

Paul Krugman - New York Times Blog

December 7, 2012, 8:42 am

Macro Trumps Micro

Or, as the late James Tobin used to say, it takes a lot of Harberger triangles to fill an Okun gap.

Dean Baker catches David Ignatius suggesting that trade liberalization can provide enough economic boost to offset the effects of austerity. As Dean says, the arithmetic is totally off — almost two orders of magnitude off.

The truth is that using any conventional economic model, the costs from current levels of protectionism are very small as a share of GDP. To some extent that reflects the success of decades of trade liberalization: there just isn't that much protection any more. But it's a more general observation that even bad microeconomic policies, which lead to substantial distortions in the use of resources, have a hard time doing remotely as much damage as a severe economic slump, which doesn't misallocate resources — it simply wastes them. Which is the point of that Tobin quote.

Right now the U.S. economy is operating something like 6 percent below capacity. You would be hard-pressed to find any microeconomic distortion that comes anywhere close to doing that much damage, or even a tenth that much damage. The one place that might qualify is health care, where we surely do waste several points of GDP. But the problem with health care in America isn't that we don't let the free market work, it is that we have a semi-private system in a sector where free markets can't work.

Two more things — and back to Ignatius.

First, there's an especially strong tendency to mythologize the power of free trade. Not that open world markets are a bad thing; they're definitely a force for good, especially for small, poor countries. But my experience is that the less somebody knows about international trade, the more likely he or she is to imagine that modest moves toward or away from protectionism will have huge effects. Trade economists, who have actually worked with the models, have a much less grandiose view.

Second, even to the extent that trade liberalization would raise the efficiency of the world economy, it is not, repeat not, a route to overall job creation. Yes, everyone would export more; they would also import more. There is no reason at all to assume that the jobs gained from export creation would exceed the jobs lost to import competition.

Globalization is not the answer to the Lesser Depression.