The Fight over Competitiveness
A Zero-Sum Debate?

Playing to Win
CLYDE V. PRESTOWITZ, JR.

Paul Krugman first achieved a measure of public recognition with a study of competition in the aircraft industry, which proved mathematically the potential efficacy of strategic—that is to say managed—trade. That this analysis was considered important might seem odd in view of the fact that the German-American scholar Friedrich List had done more or less the same work nearly 150 years ago and in view of the experience of the Japanese, who had been practicing strategic trade for more than 40 years at the time of Krugman’s study. But given the narrow scope of the research considered permissible by the conventional wisdom of U.S. economists, as well as their ignorance of history and other disciplines, Krugman’s analysis was a notable, iconoclastic achievement.

Indeed, it may have been too daring because ever since its publication Krugman has been running away from the implications of his own findings. His diatribe in Foreign Affairs (March/April) against the concept of competitiveness and those who espouse it is only the most recent example.

Krugman not only claims that concern with competitiveness is misplaced. He attacks all those who think otherwise—including leading members of the Clinton administration such as Robert B. Reich, Ira C. Magaziner, Laura D’Andrea Tyson and the president himself—as protectionists whose work is careless if not dishonest and whose motives run from simple greed to chauvinism and demagoguery.

Krugman contends that concern about competitiveness is silly because as a practical matter the major countries of the world are not in economic competition with each other. He attempts to prove this by making three points. First he argues that trade is not a zero-sum game. Trade between the United States and Japan is not like competition between Coca-Cola and Pepsi because whereas Pepsi’s gain is almost always Coke’s loss, the United States and its trading partners can both be winners through the dynamics of comparative advantage.

Although true to some extent, this rationale ignores that different kinds of trade take place. Surely Krugman is cor-
rect in the case of trade between the United States and Costa Rica, where America imports bananas it does not grow and exports airplanes and machinery that Costa Rica does not make. Both countries come out winners by devoting their resources to what each does best. But what about the kind of trade typified by the recent Saudi Arabian order for $6 billion of new airplanes? Why were the Europeans so upset and Clinton so happy when the Saudis announced that U.S. producers would win all the orders? Both the Europeans and the Americans make airplanes, and this order means that the United States will gain jobs and income that Europe might have had but lost. This was largely a zero-sum trade situation, and ironically it was precisely the case that first brought Krugman to prominence. Maybe he was right the first time.

IT'S LIVING STANDARDS, STUPID

In fact, Krugman later concedes the point by allowing that "in principle" competitiveness problems could arise between countries. But he insists that they do not in practice because trade is a relatively small part of GNP in the major countries. Consequently, living standards are determined almost wholly by how well the economy works domestically rather than by international performance. In this vein, he observes that exports constitute only 10 percent of U.S. output, apparently leaving 90 percent of the economy to purely domestic factors. Moreover, he attributes 91 percent of the 1973 to 1990 stagnation in U.S. living standards to declining domestic productivity growth and only 9 percent to deteriorating terms of trade.

But competitiveness proponents have never denied the importance of domestic economic performance. Indeed, virtually all competitiveness prescriptions emphasize domestic savings and investment rates, education, cost of capital and research and development. Trade is typically treated as a secondary issue—more a symptom than a cause of subpar competitiveness. Second, Krugman ignores
America's imports—which equal 11 percent of GNP and nearly half of U.S. manufacturing output. Thus, overall trade is equivalent to about 21 percent of GNP, and by some estimates the impact of trade is felt directly by at least half the U.S. economy. Take the U.S. auto industry. It is not a big exporter, and imports account for only about 15 percent of the U.S. market. But the prices and quality of those imports help determine the retail prices U.S. automakers can charge, wages of U.S. auto workers and incomes of those who service the U.S. auto industry.

Krugman does not explain the slowdown in U.S. productivity growth, but he implies that domestic factors are the sole culprits. Yet the slowdown came just when U.S. imports were soaring and entire industries such as consumer electronics were being wiped out by foreign competitors pursuing mercantilist tactics. Surely these dislocations had some impact on U.S. productivity growth.

Krugman's third and final argument is that although countries may be rivals for status and power, such rivalry is something apart from economics and has no impact on living standards. A high relative growth rate may enhance Japan's status, for example, but it does not reduce the living standard of other countries. Although this notion may be true in the short-term, absolute sense, it is not necessarily true in the long-term, potential sense. Since the end of World War II, the United States has grown faster than Great Britain. The United States has done so in part by taking British inventions such as jet planes and radar and commercializing them faster than the British, thereby closing off those industries as potential avenues of British growth. Of course, if Britain could enter other high-growth, high-wage industries, the U.S. position would make no difference. But at any one time the number of those industries is limited; missing the boat on one can mean losing potential gains in living standards. In the extreme, loss of economic competitiveness can weaken national security and cause greater vulnerability to political regimes and international cartels that may severely constrain a country's economic potential. This competition is, after all, what imperialism and its opposition has been all about.

**SPLITTING HAIRS**

To buttress his arguments, Krugman attacks his critics' arithmetic as careless. Yet Krugman's own arithmetic is careless and selective. His analysis of how manufacturing job loss affects real average wages ignores the relationship between service and manufacturing wages. American barbers are not notably more productive than Bangladeshi barbers. But their wages are much higher because their customers work with much higher productivity than the customers of their Bangladeshi counterparts. Loss of high-wage U.S. manufacturing jobs also depresses not only manufacturing wages, but service industry wages as well. Krugman, however, fails to mention this drag.

Krugman's discussion of value added is even more questionable. He may have a point in that "high value added" has become a kind of shorthand for technology-intensive and high-wage industries when that is not always the case. But Krugman uses very broad industry cate-
gories to make his point, although the data he draws on clearly show that a huge industry like electronics consists of many sectors, some with high value added and others with low. Overall, Krugman notes a figure of value added per worker in the electronics industry of only $64,000. But why did he ignore the tables showing the figures of $443,000 for computers and $234,000 for semiconductors?

Krugman concludes by expressing fear of the possible distortion of the U.S. economy through the application of flawed competitiveness policies. He could, of course, be right. But can the United States be confident that an analyst who has such obvious gaps of his own and who has now argued both sides of the competitiveness issue can be relied on as the guide? Perhaps he is wrong, and competitiveness, far from being a dangerous obsession, is an essential concern.

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Microchips, Not Potato Chips
LESTER C. THUROW

The Gang of Eight (Bill Clinton, John Major, Jacques Delors, Robert Reich, Laura D'Andrea Tyson, Mickey Kantor, Ira Magaziner, Lester Thurow) pleads not guilty to Paul Krugman’s charges that it is grossly exaggerating the importance of international competitiveness.

Krugman asserts that, economically, nations have “no well-defined bottom line.” Wrong! Nations seek to raise the living standards of each citizen. Higher living standards depend on rising productivity, and in any economy the rate of productivity growth is principally determined by the size of domestic investments in plant and equipment, research and development, skills and public infrastructure, and the quality of private management and public administration.

I have written articles referring to strategic trade policies as the “seven percent solution.” Ninety-three percent of economic success or failure is determined at home with only seven percent depending on competitive and cooperative arrangements with the rest of the world. My book, The Zero-Sum Solution: Building a World-Class American Economy, contains 23 pages on competitiveness issues, 45 pages on the importance of international cooperation and 333 pages on getting things right at home. The centrality of domestic invention and innovation is precisely why I agreed to lead the Lemelson-MIT program in invention and innovation, one part of which is a $500,000 prize for the American inventor and innovator of the year. The corpus of writings, speeches and actions of the rest of the Gang of Eight contains similar quotations, proportions and actions.

But remembering this sense of proportion, what is the role for competitiveness? Clearly something is wrong with Krugman’s arithmetic that shows international trade cannot make much difference to American productivity. If his arithmetic were correct, then it follows that a lot of American protection might be quite a good thing.