This Paper finds that there are sharp institutional differences between Japanese and U.S. markets. This is borne out in everything from the distribution system to the network system among companies to the financial role of banks. Some of Japan's markets appear to be characterized by cartel type arrangements between firms that may make it difficult for outsiders, including foreigners, to break in. However, there are real efficiency advantages to the Japanese style of business, arising from the virtues of long-term relationships, a flexible labour market and flexible manufacturing or corporate process "reengineering".

As a small island lacking natural resources, Japanese society has focused on manufacturing as the backbone of its economy. To import raw materials, it had to be export-oriented. To transform raw materials, it needed capital stock and technical know-how. The capital stock it accumulated has been financed by its high propensity to save. Technology it actively sought and often imported from the West. To produce new knowledge, it invested heavily in the technical education of its current and future labour force. To adapt to changing comparative advantage in global markets, it has a flexible labour market where wages and employment respond quickly. To top it all, it has responsibly managed its fiscal and monetary policies. Japan has turned in one of the lowest rates of inflation, unemployment, growth in public expenditures and national debt in the world over the last couple of decades. Japan has been an economic success because it got most of its economic fundamentals right. This is the real heart of the matter. Its lessons need more forthright recognition by Japan's trading partners.

Why is Japan not more "open" to foreigners? Japan is a capital-surplus economy that has, to a large extent, reacted as any profit maximizing economy would. The success of Japanese products was met with VERs and other trade restraints in the West. As a result, consumers in the West paid higher prices for certain Japanese exports, while, ironically, Japan got long term access to super-normal profits or rents. To divide up these rents in Japan, the banks, politicians, bureaucracy, industry and workers informally set up a mutually beneficial alliance. Outsiders, without the same degree of capital liquidity, faced by high sunk costs of investment in the expensive Japanese market, and stymied by Japanese intercorporate links (including linked sources of financing and much of the distribution system), have not generally been successful in establishing a corporate presence in Japan.

Japan bashing by the U.S. and others on a sector-by-sector basis might get a few chosen large corporations in the West to partake of these rents, but it does not create many jobs in the U.S. or Canada, nor open Japan to significant increases in foreign investment. So-called results-oriented trade management is more likely to lead to a market with more, rather than less, Japanese government and corporate control. This Paper suggests that our response to the Japanese challenge requires a more honest evaluation of how Japan's trading partners might emulate certain Japanese practices: solid, consistent monetary and fiscal management, the concerted effort to build an environment conducive to innovation, and the possible benefits of encouraging greater inter-corporate alliances (including with the financial sector) while ensuring