the export market. Import protection has acted as export promotion. Defence has proved the best form of attack.[12]

By giving a domestic firm a privileged position in its home market, Japan gives it an advantage in scale over foreign rivals. This scale advantage translates into lower marginal costs and higher market share in international markets. The extra cost to Japanese consumers is mainly just transfers to the Japanese firm. The Japanese firm, however, also benefits in the form of enhanced profits from foreign markets, and these benefits can more than tip the balance.

In sum, economies of scale and imperfect competition give rise to incentives for interventionist unilateral trade policy. They also greatly expand the gains from trade. International trade expands market size, allowing the realization of economies of scale and increased competition in imperfectly competitive industries. However, the proponents of strategic trade policy argue that, from any one country's point of view, the gains come about much more from having access to the other country's markets than from allowing foreign firms to have access to domestic markets. This is the gist of the neo-mercantalist view. It assumes, of course, that other countries will not limit access to their markets, or at least not to the same degree.

2.2 The Logic of Industrial Policy and Its Implementation

The theoretical case for an activist government industrial policy rests entirely on the premise of *market failure*. In advanced countries, two kinds of market failure seem to be particularly relevant.

- **Imperfect Competition**

Imperfect competition in concentrated markets results in a divergence between private and social returns. This is one kind of market failure and leads to an inefficient allocation of resources. Monopoly rents in concentrated international markets, whether or not induced by governments, furnish one reason for targeting such industries by governments.

The policy of industrial targeting always promotes some sectors of the economy at the cost of others. How do you choose which sectors should be encouraged at the expense of the rest? In a market economy, as a result of natural forces, some sectors will be growing while

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[12] When a single home firm and a foreign firm compete as Bertrand price-setters in a third-country market, an *export tax* rather than an export subsidy raises domestic welfare. The tax makes credible the home firm's promise not to undercut the price of its foreign rival and so allows the two firms to sustain a high degree of collusion. The home firm's profits may not rise, because this firm must pay the tax on its export sales. But the sum of tax revenue and domestic profits will rise with the introduction of a small export tax. See Jonathan Eaton and Gene M. Grossman, "Optimal Trade and Industrial Policy Under Oligopoly", in *Quarterly Journal of Economics*, (101) May 1986: 383-406.