

**Is Free Trade Passé?  
Paul Krugman**

**Glossary**

**Returns to Scale (Economies of Scale).** For normal production processes, the marginal cost of producing another unit begins to rise long before the equilibrium quantity is reached. With some production processes however, marginal cost falls and is still falling at quantities near those that satisfy consumer demand. A good example is electric power.

**Imperfect Competition.** Perfect competition exists when no buyer and no seller can influence price. Informally, economists say that individual buyers and sellers are too small to influence price and therefore take price as given. Imperfect competition exists when a producer-seller is large relative to the market and realizes that it has some control over price. A good example is the Coca Cola Company which is the only producer of Coke™ products. Many consumers consider other fizzy beverages to be imperfect substitutes for Coke.

**Laissez faire** is a French term meaning “let it be” or “leave it alone.” In economics, laissez-faire generally means that government should not interfere with the workings of free markets.

**Externality (Third Party Effect).** An externality exists when the costs and/or benefits of producing and consuming a good are not private to the producer and consumer of the good but affect other agents as well. One intuitive example is a cigarette. Consuming a cigarette has third party effects on nearby individuals since “second hand smoke” is a health hazard and, to many, otherwise unpleasant.

**Discussion Questions**

1. Why, according to Krugman, is the economic case for free trade currently in doubt?
  - a. How, according to Krugman, does the possibility of “returns to scale” affect the case against free trade?
  - b. How, according to Krugman, does the possibility of “external economies” affect the case against free trade?
  - c. What does Krugman mean by a “strategic trade policy”?
  - d. How does the example on page 136 work and how, according to Krugman, does it embody the elements of a successful strategic trade policy?
  
2. What does Krugman mean when he says “It is possible, then, both to believe that comparative advantage is an incomplete model of trade and to believe that free trade is nevertheless the right policy (p. 143)”?
  - a. What does Krugman mean when he says that there are “empirical difficulties” in designing a strategic trade policy?
  - b. What does Krugman mean when he says that firm entry may dissipate the benefits of a strategic trade policy?
  - c. What does Krugman mean when he says that “general equilibrium” considerations make it difficult to know what industry should be favored by a strategic trade policy?
  - d. What does Krugman mean by the “political economy case for free trade”?
  
3. Having read Krugman, do you think that the US government should create a strategic trade policy that promotes US manufacturing of airplanes?