1. INTRODUCTION

1.1 Japan-U.S. Trade Conflict

Japan incurs the wrath of its trade partners, the U.S. and the European Union (EU) in particular, because it continues to run large current account surpluses. The macroeconomic explanation of this issue is well known: the export-import imbalance is the mirror image of the savings-investment balance. Over a business cycle, domestic savings and investment may not keep up with each other so that a trade account gap opens up. If the problem is to fix the U.S. balance of payments position, a focus on Japan-U.S. trade frictions will not solve it. That an adjustment in exchange rates eventually can correct imbalances in trade and is the appropriate cure is not disputed by knowledgeable analysts.[1]

Nonetheless, a chorus of observers purport to have identified something quintessentially Japanese about the nature of the problem. The Japan Inc. problem, these policy analysts argue, consists of three microeconomic issues. First, government protection in Japan is able to make winners. Second, the Japanese market is closed to foreigners. Third, the Japanese have not actively enforced their antitrust regulations. In this view, the Japanese system is essentially oligopolistic, deriving economic rent from foreigners and domestic consumers. "Japan bashing" has become shorthand for U.S. criticism of Japanese trading practices and its economic organization more broadly.

This Paper asks two questions in the light of the extraordinary growth in Japan and its subsequent trade frictions with the U.S.. First, what can we learn from Japan's economic success? Second, how should trade policy in advanced countries respond to countries who successfully catch up?

- **Bashing Japan Inc.**

Post War American economic and military might has been seen to be based on the preeminence of the U.S. in science, high technology industries, management and administration. On account of high total factor productivity[2], the U.S. not only commanded comparative but also

[1] Laura D'Andrea Tyson, *Who's Bashing Whom? Trade Conflict in High-Technology Industries*, Institute for International Economics, Washington, D.C., 1992, p.14. Ms. Tyson is currently Chairperson of the Council of Economic Advisors in the Clinton Administration.

[2] Total factor productivity (TPF) measures output produced by given amounts of labour and capital together; that is, total output (Q) divided by employment of capital (K) and labour (L), or formally, $TPF = Q/(K \cdot L)$. TPF roughly measures technological progress.