman's enemies list, I understood the idea of comparative advantage perfectly well—and I also understood its irrelevance to the practice of corporate offshore outsourcing (or "offshoring," in the shortened version).

Comparative advantage and labor arbitrage are completely different concepts. Comparative advantage holds that, in order to specialize in the activities in which it is most productive, one nation should cede activities in which it is less productive to another nation, *even though the first nation is more productive in all activities than the second.* The classic example is a doctor who can type faster than a secretary but lets the secretary do all the typing anyway in order to practice medicine full time; as a result, both are better off. This is indeed a subtle concept. But since few examples of Ricardian comparative advantage thus defined can be identified in the real world, it doesn't really matter if policymakers and voters understand this academic thought experiment or not.

The logic of geographic labor arbitrage is different from comparative advantage. Given a choice between two jurisdictions (say, states in the U.S. or countries in the world) that have *equally productive* workforces—but workers in one jurisdiction have lower wages and/or fewer labor rights and political rights than those in the other jurisdiction—firms guided solely by economic considerations can transfer production from the high-wage jurisdiction to the low-wage jurisdiction at no loss in productivity, in order to save money on labor costs, fatten the profits going to managers and investors, and (maybe) lower consumer prices. Just as textile firms in the United States transferred a lot of production from Northern states with high state minimum wages and pro-union laws to Southern states with low state minimum wages and anti-union laws, so many contemporary multinationals relocated some or all production to China or Mexico, not on the basis of a Ricardian analysis of the comparative advantages of the countries involved, but simply to take advantage of cheap labor.

According to Krugman's speech, however, corporate labor arbitrage strategies exploiting wage differences among geographically separate workforces with comparable levels of productivity are impossible by definition. Behind this assumption is the marginal revenue productivity theory of wages, which holds that the productivity of workers directly determines their pay. If this is true, then among comparably productive workforces, disparities in wages should not exist.

It is testimony to the intellectual debility of neoclassical economics that this century-old theory is still taught as economic orthodoxy in the United States, even though it has always been obviously wrong. True, firms have to make profits and pay their costs. But, as Adam Smith and John Stuart Mill understood, after that the distribution of profits among managers, investors, and workers depends on the relative bargaining power of the three parties.

Implicitly invoking the bookish and discredited marginal revenue productivity theory of wages in "Ricardo's Difficult Idea," Krugman denounced Goldsmith and me for dismissing Ricardian comparative advantage as irrelevant in cases of offshoring:

Finally, and most importantly, it is not obvious to non-economists that wages are endogenous. Someone like Goldsmith looks at Vietnam and asks, "what would happen if people who work for such low wages manage to achieve Western productivity?" The economist's answer is, "if they achieve Western productivity, they will be paid Western wages"—as has in fact happened in Japan.

But high wages in modern Japan are not the automatic result of productivity growth without human intervention. The productivity of the firm (not the whole country) is a necessary but not sufficient condition for high wages for a particular firm's employees. Wage levels are influenced by institutional factors, including, in the case of Japan, political democracy, civil rights, lifetime employment at big firms, company unions, extremely low immigration, export-oriented strategic trade (of the kind that Krugman says cannot work) and so on. Did Krugman really believe that institutions do not matter, and that if Nazi Germany had won World War II, the Polish and Russian serfs laboring in German-owned factories in greater Germany in 1960 or 2000 would have automatically received increases in their wages commensurate with increases in manufacturing productivity?

As it happens, according to Outsource.dev, in 2019 the hourly cost of an American midlevel software developer was $132-$140, while that of a comparable Vietnamese worker was $25-$35. Labor productivity is presumably comparable in Vietnam and the United States, if offshoring by U.S. firms can be a profitable option. The outsourcing firm declares: "Ho Chi Minh City has been named one of the best cities in the world for software outsourcing due to [labor] cost."

Despite its quarter-century of success in U.S. establishment circles, the campaign by Krugman and other members of the neoliberal thought police to smear proponents of strategic trade and industrial policy as ignorant amateurs and hucksters did run into some opposition in the Bush and Obama years. In *Global Trade and Conflicting National Interests* (2001), the prominent economists William Baumol and Ralph Gomory deployed mathematical economics to argue that in a world of huge firms and technological progress, improvement in one country could come at the expense of the well-being of others. Even more shocking was a 2004 article in *The Journal of Economic Perspectives*, in which Paul A. Samuelson, the most eminent of mainstream American economists, upset his orthodox colleagues by arguing—*just like Pat Buchanan?*—that the combination of free trade and mass migration could possibly hurt a country. Samuelson concluded with a highly equivocal statement about policy: "It does not follow from my corrections and emendations that nations should or should not introduce selective protectionisms."

At last, on Oct. 20, 2019, in a Bloomberg essay titled "What Economists (Including Me) Got Wrong about Globalization," Krugman himself admitted that "we are in effect importing the services of less educated workers, putting downward pressure on the demand for such workers in the U.S." But according to Krugman in this essay, the only correct cure for the harm done by indiscriminate free trade is more indiscriminate free trade: "So while the 1990s consensus on the effect of globalization hasn't stood the test of time, its shortcomings don't make a case for protectionism now. We might have done things differently if we had known what was coming, but that's not a good reason to turn back the clock."

Here's a better way to put it: Things might have gone better if we had never listened to Paul Krugman.