Anarcho
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Retrieved on 28th January 2021 from anarchism.pageabode.com
A few comments on Paul Krugman winning the so-called Nobel Prize for Economics. He may be left-of-centre and a Keynesian, but his economics are sadly very much neo-classical in nature.

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As should be well known by now, Paul Krugman won this year's (non-)Nobel prize in economics for his work on trade theory.

Krugman is pretty much your standard neo-classical Keynesian, but he is left-of-centre and since the 2000 election campaign has spent much time exposing struggle the Bush Administration and its enablers. For example, while in the 1990s he refuted right-wing attempts to show that inequality was not rising in America while thinking that nothing could really be done about it, in the 2000s he has raised addressing this issue to forefront.

Unsurprisingly, given this, the awarding of the prize has proved some right-winger to proclaim him as a *"left-wing hack"* and an *"anti-capitalist"*, even a *"socialist"*, and whinge about the political biases of the Swedish Central Bank – obviously only (non-)Nobel prizes to right-wingers count! This gnashing of teeth by the right has, rightly, been a source of much amusement on the left.

Personally, I can think of worse people to give it too – and so have the Swedes. So we have Milton Friedman and von Hayek "honoured" in the 1970s while Joan Robinson, Nicholas

Kaldor and Michal Kalecki were ignored (but, then, they all rejected neo-classical economics and where, to varying degrees, socialists). Kaldor, for example, destroyed von Hayek's business cycle theory (what he ostensibly got the prize for) twice in the 1930s, before moving on to be the scourge of Friedman's Monetarism. Kalecki only managed to independently develop the key concepts of Keynes General Theory and published first. Robinson exposed key problems with neo-classical economics, not least the problems with marginal productivity theory. A few years back, they gave it to Edmund Phelps whose ideas have been used to tame the working class via his notion of the non-accelerating inflation rate of unemployment (they should have given it to Karl Marx, as it clearly echoed his analysis, or Kalecki who predicted the impact of full employment in eroding capitalist power in the workplace).

In terms of his trade theory work, it is rooted in the (flawed) neo-classical mainstream. As Steve Keen noted in passing, *"the representative agent was a kludge invented … to get around the problem that, in general, the preferences of individuals could not be aggregated … representative agent macroeconomics amounts to assuming that the economy consists of a single individual, producing and consuming a single commodity. However complex might be the reasoning used by such aficionados as Paul Krugman, the realm of applicability of this theory is that of Robinson Crusoe, living off coconuts before the arrival of Man Friday."* (**Debunking Economics**, p. 212). Only radical economist **Stephen A. Marglin (in his new recent book The Dismal Science), as far as I am aware, has presented a thought experiment on how free trade would impact on an economy with classes and it is worth reading.**

Given how free trade based on Ricardo's theory of comparative advantage is one of the most popular ideological positions of mainstream economics, it may come as a surprise how few (none!) countries have industrialised by means of it (and I'm including Hong Kong). In this, the relatively unknown Federick

their own wage agreements and an indirect one, as they *"raised the wages of less-well-paid workers more"* as the union contracts were *"reflected in the labour market as a whole."* (p. 149) Significantly: *"If gains in productivity had been evenly shared across the workforce, the typical worker's income would be about 35 percent higher now than it was in the early seventies."* (p. 128) Instead, wealth has flooded upwards to the top 10% (or even less).

As he said: *"In the end, of course, ideas must be tested against the facts."* I know that in neo-classical economics time, power and class are all ignored but they exist. Once these factors are taken into account, Krugman's "Just-So" story can be seen for what it is. Particularly as his own subsequent work can, in part, be used as evidence for another thought-experiment which does not abstract from essential elements of any real capitalist economy.

So if this award gets more people reading Krugman's exposures of the Bush Junta and his well documented accounts of the explosion of inequality in America then, I would suggest, it would be for the best. Hopefully, though, they will see past the limitations of both his (neo-classical rooted) economics and his New Deal-style politics to something more radical in terms of both analysis and solutions to the social question.

becomes simply misleading. Productivity gains, regardless of neo-classical assumptions, need not be shared equally between classes. There is a struggle over who gets what.

This brings me to my next objection: the ignoring of market power. Mass unemployment in an economy will mean that employed workers will be fearful of standing up to their bosses. They will be well aware that there are others waiting to take their jobs and, as a result, we would expect wages to fall as well as ensuring that productivity growth accumulates into the hands of their bosses (unsurprisingly, the evidence is that unemployment coexists with low, not, high wages). This increase in market power of the boss caused by unemployment would increase inequality while making wages decrease or stagnate. Eventually, workers in the affected sectors would find work elsewhere, but during the time that took to happen all workers would have had their economic power eroded, weakening unions, decoupling productivity growth from wage growth and so on.

So, yes, over time employment would equalise over the two sectors of the economy but the balance of class power, the levels of inequality within the society and so would be fundamentally different. This is all ignored by Krugman's simplistic model.

Krugman pointed to the *"past generation"* in American history. The alternative model proposed here is, basically, exactly what **did** happen in America (and elsewhere) since the 1970s. Ironically, Krugman laments precisely these developments in his new book (**The Conscience of a Liberal**). There is, he now argues, *"no question that US trade"* with Third World countries *"widens inequality"* and *"reduces job opportunities for less-skilled American workers."* (p. 135) Which is an improvement on his previous orthodox defence of globalisation in the 1990s. He also points to *"changes in institutions, such as the strength of labor unions"* (p. 136) as another factor in widening inequality, arguing that the unions had a *"direct effect"* on equality by

List has been repeatedly proven to be right. As such, Krugman's work, however innovatory it is, is building upon weak foundations.

Krugman really is pretty much a mainstream neo-classical economist. This can be seen when he notes in his introduction to economic textbook *"the prevalence of oligopoly"* and admits it *"is far more common than either perfect competition or monopoly."* However, *"the analysis of oligopoly turns out to present some puzzles for which they is no easy solution"* as *"the analysis of oligopoly is far more difficult and messy than that of perfect competition."* Why? *"When we try to analyse oligopoly, the economists usual way of thinking — asking how self-interested individuals would behave, then analysing their interaction — does not work as well as we might hope."* Rest assured, though, there is not need to reconsider the *"usual way"* of economic analysis to allow it to analyse something as marginal as the most common market form for, by luck, *"the industry behaves 'almost' as if it were perfectly competitive."* (Paul Krugman and Robin Wells, **Economics**, p. 383, p. 365 and p. 383) Which is handy, to say the least.

Which brings me to why I decided to write this blog entry. A few years ago, I read Krugman's dismissive review of William B. Greider's **One World, Ready or Not: The Manic Logic of Global Capitalism** (**The Accidental Theorist**). He uses it to *"illustrate a paradox: You can't do serious economics unless you are willing to be playful. Economic theory is not a collection of dictums laid down by pompous authority figures. Mainly, it is a menagerie of thought experiments – parables, if you like – that are intended to capture the logic of economic processes in a simplified way."* And he presents one:

"Imagine an economy that produces only two things: hot dogs and buns. Consumers in this economy insist that every hot dog come with a bun, and vice versa. And labor is the only input to production … Suppose that our economy initially employs 120 million workers, which corresponds more or less to full employ-

ment … Now, suppose that improved technology allows a worker to produce a hot dog in one day rather than two. And suppose that the economy makes use of this increased productivity to increase consumption … This requires some reallocation of labor, with only 40 million workers now producing hot dogs, 80 million producing buns.

"Then a famous journalist arrives on the scene. He takes a look at recent history and declares that something terrible has happened: Twenty million hot-dog jobs have been destroyed. When he looks deeper into the matter, he discovers that the output of hot dogs has actually risen 33 percent, yet employment has declined 33 percent … Global capitalism, in short, is hurtling toward crisis. He writes up his alarming conclusions in a 473-page book; full of startling facts … and punctuated with occasional barbed remarks about the blinkered vision of conventional economists …

"Meanwhile, economists are a bit bemused, because they can't quite understand his point. Yes, technological change has led to a shift in the industrial structure of employment. But there has been no net job loss … In our hypothetical economy it is – or should be – obvious that reducing the number of workers it takes to make a hot dog reduces the number of jobs in the hot-dog sector but creates an equal number in the bun sector, and vice versa."

From this parable, this thought experiment, Krugman draws the obvious conclusion that technological change need not be feared, that the market will ensure that workers are redeployed to new industries. He dismisses the objection that this *"thought experiment [is] too simple to tell us anything about the real world"* by arguing that *"if for 'hot dogs' you substitute 'manufactures' and for 'buns' you substitute 'services,' my story actually looks quite a lot like the history of the U.S. economy over the past generation."* He proclaims that Greider's mistake was *"systematically cut[ting] himself off from the kind of advice and criticism that could have saved him from himself. His acknowledgements conspicuously do not include any competent economists … To test-drive an idea with seemingly trivial thought experiments,*

with hypothetical stories about simplified economies producing hot dogs and buns, would be beneath his dignity. And it is precisely because he is so serious that his ideas are so foolish." Hence the conclusion: *"It is an insight that you can gain only by playing with hypothetical economies – by engaging in thought experiments."*

I was not convinced at all when I first read this a few years back. I still reject it and since Krugman is in the news, I thought now would be a good time to actually write it down. I do not deny the importance of thought experiments and simplified models, but if you simplify reality too much then any conclusions to be drawn from the experiment will be deeply flawed. Simply put, an unrealistic model will produce misleading results.

My objections lie in the obvious fact that Krugman's little story ignores time, class and market power. This is not that unexpected, given that neo-classical economics was developed to combat socialist economic analysis and so focused on individuals rather than institutions and social relationships. Instead of the classical theory of value, which was utilised to show the dynamics of an economy over time (and inadvertently showed that labour was exploited by capital), neo-classical economics started with a fixed amount of goods and so took a snapshot of the economy as its starting point. With production ignored, price was determined by effective demand (something classical economics did not deny happened in the short term). So, neo-classical economics is based on ignoring time – at best it compares two different snapshots while ignoring what happened in between.

This impacts into the next two ignored factors, class and market power. Krugman's model, as is clear, is based on workers with no mention of bosses. The assumption is that a capitalist economy is one of self-employment, one without capitalists! Given that there are classes, with returns to both capital and labour, in any real capitalist economy, this simplification