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Comments
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The following paper takes issue with the tone and substance of Paul Krugman's article "The Illusion of Conflict in International Trade" (Peace Economics, Peace Science, and Public Policy, 2(2):9–18).

In a perhaps unduly confident article, Paul Krugman argues that metaphors about international trade being akin to military rivalry are misleading. Moreover these metaphors are put forth by people whose views "are based on a failure to understand even the simplest economic facts and concepts" (9). According to Krugman, "the conventional wisdom about international trade is dominated by entirely ignorant men" such as Lester Thurow in Head to Head and U.S. Secretary of Labor Robert Reich who "are in fact unaware of the most basic principles of and facts about the world economy" (14). Krugman explains that "we learn that there are very simple things in economic theory -- things that are not really debatable, like accounting identities, or very basic principles, like the idea that wages should reflect average national productivity rather than productivity at the plant level - which are very easy for people who have no familiarity with academic economics to get wrong" (14).

According to Krugman these people have views which are "startlingly crude and uninformed" (14) and the picture of trade as conflict "dissolves at the first serious confrontation with logic or evidence" (17). In his professorial wisdom Krugman asks "Did you understand why low-wage countries cannot both run trade surpluses and attract capital inflows on the first reading? (Do you understand it now?)" (16) and magisterially concludes that "for all their faults the [economics] professors are right. The conflict among nations that so many policy intellectuals imagine prevails is an illusion..." (18)

I will restrict myself to just a few brief comments to this provocative piece.

1. Contrary to what Krugman suggests, one can use basic economic theory of supply and demand without marginal productivity theory of, e.g., Adam Smith, to argue that there are forces in the world economy which could lead to downward pressure on wages in the advanced capitalist countries. Using a simple Smithian type of analysis, if real wages are lower in third world countries, there will (ceteris paribus) be incentives for investment of real capital equipment to move to the poorer countries, and for their workers to move to the richer countries. Either one or both of these movements would tend to lower wages in the rich country. Moreover, if there is a large supply of unemployed or underemployed labor in the poor country (which in aggregate there is), then

the increase in the demand for labor in the poor countries may not raise wage rates there much. Indeed, if the supply of labor there is perfectly elastic (as it is in a Lewis type of model), wages there would not go up at all. In any event, by this economic theory, increased globalization is putting downward pressure on wages in the richer countries; and, hence is a potential source for conflict.

2. Furthermore, using Schumpeter's theory of creative destruction, it is easy to see why international economics could become a game where there are winners and losers. Assume that changes and innovations are spatially distinct. In that case, policy makers and local denizens would want successful creative changes to take place in their region or country. Within the U.S., Massachusetts folk would benefit if the latest advances and implementation in computers occur in Massachusetts rather than in California or North Carolina. Internationally, it may make quite a difference if the latest techniques of production are utilized in Pittsburgh or Sao Paulo; in Seoul, Korea, or Manchester, New Hampshire. By Schumpeterian thought, those regions or countries on the cutting edge of creativity, innovation and technological change will boom; those not will suffer from economic destruction.

3. Using most <u>any</u> kind of Keynesian theory, when there is involuntary unemployment in the world, (and when is there not?) there may be economic conflict between nations, and trade protection might indeed increase domestic employment. In Keynes' view, "The extraordinary achievement of the classical theory [which Krugman essentially defends] was to overcome the beliefs of the 'natural man' and, at the same time, to be wrong" (<u>General Theory</u>, p. 350). It is not entirely clear that times have changed much in the half a century since Keynes penned these fighting words.

4. The theory that bases wage determination upon marginal productivity, or that "wages should reflect average national productivity" is hardly without its controversy within the economics profession. Professional economists such as Thurow himself argue that the theory is hopelessly muddled and unspecified (see his <u>Generating Inequality</u>) and hence misleading. Others, following Sraffa (<u>Production of Commodities by Means of Commodities</u>) and the Cambridge capital controversy, believe that the marginal productivity theory of income distribution is just plain wrong.

5. Speaking of capital controversy, Krugman seems to have fallen into a confusion with the use of the word capital (13). Conceivably, one or more low-wage countries could import "capital" from the U.S. in the form of equipment and factories. This would raise their level of employment; moreover, it would tend to lower employment and/or wage rates (or their rate of growth) in the U.S. The U.S. would be exporting its factories and "real investment" (or

"capital") to the poor countries; or "deindustrializing". The deindustrialization could be decreasing U.S. exports and increasing U.S. imports. At the same time, the low-wage countries could be exporting "capital" in the form of money to buy financial assets in the U.S. Hence, in this scenario, the U.S. would also be running a current account deficit and importing "capital" as financial assets are purchased by the low-wage countries. This does not seem to be a totally unrealistic scenario. Difficulties arise not so much from the internal logic of the argument as from the terminological (and hence conceptual) confusion surrounding the word capital.

6. According to Adam Smith, richly endowed universities may have a tendency to become the home of exploded and obsolete theories (Wealth of Nations, V.i.f.34) and that (quoting Cicero) "there is nothing so absurd ... which has not sometimes been asserted by some philosophers" (ibid. V.ii.k.14). (Presumably Smith would include economists among the ranks of philosophers.) There is the possibility here that there may indeed be a problem with the system of thought which Krugman is pedantically defending from the putative "ignoramuses". This possibility merits further investigation.

7. Per contra Krugman, there may indeed be real economic differences/conflicts between nations which even the current introductory textbooks cannot totally hide. Economists will have difficulty promoting "better understanding and friendlier relations between nations, races and classes of people"[1] if, following Krugman's example, they merely use the shibboleths of introductory economics textbooks to simply deny what, for most people, is only common sense.

Endnotes

1. Back cover, *Peace Economics, Peace Science and Public Policy*.