In this chapter, we explore why the issue of the Japan-U.S. trade imbalance is not merely a macroeconomic adjustment problem but is rooted in international productivity differentials. Economic nationalists point to the decline in U.S. productivity growth during the last two decades, while Japan has managed to come out on top. The lesson economic nationalists draw from Japanese success is the importance of actively using industrial policy to promote national industries. But a recent study indicates that the fears of economic nationalists are not based on facts.

4.1 The Loss of U.S. Competitiveness and Deindustrialization

● Competitiveness and the Trade Balance: From Passion to Real Issues

Competitiveness means that firms produce high quality products and sell them in international markets at low prices. A competitive nation, though hard to define, is one that can succeed in international trade via high technology and productivity, with accompanying high income and wages. *Productivity* is one overall measure of competitiveness. High *total factor productivity* (TPF) comes from the use of a high level of technology and results in high incomes for both capital and labour while the cost of production remains low.[77] A nation with high labour and total factor productivity is one that can compete internationally, while generating high incomes and a high standard of living.

The large U.S. trade deficit during the 1980s, in the face of large surpluses in Japan and Germany, have been cited in the popular press as evidence of loss of U.S. competitiveness. The argument runs as follows. If a country has competitive firms in many subindustries, then it should have a trade surplus. Conversely, a country with only a few competitive firms would have a trade deficit. The problem with this approach is that trade imbalances tend to be temporary. Certainly, the U.S. deficit has persisted for nearly a decade. But over long periods of time there are solid economic reasons why a nation's trade roughly balances. Having taken on a large amount of international debt in the 1980s, the U.S. will almost certainly shift in the future to a position of trade surplus as it pays interest on that debt and perhaps repays some of it.

Broadly speaking, the U.S. trade position can improve either on the basis of low wages and devalued exchange rates, or as a result of high TFP. In the late 1980s, the U.S. trade position improved because the dollar depreciated, reducing U.S. wages relative to wages in other industrial countries. Consequently, the U.S. can run a trade surplus with lower real wages. Would you take that as a sign of improved U.S. competitiveness? Certainly not. This is not what is meant by competitiveness. This demonstrates that <u>export</u>

[77] TPF measures the output produced by given amounts of labour and capital together.