TRADE talks

A podcast about the economics of trade & policy
with Chad P. Bown

Episode 206. Paul Krugman talks trade, industrial policy, and Trump

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Transcript

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Chad Bown: Paul Krugman is probably the world's most famous trade economist. He won the Nobel Prize for Economics in 2008 for his incredible contributions to the theory of international trade as well as economic geography. Paul has been a professor at MIT, at Princeton, and most recently at the City University of New York.

Aside from trade, Paul has done some other things – he knows a lot about macroeconomics and he was, after all, a columnist for the *New York Times* for the last 25 years.

But for some of us, Paul Krugman is just all about trade.

So I was super excited this week, when I got a chance to sit down with Paul to have a free-wheeling conversation about some really geeky topics. We start with what economists got a little bit wrong about agglomeration externalities, one of the areas of international trade that he pioneered in the 1970s and 1980s. We then hit on the recent resurgence of industrial policy, as well as the Draghi Report, and AI. And because it is 2025, we conclude on tariffs and President Trump.

You are listening to an episode of *Trade Talks*, a podcast about the economics of trade and policy. I'm your host, Chad Bown, the Reginald Jones Senior Fellow, at the Peterson Institute for International Economics in Washington.

Here is my conversation with Paul Krugman – and apologies in advance for the beeping taxis in the background – that's what happens when you record a podcast in midtown Manhattan.

TRADE AND AGGLOMERATION ECONOMIES: WHAT DID WE GET WRONG?

Chad Bown: I want to start off by getting nerdy right away, and I promise to listeners that we will eventually turn this into policy relevance for today. But I want to take us back to some of your early research from 30, 40, 50 years ago – this thing about agglomeration economies/ externalities. Tell us about it.

Paul Krugman: At a certain point in my fairly early career, it didn't seem that early then, but now, in retrospect, like the Molière guy who realized he'd been speaking prose all his life, I realized that I'd been doing economic geography all my life. And the most striking thing about economic geography – where stuff is, where production takes place, where people locate – is that it's extremely uneven.

That you have, first of all, large concentrations of people and economic activity in fairly small parts of nations. We're sitting in the middle of the New York metropolitan area and there's 23 million people in a relatively small area here.

And also that individual industries are often extremely localized. We've known, really since Alfred Marshall, since the Victorian era, that there are several forces that lead to agglomeration economies, that lead to stuff clumping together. There is the advantage, for a particular industry, of being able to support suppliers of specialized goods and services. There is the advantage, especially for specialized skills, of a thick labor market.

So, if your Silicon Valley startup goes bust, you can move to another one the next day. And if a Silicon Valley startup wants to hire more people, it can poach its competitors the next day.

And there's knowledge spillovers of various kinds and which we now talk about technological spillovers, which is boring and modern, and I always like Marshall's, "The mysteries of the trade become no mystery, but are, as it were, in the air."

And all of those things have been characteristic of economies, one way or another, since the 19th century at least, and to some extent even before then. We can argue about whether they've increased or diminished in importance over time. I think it's fairly clear they've increased over the past couple of decades and also are interacting now with geopolitical stuff in a way that wasn't true before.

Chad Bown: So, before we get into the geopolitical stuff, what are some of your favorite examples from the real world, from history, of where these agglomeration externalities have tended to pop up?

Paul Krugman: Industrial agglomeration was much more of a thing in the United States circa 1900 than it is today, although it still exists.

There are all these great examples. There was the detachable collar and cuffs industry of Troy, New York. There was the costume jewelry industry of Providence. If you drive into New York via the Lincoln Tunnel, you pass under a sign that says, "Welcome to North New Jersey, Embroidery Capital of the world," which it once was.

In advanced countries, Silicon Valley is a massive, massive example of agglomeration economies. New York – the core of the New York economy is the financial industry. And the reason the financial industry is here is because it's here. Everybody wants to be near everybody else who's in that business. And London is the only, even approximate, counterpart, and there's really just two centers like that in the whole world.

For industrial stuff, there are some industrial clusters in the United States. There are actually more than we realize, and there are even service industries that are clustered in particular spots.

China looks a lot like America circa 1910 in terms of industrial clusters. And some of them are really important, and we'll probably get to those, and some of them are more fun than anything else. So there's one town, a fairly small city, that produces most of the world's buttons. There's another town that produces a large share of the world's underwear.

And it's always the same forces that apply. There's often a strong advantage to clustering near other people who are doing the same kind of thing that you are. Sometimes there are centrifugal forces also that make you want to spread out. You can often pay lower wages or have lower land costs or something, if you can move away from one of those established centers. And there's always tension between those two. But clearly, there's a lot of agglomeration that goes on in the world.

The economy is inconceivably complex, and there are millions and millions of different goods. But if you narrow it down to any particular sector, you're often surprised at how few places actually produce it – it's just one town in China or two places in Europe that actually do it.

Chad Bown: In my experience over the last couple of years, both in government and in watching policymakers, there's a lot of worry today, with the fact that, for some of these industries, they have ended up very, very geographically concentrated.

So, if we think back to COVID-19, a lot of the personal protective equipment (PPE) – i.e., masks and gowns that hospital workers needed during the height of the pandemic that we ran short of – a lot of that could be made anywhere, it's not particularly complicated to make, but it was really massively geographically concentrated in China.

Similarly, take high end semiconductors. We all know the story today that more than 90 percent of them are being manufactured in just one location on the island of Taiwan, just off of China's shores there.

Another one might be critical minerals processing. These critical minerals are located in the ground all over the world, but over the last two decades, the processing of them – so turning the rocks into the things that you can actually use – is now increasingly geographically concentrated in China too.

And for some of these things, policymakers are now worried. They're worried because… Maybe it's where the sources of supply ended up. Maybe it's that the world has changed. Maybe we're now exposed to climate shocks and droughts and floods and the worries about pandemics and then obviously the geostrategic concerns as well.

My question for you is: When you were at the forefront of really thinking about these agglomeration issues back in the 1970s and 1980s, and you were thinking about the benefits of all this agglomeration, as well as the benefits of trade, how much thinking was there about these potential downsides? I.e., about the potential costs?

Paul Krugman: I would say that I devoted approximately zero time to worrying about the risks. The world just seemed like a much less risky place then, probably because we were kind of blind.

And, by the way, we should say that, naturally being Americans, we think about the dangers of having other countries that we might have quarrels with controlling stuff. But other countries look at us – so take the fact that so much of the world's financial system is either in or runs through New York – is a big deal if you're Iran, or Russia, and you discover that the U.S. can cut you off from the world financial network because all of that stuff is on U.S. soil or the soil of U.S. allies, and is also a concern in a way that it might not have been.

The world used to be – well, okay, there was the Soviet bloc – but the world's market economies were relatively easy with each other. It was a relatively frictionless world and a world in which disputes tended to be minor. We had trade issues. We had chlorinated chickens and that sort of thing, but not existential issues. And the world is a much scarier place now.

Now, it's still true that if it's a country that you don't imagine abusing its position that we don't get very excited, although even that changes. So, even a couple of months ago, I would've said that nobody worries about ASML and the fact that that really high-end chip manufacturing equipment is all in the Netherlands. No one expects the Dutch to engage in an aggressive campaign of conquest.

But, on the other hand, if we're talking about a looming trade war between the United States and the EU, the United States might suddenly find itself cut off from the equipment that it needs to produce high-end chips.

So, I would say that we weren't thinking about it. I would have actually said it was inconceivable that we would be in the kind of world that we're now in – so, a failure of imagination.

POLICY TO TACKLE THE COSTS OF AGGLOMERATION?

Chad Bown: Now that we're headed into this world, though, I want to ask your advice for policymakers.

If we take as given, that for some of these products, there's been "too much" agglomeration and that we've gotten too much geographic concentration of production, how should policymakers think about tackling that problem? What are the right kinds of policy instruments they might use? How do you think about these things?

Paul Krugman: Okay, there's a lot of wisdom in old literature here. Somebody once said that, "New economic thinking often seems to consist of re-reading old books." And many of these issues come up in the old development literature. There used to be a time when many developing countries thought that import substitution – behind tariffs and quotas – was the way to modernize, and that view is largely discredited now, but it was out there.

And we did a lot of hard thinking. Max Corden's 1974 book *Trade Policy and Economic Welfare* remains relevant. And what Corden and others said was, if there's something that you think you need to be producing, then encourage production. The answer is industrial policy. The answer is to subsidize or otherwise promote.

In general, a tariff has side effects that may not be what you want. If you were worried that too many of the world's semiconductors are being produced within striking range of China, then you want to subsidize production of high-end semiconductors in the United States. But that's not a good reason to raise the cost of semiconductors to the U.S. downstream industry. So, there's a really pretty strong case for industrial policy here. That's the generic principle.

Now actually implementing it is tricky, by the way. The thing about these agglomeration economies is that, once they're well established, they're really hard to break.

The global role of the dollar is, in many ways, the same kind of thing. People use dollars for transactions, for reserves, for all this stuff, basically because everybody else uses dollars. It's a tremendous thing.

And I've been hearing imminent predictions of the demise of the dollar as the world's key currency for at least 45 years. The U.S. does occasionally abuse its privilege, though hasn't done it a lot so far, but Iran might disagree with me about that. And there are periodic movements to say, "Let's emancipate ourselves from the dollar," all of which have gotten nowhere because the forces of history, and the forces of cumulative advantage, are really hard to fight.

And so if you want to develop rival agglomerations to the existing agglomerations that you think are in the wrong place, it's going to be expensive and hard, which doesn't mean you shouldn't do it, but you should realize that it's not something you do by throwing a few dollars at the problem.

Chad Bown: I think one of the things that the Biden administration was trying to do along that front is, yes, there was definitely a domestic industrial policy piece when you're thinking about semiconductors and some of these other goods as well. But there was also an attempt at recognition that if we could work with trusted countries, that we didn't need to do it all here.

So we seemed to be perfectly happy when Japan was also subsidizing a TSMC factory and Europe was as well, so we could get more of TSMC outside of Taiwan. But it didn't have to all be here. And it'd be great because we wouldn't be the ones entirely paying for that diversification as well.

Paul Krugman: I don't know enough about semiconductors, but you can imagine that it might be easier to pry some of these industries loose from hostile nations, to put them someplace else than the United States. The advanced countries are similar in many ways, but there are some differences in aptitudes. There are some differences in the local home base and in the particular skills possessed by the workforce. So, it might be easier to get some stuff to relocate to Japan than to get it to relocate to the United States. It might be easier to get it to relocate to Europe. It might even be easier to relocate to Canada in some cases.

So, a strategy of "Let's have the world's stable democratic nations jointly try to make sure that critical industries are sufficiently well established in that grand alliance" so that we don't need to be too afraid of disruption, that's a great thing. Or it would be a great thing if the alliance of democratic nations included the United States, which is what we're not sure about now.

Chad Bown: Given our recent experience with this ex post, and recognizing, wow, we got geographic concentration of certain things, which ex post we wish we hadn't had that happen. When new technologies come along and it starts to seem like these agglomeration forces might be kicking in and we might end up at that same place, do you think there's a rationale now for policy makers to try to step in earlier and get in the way to prevent those kinds of things from happening? What are the risks there too?

Paul Krugman: No, I mean, it's speculative, although AI may be kind of in that position right now.

I do think that it's a lot harder. The whole logic of agglomeration says that there's a cumulative process where an agglomeration gets established and it's very hard to dislodge later on.

And that's not necessarily a political or strategic thing. It's just, you know New York is New York in large part because of the Erie Canal. That hasn't been relevant for 150 years, but it still shapes, in some ways, where things are. It would have been much easier to develop Philadelphia as a rival to New York, if you'd been able to do something about that before New York was as fully established as America's dominant financial hub.

So, yeah, there is a precautionary argument for relatively early intervention to at least diversify the global production of potentially strategic stuff.

EUROPE AND THE DRAGHI REPORT

Chad Bown: You mentioned earlier Silicon Valley and the agglomeration externalities and how sometimes the shoe is on the other foot, since we also have them here in the United States.

You've recently written also about Europe and the *Draghi Report*. What do you think are the lessons learned from all of this for what Europe is going through at the moment?

Paul Krugman: Europe is a really interesting case.

I would suspect that the Europeans would be feeling relatively okay about their economic performance if it weren't for the comparison with the United States. The old Eurosclerosis of persistent high unemployment is gone. In general, prime age workers are more likely to be working in Europe than they are in the U.S. In a lot of ways, the quality of life is decent. Their life expectancy is several years longer than ours.

So Europe looks pretty good, except that they have clearly fallen behind in some advanced technologies and a significant productivity gap has opened up.

And so Mario Draghi – the world's greatest central banker, now trying to do other things – has this report saying this is a crisis and Europe really needs to move and to the extent it gets the Europeans thinking, then that's great.

A significant part of that gap in productivity between the U.S. and Europe is really very localized. It's a reasonable guess that roughly half of the U.S.-European productivity differential reflects very high value-added per worker in Silicon Valley and also Seattle, which operates in somewhat the same way, on one side of the continent, and greater New York on the other. That it's really the agglomerations of the tech industry in Silicon Valley and the agglomeration of the financial industry, on the East Coast, that are the difference.

And from a globalist point of view, well, there are strong forces that want there to be a Silicon Valley somewhere, and it happens to be in the United States. There are strong forces that want there to be a New York somewhere, and it happens to be in the United States. From the point of view of global income, that's probably a good thing. We get efficiencies from those concentrations.

Now, what is harder is, to what extent does it hurt Europe that these agglomerations are in the United States? We have two regions in the United States that have very high value-added per worker, and it's clearly agglomeration economies.

It's not at all easy to parse the data. It's not entirely clear that ordinary workers in Silicon Valley or New York particularly benefit from those agglomeration economies – the rewards are going to a relatively small number of high-income people and to corporate profits. How much of that are benefits that accrue to the American people? I.e., 40 percent of U.S. equity is foreign owned.

It's not entirely clear that this is a problem for Europe. It's a little embarrassing that all of that really high tech stuff seems to be coming from America. But if America is friendly and open and doesn't abuse its monopoly on these things, it's not clear how much of a problem it is.

And if you had asked me a year ago, is there any chance that America will abuse this position? I would have said no.

INDUSTRIAL POLICY REVISITED

Chad Bown: Next, I want to turn to industrial policy. I assume you're in the same camp as me being a student of policy, but for me, I've been pretty struck by how quickly and massively there's been a resurgence of industrial policy, especially in the United States when you think of the CHIPS Act for semiconductors and the Inflation Reduction Act for all these climate-related technologies. And we've seen a lot of other countries subsequently follow along – the Europeans are doing more now themselves, the Japanese, the Koreans, and obviously China is a big part of this conversation too.

It's like we've gone from one equilibrium where at least these western, market-oriented economies weren't doing it to now everybody's doing it.

So my first question for you is what do you think are the main drivers behind why we've started to go down this path?

Paul Krugman: My answer is really not as clean; I'd like it to be monocausal. I think it's at least bi-causal. There are at least two different things going on.

So, one of them is national security. It has just turned out that the world is a much more dangerous place than we ever imagined. And reliance on foreign countries for crucial stuff, typically technology, but it could be other things as well, poses risks that we hadn't thought of.

There was a big industrial policy debate in the U.S. in the late 1980s, early 1990s where I was very much on the anti-industrial policy side. And the reason I was on the anti-side was that the industrial policy advocates were claiming that they could raise America's growth rate – i.e., that we could match Japanese growth or something, and that you could have big gains in total factor productivity – by promoting the right industries. And I was highly skeptical that we could actually do that, that we would be able to pick the right industries, that we could escape political capture of the process, and it just seemed that it was a misguided view of how you achieve economic growth. And I will cling to the view that I don't think there's a convincing case that industrial policy can do a lot to accelerate economic growth.

In fact, I don't think it's a convincing case that anything except more immigration can do a lot to accelerate economic growth. In the end, one of my favorite Bob Solow quotes was that, "Attempts to explain differences in growth rates always end up in a blaze of amateur sociology." And it's not at all clear that if growth is what you're looking for, that industrial policy is the answer.

But there are now two other considerations, which we weren't thinking of, or which I wasn't thinking of. And one of them is the strategic thing. I never imagined a world where conventional armed conflict or trade wars that shut down international commerce to a large degree would occur in the 21st century. But guess what?

So, this means that that the national security argument for having a significant presence in industries, even if that means sacrificing some agglomeration economies, is now a powerful one in a way it wasn't before. And that's the CHIPS Act.

The other argument for industrial policy, and the reason it's shifted, is that there are things that we should be doing that are hard to sell politically. Environmental – climate change, in particular, but environmental stuff in general – there you actually have massive negative externalities and you want to address those and every textbook says the way you address those is with a tax. Let's have a carbon tax or a cap and trade system which ends up being functionally pretty similar, which is not going to happen. Politically, we just aren't able to sell that, at least to anything like the right degree.

But we happen to be in a position where we've had sufficient technological progress in green energy that we can certainly take significant action against climate change by encouraging a switch in production toward stuff that uses renewable energy. And that means that you can try to do it with carrots instead of sticks. You can use industrial policy instead of a carbon tax.

And what's really strange about that is that the whole political capture argument, instead of becoming a reason *not* to do industrial policy, becomes an argument *in its favor*.

That we actually want people to become addicted to subsidies for battery factories and green technology and electric cars. Because that's how we get people to adopt those technologies. And we sell them because people see the benefits and the subsidies – exactly what was supposed to be the reason not to do this stuff – becomes a good reason to do this stuff because that's how you make these things politically possible!

And it may, despite the change in US administration, it may be working. There's a lot of backlash against proposals to cut those IRA subsidies because a lot of places have already become dependent on those subsidies for the return of some manufacturing.

So it's a weird thing. The world became more dangerous, which was one reason that industrial policy became suddenly popular again. And the need to sell good policies that in themselves are not popular becomes another reason to pursue industrial policy.

Chad Bown: Paul, now that we're three or four years into this industrial policy in the United States, we have some experience. Do you think there's lessons learned, at least preliminary lessons learned, so far?

Paul Krugman: It's really hard to draw broad lessons because although we are several years into it, we're really only about a little over two years into the IRA and the CHIPS Act, I believe.

I think most of the lessons are positive. There was a lot of bad mouthing of the United States. It was sort of "Oh, we can't get semiconductor production here because TSMC will discover that American workers are just not good enough." And that's being disproved daily. It turns out that, yeah, hey, we can do this. Given some financial incentive, we can actually do this stuff here in the U.S. as well.

And the political economy argument, as I said, we'll see, but it does seem to be working at least to some extent. And it's actually even working under extremely adverse circumstances. We have an administration and a Congress that are deeply hostile to the whole notion of climate policy, and yet a lot of the climate policy initiatives look like they have a pretty decent chance of surviving because essentially we've harnessed special interest politics on behalf of a good aim.

Which, by the way, is how the long history of trade policy worked. The way that we got to a relatively free trade world was not by getting politicians to read David Ricardo. It was by the Reciprocal Trade Agreements Act, which linked trade liberalization to exporters, to a special interest group. There's a long, honorable history of exploiting the baser motives in our politics to actually get good stuff done.

Chad Bown: Let's talk about the downside risks and potential costs of this move toward industrial policy. What strikes you as being the most important things that we have to look out for?

Paul Krugman: Industrial policy could lead to a lot of waste and higher costs. We've seen this to some extent at the local level. There have been times when every state wanted to have its own Silicon Valley, and most of that ended up being money poured down the drain. And even to the extent that it succeeds, a world with five mini-Silicon Valleys is also going to poorer than a world with one Silicon Valley.

There's also a serious risk that you'll start an industrial policy for what might seem like good reasons, and by the time it gets through the legislative process, it's ending up subsidizing a whole bunch of stuff that really shouldn't be on the list. And then will be very hard to ever get it off the list.

So I know, I know we're going to be talking Trump trade policy, but we have now the Secretary of Commerce talking about getting the manufacture of T-shirts back to the United States. I don't think that's a strategic industry by any measure, but once you get down that road, the old arguments about how political capture can end up being destructive do still apply.

Chad Bown: So stepping back from this, in 1987 you published one of my favorite articles called "Is Free Trade Passe?"

And I'm paraphrasing you here, but I interpreted your answer to that question at the time as something like, "Yes, while industrial policy and government intervention can work in theory, it's almost impossible for governments to have enough information about markets or to foreclose political capture to be able to pull it off in practice. So free trade is still a pretty good rule of thumb."

So how would you say 2025 Paul would evaluate 1987 Paul?

Paul Krugman: Looking back, I did not envisage that there would be strategic arguments with national security which, at the time, if you'd asked me, and I would have said, "Oh, nobody cares about that anymore. That's just not a concern in the modern world." And boy, was I wrong about that. So it's turned out that, first of all, the security. And it's hard to identify good industries from the point of view of raising total factor productivity. It's not hard to identify industries that are important for national security. So that piece – i.e., a change in the criteria – matters a lot.

I guess I'd say that the idea of harnessing political capture on behalf of good goals didn't occur to me. And that's probably a mistake.

And I would actually add something else which hasn't come up in our discussion so far. It's turned out that the downsides of globalization – the "China shock" and all of that – weirdly, is tied to agglomeration economies. Because it turns out that while the total job displacements from Chinese imports were on the order of the number of people who are fired from U. S. companies every month – and so, "why is it a big deal?" – except that the particular industries were highly geographically concentrated.

So, it's having Chinese furniture come in and displace a couple hundred thousand U. S. workers – that's callous, but hundreds of thousands of workers are displaced all the time – but if you're Hickory, North Carolina, where the heart of the town's economy is the furniture industry, it looks a lot more serious.

So there were a bunch of things that I didn't understand at the time.

It still remains true that it's very easy to get carried away, and once you start saying, "Oh, well, all that free trade stuff was nonsense, and let's start throwing around tariffs," you can end up doing a lot of damage, again rather contemporary. I shouldn't say it, but most of us had a kind of complacency about the world and about the downsides of change that now looks naïve, almost 40 years later.

PRESIDENT TRUMP AND TARIFFS

Chad Bown: Now I want to turn to President Trump. We are both trade economists, and so we have to talk about what's happening right now in the United States with the Trump administration on trade and tariffs.

Let's start positively. What do you think President Trump gets right about trade?

Paul Krugman: Oh, I'd really like to be open minded here and say something positive about Trump and trade.

It is really hard. I was never a complete free trade purist, but certainly saw a lot of virtues in it. But even if you were someone who was a fairly sophisticated critic of free trade, it's really hard to see any coherent conception in what's going on now.

Trump is fixated on bilateral trade imbalances. And nobody who has thought about the subject for more than 10 minutes thinks that that's a valid criterion. So, it's hard to see anything in there that makes any sense.

Chad Bown: So let's talk then about, beyond bilateral imbalances, what President Trump gets wrong about trade. Where would you start?

Paul Krugman: Well, the first thing is that he thinks about it as being about the trade deficit in general. I.e., we want to end the U.S. trade deficit and that tariffs are the way to do that.

Now, first of all, it's not at all clear that the U.S. trade deficit is a problem. We can worry about particular sectors, but the fact that we buy more from the world than we sell to it is, well, that could be a problem if we were an underemployed, depressed economy without policy instruments to fight that. But that's not where we are right now – at 4 percent unemployment and the rest of the world sends us useful stuff and we send them IOUs. It's hard to see that that's a problem.

It's also probably not the case that tariffs will do much to reduce the trade deficit. There are some subtleties there, but the basic point in textbook economics says that the trade deficit is really determined by the capital account. It is the fact that foreigners want to invest in the United States – so there's a net inflow of capital – and just as a matter of accounting that means that we have to have a trade deficit on the other side.

If you ask, "So what happens if you put on tariffs?" The answer is, even if other countries don't retaliate, what happens is that the dollar rises. And we have lower imports, but we also have lower exports because we have a stronger dollar. And of course, if other countries do retaliate we don't need as strong a dollar. But one way or another, exports fall to pretty much offset the effect on imports.

And there are some subtleties there. If you raise tariffs to the point where international commerce basically dries up, then so will trade imbalances. (We're not going to be able to run a trade deficit with Mars because ultimately you have to be able to get stuff back and forth.)

Within the range that we're talking about, tariffs are really unlikely to have an impact on the trade deficit.

At the same time, they will raise costs. What's really striking – and this is one of the things I learned from you, during the first Trump trade war – was this disproportionate concentration of tariffs on intermediate goods rather than consumer goods, which meant that even manufacturing was probably not benefiting. You were probably actually reducing manufacturing employment.

And we're doing it again. As we're holding this conversation, the tariffs that have already gone into effect are on steel and aluminum. That's good for steel and aluminum manufacturer, I guess, and apparently lawn furniture, which for some reason is covered by this as well. But it's pretty bad for everybody else who's downstream.

These are not tariffs that look like they're going to achieve even their ostensible goals.

Chad Bown: Let me try to play devil's advocate. Maybe these tariffs are just temporary. And President Trump is threatening some of them – he's threatening tariffs on a lot of different countries – but with a goal in mind. He wants countries to come to the table and actually do something for a change. Countries have just been sitting around talking and not really doing much on a lot of different issues over the last 5, 10, 15 years. And we need to get them moving. What do you think about that argument?

Paul Krugman: You can imagine that as a strategy if we had comprehensible demands on other countries.

I fixate a lot on the confrontation with Canada, precisely because it's so bizarre. What has Canada ever done to us? We've had a free trade agreement with Canada for 30 years, and we actually had a free trade agreement in autos even before that. So, it's not as if the Canadians are levying heavy tariffs on U.S. goods. Once upon a time they did, but that's long gone.

So, what is the demand? And at least rhetorically, the administration keeps on talking about fentanyl, which would be funny if it wasn't that they were getting real policy. Because if there's one thing Canada is not, it's not a significant source of fentanyl. Mexico is, although it's a lot harder than people think to stop that, but what is this even about?

Mark Carney is the new Prime Minister and may remain if the election polls are right. What can Mark Carney give? What harmful Canadian policy can he reverse? So, it's not clear at all what the demand is.

The thing that I would also say is that, in a way, unstable tariffs can be worse than permanent tariffs. If we really just went ahead and had 25 percent tariffs on everything from Canada and Mexico, then that's bad. That'll cause a lot of disruption and force the U.S. industry, especially the auto industry, to do massive, expensive restructuring. But at least they'll eventually pull it off.

If you don't know from month to month whether those tariffs are on or those tariffs are off, what do you do if you are manufacturing?

Suppose you're trying to make plans in the auto industry. Should you invest in upgrading your Mexican facility which let's say that you wanted to do that before all this started. But if you do that and then there's 25 percent tariffs you've wasted a bunch of money.

So you could invest in trying to build components capacity in the United States, instead, which will make sense if we're going to have 25 percent tariffs. But if Trump calls them off again, then you've wasted the money.

And so you end up paralyzed. You end up probably accumulating cash.

It would be one thing if we really did have demands on the rest of the world. But for the most part we don't. And one thing that people don't realize is that, look, the U.S. got to a position of really quite free trade, extremely low tariffs by historical standards, through a process of negotiation. It wasn't that we just unilaterally cut tariffs. It's the Reciprocal Trade Agreements Act. It's eight GATT rounds that brought tariffs down reciprocally.

So the reality is that advanced countries all have low tariffs. It's not the case that we're free trade and the rest of the world is protectionist. Advanced countries are almost as free trade as we are. So, what is the demand here?

Chad Bown: I think for me, one of the challenges with President Trump and the tariffs being in the news every day is that he seems to be motivating them to solve every potential problem that one could imagine. So they're going to solve the fentanyl problem with Mexico and Canada, but the Canada one doesn't exist. They're going to solve border security with those countries as well. They're going to reduce the overall trade deficit and bilateral trade deficits with countries. They’re going to bring in so much tax revenue that is being paid by foreigners that we’re going to be able to cut all kinds of other taxes. We're going to impose them for reciprocal reasons, to get the few higher tariff countries out there to actually lower their tariffs.

Sometimes we economists lose the forest for the trees and we try to argue against every single type of tariff, or motivation for the tariff, that President Trump is throwing out.

What should we be most concerned about when President Trump goes down this path?

Paul Krugman: What worries me most is that Trump will just find a reason for tariffs on everyone and everything.

It won't really have anything to do with the alleged objectives. It's supposed to be, oh, we're going to have reciprocity, except he doesn't realize that we already pretty much do have reciprocity. But they'll invent something.

So, one of the things that's on my radar is that this old, wrong argument that value added taxes are a form of protectionism. And most European countries have 20 to 25 percent value added taxes.

So, if they choose to get the economics wrong, then that could be high tariffs. Or just anything – just we're being taken advantage of. So, I guess my concern is not about any of the particular reasons. It is that these supposed reasons don't matter. That Trump just wants to put on tariffs.

And he does seem to view them as a kind of – I'm showing my age here, I guess, but – a vegematic it slices, it dices, it purees, right? It'll solve all problems. Whatever the reason for it, he really does really seem to want to impose tariffs.

And one of the interesting things, I think this is important, is what is getting put aside. Because we talked a lot about industrial policy and the reasons why lots of countries have gone in for industrial policy. I have become an advocate of industrial policy for certain purposes, strategic or just political economy of environmental policy.

Trump is pushing to scrap those. I mean, on the one hand, he says, “Oh, it's terrible, America is being exploited, we have to impose tariffs on everybody.” And he also wants to cancel the CHIPS Act.

So we're going to have tariffs that encourage production of T-shirts in America, while ceding high-end semiconductors to the Chinese. And that's crazy. And yet, there's this fixation he has.

Chad Bown: Paul, thank you very much.

Paul Krugman: Thank you.

GOODBYE FOR NOW

Chad Bown: And that is all for *Trade Talks*.

A huge thanks to Paul Krugman, distinguished professor at the City University of New York. Do check out Paul’s Substack for all of his latest writing, research, and thinking about the world around us today, including for more on trade.

I would also like to plug one thing that I wrote this week. With my Peterson Institute colleague Doug Irwin, we have an essay out in *Foreign Affairs* titled “The Incoherent Case for Tariffs: Trump’s Fixation on Economic Coercion Will Subvert His Economic Goals.” I will post links to that *Foreign Affairs* piece as well as to Paul’s Substack, on the *Trade Talks* episode website.

Thanks to Melina Kolb, our supervising producer. Thanks to Isabel Robertson, our audio producer. And thanks to Sam Elbouez on digital.

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