

# TREASURY

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Part A

Visit of Mr Komoto

18/6/81

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GUEST LIST FOR A LUNCHEON AT 11, DOWNING STREET  
ON THURSDAY, 18TH JUNE, 1981

HOST

The Rt. Hon. Sir Geoffrey Howe, Q.C., M.P. - Chancellor of the Exchequer

GUEST OF HONOUR

His Excellency Mr. Toshio Komoto - Director General, Japanese Planning Agency

GUESTS

His Excellency Mr. Naraichi Fujiyama - Ambassador of Japan

Mr. Hiroshi Ikawa - Director General, Japanese Co-ordinate Bureau (economic planning agency)

Mr. Hideo Usui - Member of Japanese House of Representatives

Mr. Masahiko Komura - Member of Japanese House of Representatives

Sir Hugh Cortazzi, K.C.M.G. - H.M. Ambassador to Japan

The Hon. John Baring, C.V.O. - Chairman, Accepting Houses Committee

Mr. R. A. Henderson - Chairman, Kleinwort Benson Limited

Mr. Ivor Cohen - Managing Director, Mullard Limited

Mr. P. Norman - Chief Executive, John Brown Machine Tools

Mr. W. S. Ryrie, C.B. - Second Permanent Secretary (Domestic Economy), H.M. Treasury

Mr. A. R. H. Bottrill - Assistant Secretary, World Economy Division, H.M. Treasury

Mr. A. J. Wiggins - Principal Private Secretary to the Chancellor of the Exchequer



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Points for Mr. Komoto - 18 June 1981

- Oil

Unemployment

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1. Japanese economy adjusted well to 1979 oil price increase; but growth in 1980 (4 1/4%) entirely due to 20% inc in export vol & 6% fall in import vol (Yen fell from 175 to \$ to 260 to \$ between 1978 & 1980; now back to 225 to \$). Fiscal policy tightened in 1981, but monetary policy relaxed. Unit labour costs inc by What assurance is there that 1981 growth will be more balanced? [only 4%] Is there any risk that domestic demand will be lower than forecast? What evidence is there that strengthening of Yen will hold back export growth & stimulate imports? Prospects for Yen?

2. International issues

(i) What shd US do about (a) level and (b) variability of interest rates? Japanese views? [Discussion at Ottawa summit.]

(ii) Can Japanese contribute more to recycling process? What do they expect from Mexico summit\*? [Could Japan further relax restrictions on capital flows?]

(iii) Problem of distribution of current deficits which are counterparts to OPEC surpluses - is

3. British and European economic relations with Japan [Japan's posn improving 170% fast?]

(i) UK visible trade deficit of £1.1 b in 1980 - & Japanese exports concentrated in sensitive sectors giving rise to protectionist pressures.

(ii) Important that bilateral understandings on Japanese exports (esp. of vehicles and consumer electronics) shd be observed. Wavering trends on cars and light vans: shares of UK market must be lower in 1981 than 1980.

(iii) Japanese Govt needs to give practical encouragement to imports from UK.

(a) by instructing Ministers to take a positive attitude

(b) by removing barriers to exports (discriminatory duty on Scotch whisky (compared to bourbon & rye), high tariffs on confectionary etc, restrictive testing procedures on pharmaceuticals, chemicals, cosmetics)

(c) by purchases of UK equipment, inc. in defence field (eg Sea Harrier).

(iv) Keen to strengthen industrial collaboration, esp in high technology. Also Nissan.

(v) regrettable lack of progress at EC/Japan high level consultations (1 June): Japan/Germany agreement on cars a helpful step, but needs to go much further.

(vi) Japanese exports to EC putting open trading system under strain. Need to honour export restraint agreements and to adopt positive attitude to imports. Removal of formal import barriers helpful, but not enough.

(vii) Need to import raw materials not a reason for large Japanese trade surplus with EC: Europe too depends heavily on imported raw materials. EC deficit with US quite different from that with Japan: imports from US widely distrib, inc food and raw materials, but from Japan concentrated in sensitive manufacturing areas.

\* [We object to Algerian idea of a link with global negotiations.]

UK issues

EC issues

[discussion likely also at Ottawa]



4. Export credit, important to preserve consensus. Problem for others if Japanese exporters can offer both official finance and lower rates than their competitors.

(Situation arises because of low market interest rates for Yen, & channelling most of finance through state Ex (m bank.) Need for increase in consensus interest rate minima; if Japan to be allowed to offer yen finance at lower rates, Japanese exchange restrictions should be relaxed to enable others to offer yen finance at comparable rates.

5. Lessons to be learned from Japanese industrial adjustment policies

Japanese aim to anticipate market change: & organise (oligopolistic) industrial structure to exploit it, using NEDC type machinery & effective control of finance via official supervision of banking system.

Special subsidies for running down declining industries / retraining workers involved.  
Grants & subsidies for research / new industries.

Annual spending on industrial rationalisation & development £12b a year  
(        % of public spending &        % of GDP )

Very favourable trends in manufacturing productivity / unit labour costs fixed in money terms since 1975. Output up 39%, numbers employed down 11%.



JAPAN - BASIC STATISTICS

% increase over previous period	1979	1980	1981*
GNP Growth 1975 = 100	5.6	4.2	3.3
Industrial production	8.3	7.1	3
Export growth (volume)	6½	19	5
Import growth (volume)	15	-4	-½
Consumer price inflation	3½	7.6	5½

Year to April 5.2

Unemployment	2.1	2.0	2.2
Current account deficit ¥ billion	-8.7	-10.7	-2

Q1 1981 (a.r.) \$4 billion

GDP 1980 \$10506 per head \$9062 not v. diff to UK

manufacturing 30% of GDP in 1978

\* OECD

PRINCIPAL PRIVATE SECRETARY

MR KOMOTO

One of the briefs (J) covers industrial policy in Japan. Over lunch, if not in full meeting, the Chancellor might be interested to cover some of this: how they create the right climate for enterprise, the extent to which the Government influences the choice of sectors and projects into which the major investment goes, how projects are nursed through the awkward stage between conception and large-scale production (the "post-development gap"), the extent to which firms rely on cheap finance and how far this has its source in the Government, and so on. In other words, how do the Japanese do it? Mr Komoto may not wish to divulge his trade secrets; but if he opens up at all, it could be interesting.

*Pg.*

P V Dixon  
18 June 1981



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LUNCH: MR KOMOTO, THURSDAY, 18 JUNE, 1.00 FOR 1.15 P.M. AT  
NO.11 DOWNING STREET

Guest List

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Mr Toshio Komoto - Director General of Japanese Planning Agency  
Sir Hugh Cortazzi KCMG - British Ambassador to Japan  
His Excellency Mr Naraichi Fujiyama - Japanese Ambassador  
Mr R A Henderson - Kleinwort Benson  
Mr John Baring - Chairman of Accepting Houses Committee  
Mr Ivor Cohen - Managing Director, Mullard Limited  
Mr P Norman - Chief Executive, John Brown Machine Tools  
Mr <sup>P V Dixon</sup> ~~W S Rylie~~ - Second Permanent Secretary, Domestic Economy,  
H.M. Treasury  
Mr A J Wiggins - Principal Private Secretary to Chancellor of the  
Exchequer  
Mr A R H Bottrill - Assistant Secretary, World Economy Division,  
H.M. Treasury  
Mr Hideo Usui - member of Japanese House of Representatives  
Mr Masahiko Komura - member of Japanese House of Representatives  
Mr Hiroshi Ikawa - Director General of the Japanese Co-ordination  
Bureau (Economic Planning Agency)

CHANCELLOR OF THE EXCHEQUER

Copies with all briefs

PS/Financial Secretary  
Sir Kenneth Couzens  
Mr Ryrie  
Mr Hancock  
Mrs Hedley-Miller  
Mr Bottrill

Copies of cover note only

Sir Douglas Wass  
Mr Hawtin  
Mr Peretz  
Mr Slater  
Mr McLaren:FCO  
Mr Sunderland: DOT

VISIT OF MR KOMOTO: 18 JUNE 1981

You are seeing Mr Komoto for lunch at No. 11 on 18 June, followed by talks lasting until about 4 pm. Mr Komoto is the Director-General (i.e. Minister) of the Japanese Economic Planning Agency. A personality note is at flag A and the guest list for lunch at flag B.

2. Mr Komoto is one of three Japanese Ministers who will be in London this week. The Prime Minister, Mr Suzuki, will have talks with Mrs Thatcher on 17 June. The Trade Minister, Mr Tanaka will see Mr Nott on 18 June. Mr Komoto, who will attend the OECD Ministerial meeting on 17 June, will also see Sir Keith Joseph after his meeting with you, and Mr Howell on the following day.

3. Mr Komoto has indicated that he would like to cover three main areas in his talks with you:

- a) Economic prospects for the UK and Japan.
- b) International economic issues, including interest rates, recycling and North/South.
- c) The Ottawa Summit.



4. There are a number of other subjects you could usefully raise:

- (i) bilateral economic relations (trade and investment).
- (ii) EC/Japan relations.
- (iii) Japan's current account balance and the yen.
- (iv) Export credits.

5. Briefs are attached on each of these issues, except the UK economy on which we have assumed that you will not need briefing.

The Japanese economy (brief at flag C)

6. You could applaud Japan's ability to adjust so rapidly to higher oil prices: but express concern that in 1980 GNP growth (4 $\frac{1}{4}$  per cent) derived almost entirely from a surge in export volume and a fall in import volume. The Japanese Government has said growth will be better balanced in 1981 and has taken some modest stimulatory measures. But the 1981 Budget is more restrictive than last years and might not allow much flexibility if domestic demand is weaker than officially forecast.

International issues (flag D)

7. This brief pulls together both the questions Mr Komoto is likely to raise and those which you might wish to discuss. Mr Komoto has said publicly that he wants to talk about US interest rates. Japan has recently added its voice to those criticising the US. Sir Kenneth Couzens' note of 9 June on the Vancouver meeting of the Summit Preparatory Group indicates a possible "middle way" approach for the UK. Japan generally supports the US determination to combat inflation, though some recent public statements (e.g. by the Central Bank Governor) have questioned the role of monetary policy.

8. The discussion of recycling and North/South Issues will probably be fairly general. We are not aware of any specific points Mr Komoto wishes to raise. The briefing is largely for background. However, you might like to ask about the prospects for a greater Japanese role in the recycling process. And about what Japan expects from the Mexico summit.

9. Japan's current account deficit has all but disappeared. This inevitably means that other and perhaps weaker countries are shouldering a larger part of the combined OECD deficit than is desirable or equitable. Mr Komoto might be asked to comment on this and on the prospects for the yen as Japan's external position improves. It is important for the international adjustment process that this improvement is fully reflected in the value of the yen.

Bilateral economic relations flag E)

10. We are submitting the brief prepared for the Prime Minister's talks with Mr Suzuki. It covers both trade and investment. The concentration of Japanese exports in sensitive sectors and the growing visible trade gap (£1100 million in 1980) is giving rise to protectionist pressures in the UK. Current bilateral understanding to restrain Japanese exports to the UK are welcome but must be made to work effectively. On investment, you could assure Mr Komoto that we are keen to see a strengthening of UK relations with Japan through industrial collaboration. Areas of particular interest are high technology industries. Also at flag E is a note rebutting Japanese arguments on bilateral trade, prepared by the Department of Trade.

EC/Japan economic relations (flag F)

11. Again, the brief is that prepared for the Prime Minister. The Japanese need to be convinced that the EC is united in its approach to the problem of the EC/Japan trade imbalance. There is much disappointment at the apparent lack of response by the Japanese so far, and concern over reports that Japan will not give an understanding on car exports to the EC as a whole analogous to that concluded recently with the US.

Export credits (flag G)

12. The Japanese have made it clear that they are not prepared to agree an increase in the present level of consensus minimum rates unless they are allowed to provide finance at rates below



the new level, reflecting their low domestic market rates. We appreciate the Japanese position but it would be very difficult for us, or the EC generally, to accept arrangements that seem to give favourable treatment to Japanese exporters. If Japan was to be allowed lower rates it would be very important that there was adequate access to yen financing at corresponding rates for foreign exporters. You could ask Mr Komoto if Japan felt able to respond positively on this point.

The Ottawa Summit (flag H)

13. Discussion about the Summit could provide a further opportunity to emphasise the strain on the open trading system created by Japan's exports of manufactures. We share the EC view that Japan's trading policies should be discussed at Ottawa. It will no doubt fall to the UK, which will have the Presidency in July, to represent the EC view.

Japan's industrial adjustment (flag J)

14. You may wish to glance at the background note. There are no particular points to make, but the note attempts to draw out the main administrative and financial elements in Japan's very successful policy of encouraging new high technology industries and running down uncompetitive, energy intensive ones.

15. You will be supported at the meeting by Mr Bottrill and by Mr Sunderland from Department of Trade.

*M. C. Mercer*

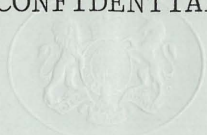
M C MERCER

15 JUNE 1981

CONFIDENTIAL

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MR TOSHIO KOMOTO

Director-General (ie Minister) of the  
Economic Planning Agency (since July 1980)

Born 1911

Founder of the Sanko Shipping Company, now one of Japan's largest shipping enterprises, in which he retains an interest. Elected 13 times to the House of Representatives. One time Minister of Posts and Telecommunications; Minister of International Trade and Industry (twice); Chairman of the LDP Policy Research Council (twice).

Until 1978 he was known as a loyal member of the Miki faction whose retiring disposition tended to keep him out of the limelight. He had the reputation of a man of few words but possessing exceptional business acumen. Something of a lone-wolf in business and politics.

During his years as Minister of International Trade and Industry he gained considerable weight in the political world and began to appear much more ambitious. In December 1978 he ran as a candidate in the LDP Presidential Election as the representative of the Miki faction. His candidacy was very much a token challenge on behalf of Mr Miki and he came last with 80,000 votes out of about 1.5 million. However the results of the LDP campaign to double its membership from 1.5 million to 3 million in late 1979 proved a startling success for Komoto, whose personal following among party members in the country is now the largest. Komoto had hoped that this would give him an advantage in the Presidential election. However, the election in 1980 was not contested, Mr Suzuki being chosen by talks in the party and his chances in 1982 have been lessened by the new rules for the Presidential election which

/make





make it unlikely that a primary election will be held. Komoto nevertheless still has ambitions to become party president and Prime Minister. Following Miki's semi-retirement after the 1980 election, Komoto has taken over the leadership of his faction, which is now commonly called the Komoto faction.

Fond of reading and an expert at Go. A dour unsmiling man but one with whom discussion can be straightforward and to the point.

Speaks no English, but understands it.

B

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Mr Masahiko Komura - member of Japanese House of Representatives  
Mr Hiroshi Ikawa - Director General of the Japanese Co-ordinate  
Bureau (economic training agency)

THE JAPANESE ECONOMY

Points to make

1. (i) Admire Japanese ability to adjust so rapidly to higher oil prices;
- (ii) But disappointing that GNP growth in 1980 was based almost entirely on external rather than internal demand;
- (iii) Mr Komoto will be aware of international trade friction created by renewed Japanese export surge, coupled with falling imports last year.
- (iv) Welcome Japanese Government's forecasts that growth will be **better** balanced in 1981. Measures already taken to stimulate domestic demand should help;
- (v) Note, however, that 1981 Budget proposed further tax increases and is a good deal more restrictive than in 1980. Wonder if it allows enough flexibility to support domestic demand if this picks up less than Japanese Government expects;
- (vi) How far might restrictive fiscal stance and continuing fall in inflation permit further easing of monetary policy, eg "window guidance" lending limits?

Summary

2. Despite relying on imported oil for around 70 per cent of primary energy supply, Japan has coped with the second oil shock remarkably well:
  - (i) Japan was the only major country where GNP grew continuously in 1980;
  - (ii) Inflation has fallen to around 6 per cent and is still declining ;
  - (iii) The current account deficit fell from an annual rate of over \$20 billion in the first quarter of 1980 to one of only \$4 billion in the first quarter of this year.
3. However from an international standpoint Japan's adjustment gives rise to unease. In 1980 GNP growth was based on an export surge. Mildly stimulatory measures have been taken to support domestic demand but the overall stance of



fiscal policy is becoming more restrictive. The expected shift to a more balanced pattern of growth this year could be less pronounced than the authorities envisage, or than Japan's low inflation rate and her role in the world economy might justify.

Output

4. GNP grew by  $4\frac{1}{4}$  per cent in 1980, though activity slowed down in the second half when industrial production fell at an annual rate of 3 per cent. Production has since revived, growing at 4 per cent, annual rate, in Q1 1981.

5. The external sector (net exports) contributed over 85 per cent of Japan's GNP growth in 1980. In the two previous years the external sector's contribution was negative. Real earnings declined in 1980 for the first time in 30 years. Private consumption and residential investment stagnated. Business investment was fairly resilient.

6. Export volume grew by nearly 20 per cent in 1980. Unlike the quantitatively similar surge in 1976 this was against the background of very little growth in Japan's export markets. Import volume on the other hand fell by 6 per cent with the volume of manufactured imports almost  $2\frac{1}{2}$  per cent down.

7. With an eye to external reactions, the Japanese Government is aiming for a much more balanced pattern of growth in 1981. It hopes that increased real wages and a fall in the savings ratio will stimulate a revival in private consumption. And it believes that the lagged effect of competitiveness changes will restrain exports and boost imports.

Inflation and earnings

8. Inflation accelerated rapidly in the first half of last year. But this was much more marked at the wholesale than the retail end. The year-on-year increase in wholesale prices peaked at 24 per cent in April 1980. In the year to April 1981 wholesale prices fell  $\frac{1}{2}$  per cent, mainly because of yen appreciation. The rise in consumer prices peaked at 9 per cent in September last year but by March 1981 has fallen to 6.2 per cent. Most forecasts expect the rate for 1981 as a whole to be around  $5\frac{1}{2}$  per cent.

9. Two key elements in containing inflation have been wage moderation and higher productivity. The 1980 spring wage round (the "Shunto") produced only a 7 per cent increase in basic wages - despite a marked simultaneous recovery

in company profits. Labour productivity in 1980 increased by 3 per cent. Basic wages increased by 7-8 per cent in the 1981 Shunto.

Balance of payments and exchange-rate

10. Rising oil prices turned a current account surplus of \$ 16½ billion in 1978 to a deficit of nearly \$9 billion in 1979. A sharply improving trade account brought the current account back into approximate balance by the end of 1980, although the deficit for the year increase to around \$11 billion (see brief on international issues at flag D)

11. The trade balance benefitted from three favourable developments - a large increase in export volume following a sharp depreciation of the yen through 1979 and the first half of 1980, the effect of the subsequent appreciation on export value, and sluggish domestic demand, which caused the volume of imports to decline. These trends have continued into 1981 taking the current deficit to \$1 billion in Q1. A small deficit is likely for the year as a whole. A 30 per cent deterioration in the traditional deficit on invisibles to \$13 billion in 1980 is expected to continue into 1981.

Substantial inflows of foreign capital, principally from OPEC, accompanied by a significant decline in long term capital outflows took the capital account into surplus in 1980 for the first time in more than seven years. This allowed the progressive liberalization of foreign exchange flows.

13. The yen depreciated to around Y260/\$ in April 1980 from its peak of Y175/\$ in 1978. This principally reflected concern over the effect of the second oil price hike on the economy. Confidence was restored by about the middle of 1980 and by December the rate had reached Y204/\$. Widening interest rate differentials have since resulted in a depreciation to about Y225/\$ - but good Japanese inflation performance and tight fiscal policy mean the yen has been hit less badly than most European currencies.

Policies

14. Monetary and fiscal policy were kept tight during the first half of 1980 in a successful attempt to limit the impact of oil price rises on domestic inflation. Emphasis shifted to stimulating domestic demand in the second half of the year, following a slowdown in economic activity. Further measures to support activity have been taken in 1981, including a 1 per cent cut in the

discount rate and the acceleration of public works programmes. But in line with the Government's medium term policy the main **priority** remains cutting the budget deficit. Any further stimulus will have to come from a further relaxation of monetary policy, if external constraints allow.

15. Fiscal policy has been tightened over 1980 and 1981 in order to gradually reduce the budget deficit. One element in the first half of 1980 was a slow down in spending on public works. But, in order to stimulate activity, public works' spending was speeded up again in the second half of the year. The FY 1981 Budget plans to reduce the central Government's general account deficit by Y2 **billion** ( $\$9\frac{1}{2}$  million) to Y12 billion, or 4.6 per cent of GNP. It contains the smallest percentage increase in public spending and the largest increase in taxation for over 20 years.

16. Monetary policy has been very successful over the last few years using a mixture of direct credit controls and interest rate adjustments. Window guidance ceilings limit the permitted increase in bank lending by the City banks. The ceilings are set quarterly and in the post war period have had considerable influence on the availability of credit. But in recent years diversification of corporate funding and liberalisation of foreign exchange flows have somewhat reduced their efficiency. Nevertheless the Bank of Japan would be reluctant to abandon what **they** regard as a useful tool in controlling **inflation**.

17. In 1979/80 credit was tightened gradually, quarter by quarter through window guidance ceilings, and the official discount rate was raised four times - from  $3\frac{1}{2}$  per cent in April 1979 to a historical high of 9 per cent in March 1980, dampening inflationary expectations. Sluggish domestic demand and stabilizing inflation brought about relaxation of policy thereafter. The discount rate was cut three times to its present level of  $6\frac{1}{4}$  per cent, reserve requirements were reduced and window guidance ceilings raised. Money supply growth, which slowed down substantially through 1980 mainly because of the balance of payments deficit and a shift from bank deposits to postal savings, has picked up since, reflecting the easier monetary stance.



INTERNATIONAL ECONOMIC ISSUES

Mr Komoto will have attended the OECD Ministerial meeting on 17 June and so will be familiar with the main international issues. This note very briefly summarises the outlook for the main economies and provides points to make and background on issues Mr Komoto has indicated he wants to discuss; and on issues you might wish to raise.

Points to make

- 2. (i) Should assure US that we fully support determination to reduce inflation through monetary restraint. But at the same time underline the need for this to be supported by appropriate fiscal policy if interest rates not to bear too much of the burden.
- (ii) Is Mr Komoto concerned that rapid decline in Japanese current account deficit could shift burden of OECD deficit on to the shoulders of other countries less well able to carry it?
- (iii) Interested to learn about what Japanese consider is likely evolution of the yen. Further strengthening appropriate, given rapidly improving external balance?
- (iv) Welcome emergence of Japan's "turntable" role in recycling process. Hope this can be developed further through continued liberalization of capital markets.
- (v) What do the Japanese hope for from the Mexico Summit? UK anxious to avoid any formal link between Mexico and the Global Negotiations.

The outlook

- 3. (i) GNP in the OECD economies is expected to grow by 1-1½ per cent this year, and by rather more than 2 per cent in 1981. The recession has been less marked in Japan than elsewhere. The recent surge in US output is not likely to be sustained. Recovery will be particularly slow in Europe, partly because of the impact of currency depreciation on inflation and real domestic demand.

(ii) Inflation in the OECD area should fall over the next 18 months, but progress in reducing it is likely to be unspectacular. In 1982 the average OECD rate could be over 8 per cent, with very wide dispersion between countries.

(iii) The combined OECD current account deficit should begin to decline quite sharply from the second half of this year. But the imbalance between the continuing deficits of most European countries and the broad balance of the US and Japan could prevail for some time. The position of the smaller OECD countries and the ldc's is unlikely to improve by 1982.

Interest rates

4. Mr Komoto has said publicly that he will raise the question of US interest rates while he is in Europe. Japan has only recently added its voice to the chorus of criticism of US monetary policy. The Governor of the Bank of Japan, Mr Mayekawa has questioned whether interest rates of 20 per cent or more. And at the Vancouver meeting of the Ottawa Summit Preparatory Group, the Japanese said that, internationally, too much attention was being paid to monetary policy.

5. You are familiar with the UK's position on this issue. Sir Kenneth Couzens' note of 9 June (copy attached) indicated that the UK could adopt a "middle way" between the US and its critics, acting to some extent as a conciliator.

6. There have been signs of US interest rates easing over the last few days. This might continue following the latest money supply figures. These show that in the week ending 3 June the most closely watched aggregate, M1B, fell quite sharply; over the last reported month M1B has fallen at an annual rate of over 8 per cent and is now well within its target range.

7. Our basic interest rate line - that fiscal policy should be tight enough to prevent excessive pressure on monetary policy - ought perhaps to be used cautiously with Mr Komoto. The emphasis should be on the need for the right for the right fiscal/monetary mix in high inflation countries, such as the US. Japan, like the UK, has been able to move to lower interest rates on the back of restrictive fiscal policy. Indeed as brief C indicates Japan's fiscal stance in 1981 could be unnecessarily restrictive.

Distribution of current account balances

8. This is a question you might like to raise. In 1979 and 1980, the

distribution within the OECD countries of the current deficits which are the counterpart to the OPEC surplus was better than in the mid 1970's. Between 1978 and 1980 the combined OECD current balance moved from a surplus of \$10 billion to a deficit of \$75 billion - ie an adverse swing of \$85 billion. Four countries accounted for all of this swing: Japan (\$26 billion); Germany (\$24 billion); Italy (\$15½ billion); and France (\$11 billion). Over the same period the US moved from a deficit of \$15 billion to broad balance.

9. It is appropriate that these four countries should have shouldered a major share of the OECD deficit. They had the strongest starting positions in 1978 and are able to finance large deficits. However, recent developments have been unwelcome: a) the relative movement of US and European current balances has contributed to currency instability which the EMS countries have tried to counter through higher interest rates; b) the position of the smaller OECD countries and the ldc's has weakened considerably; and c) Japan's deficit is declining rapidly.

10. The Japanese officially forecast a deficit of \$6 billion in fiscal year 1981 (beginning 1 April). However an outturn rather closer to balance seems likely and a shift into surplus would not be surprising.

11. This raises the general question about the equitable distribution of the counterpart to the OPEC surplus. You will not wish to revive the arguments about "burden sharing" which lay behind the adoption of the "locomotive" theory in 1978. However, it might be pointed out that, with the OPEC surplus unlikely to decline very much over the next couple of years, Japan, which is financially strong and a low inflator, can only reduce its deficit at the expense of other, probably much weaker countries.

The yen

12. The yen has moved like a roller coaster since the mid-1970's:

- Between Q1 1974 and Q3 1978 it rose by almost 50 per cent in effective terms
- between Q3 1978 and 21 1980 it fell by 30 per cent
- between Q1 1980 and Q1 1981 it rose again by 25 per cent



13. In the last three months it has fallen by less than 1 per cent in effective terms, though by around 7 per cent against the dollar.

14. At the end of 1980, Japan's competitiveness (relative unit labour costs) was almost 7 per cent better than in 1975 and 33 per cent better than in the third quarter of 1978.

15. During the period of pronounced yen weakness between end-1978 and spring 1980 there was some suspicion (eg in the EC) that Japan was manipulating the exchange rate to maintain competitiveness. The evidence does not really support this view: official ~~intervention~~ to prop up the yen over the period exceeded \$25 billion.

16. But in the early weeks of 1981 the authorities spent around \$1.2 billion to hold the rate down and they have intervened only on a limited scale to support it as it has weakened over the past two months.

17. The Japanese authorities say that they favour a high exchange rate to fight inflation and have mentioned a dollar rate of about Y200 as appropriate (Y225 at the moment). It is very important for the international adjustment process that the yen be allowed to appreciate as the Japanese current balance improves.

18. The Japanese have recently criticised the Reagan administration's policy of intervening only to "counter conditions of disorder in the market", and their action in January suggests that they might intervene heavily in order to prevent a rapid appreciation of the Yen. You may wish to mention that you support the US approach to intervention, and that whether sterling is rising or falling the Government's policy is to allow the exchange rate to be determined by the balance of market forces, with the Bank of England intervening only to smooth undue fluctuations and preserve orderly markets.

The ldc's and recycling

19. Mr Komoto may wish to talk generally about the issues. There are no particular points for the UK to raise, though you might wish to ask about Japan's role in the recycling process.

20. In 1980 the combined current deficit of the ldc's amounted to around \$55 billion. Despite a probable fairly sharp reduction in import growth the deficit might be slightly larger this year and in 1982.

21. The increase in the ldc's deficit between 1978 and 1980 was met largely by an end to their accumulation of reserves and an increase in borrowing from official sources. The outlook for 1981 suggests that private banks and the international financial institutions will have to meet a larger share of the financing.

22. So far the private capital markets have successfully taken the strain of recycling, though there has been some widening of margins. Prudential supervision of international banking is better than it was a few years ago. Banks have improved their own internal management and there is better cooperation between supervisory authorities.

23. IMF lending to developing countries is being increased substantially, accompanied by agreed adjustment programmes. Fund resources have been increased through borrowing from both Saudi Arabia and overseas countries.

24. Over the last two years Japanese restrictions on inward and outward capital flows have been progressively liberalised - initially to help finance the current deficit, more recently to enable Japan to play a larger role in recycling. However, the latter has not gone very far. The Japanese bond market is <sup>open to ldc issues as</sup> as most other major centres. But the participation of Japanese banks in eurocurrency lending is still subject to restriction. The banks were only allowed to participate in this from April of last year. And in fiscal year 1980 Japan's share of total eurocurrency lending was less than 10 per cent (ie less than Japan's share of world GNP). The IMF and others have expressed the hope that, through further liberalisation, Japan might be able to play a larger "turntable" role in the recycling process.

North/South issues

25. Mr Komoto has said he wants to cover this, though there is not very much to be said.

26. The Summit meeting of a limited number of developed and developing countries is to be held in Mexico on 22/23 October. The Summit was proposed by President Lopez Portillo of Mexico and Chancellor Kreisky of Austria. Both the UK and Japan will participate. President Reagan's attendance is also now certain.

27. Discussions at the Summit are expected to cover four main areas - food and agriculture; trade and industrialisation; energy; and finance.

We hope that they will be pretty informal. Foreign Ministers of all the participating countries will meet in Mexico on 1/2 August to discuss the agenda and format of the meeting.

28. The Japanese originally appeared enthusiastic about the summit. But their efforts to participate in early preparations for it were rebuffed. We do not know whether they are hoping for any particular concrete results from the Summit.

29. We are anxious to avoid any formal link between the Mexico Summit and the Global Negotiations. Algeria has sought to make such a linkage, but we believe that most of the other co-sponsors do not share the Algerian view. Attempts to get the Global Negotiations off the ground are currently on ice since the US announced that it would not be in a position to give its views on the issues involved until after Mexico.



JAPANESE PRIME MINISTER'S VISIT TO UK, 16-18 JUNE 1981

BRIEF NO 3: BILATERAL ECONOMIC ISSUES

POINTS TO MAKE

Trade

1. Concentration of Japanese exports in sensitive sectors and growing visible trade gap (£880 million in 1979; £1,100 million in 1980) gives rise to protectionist pressures (eg recent paper by CBI).
2. Current bilateral understandings to restrain Japanese exports to UK (particularly motor vehicles and consumer electronics) welcome. But must work satisfactorily.

Cars

3. Level of Japanese car and light commercial vehicle sales in UK much too high last year; and worrying trend so far this year. Japanese shares of these markets during 1981 must be significantly lower than in 1980.

Proposals to reduce imbalance

4. Need to seek practical ways to reduce imbalance. UK exporters already making considerable efforts with official support (British Export Marketing Centre in Tokyo only one of its kind). Look to Japanese government to help by:
  - (a) instructions to Ministries to facilitate imports and encourage public and private sector purchases of our goods;
  - (b) purchases of defence equipment, eg Sea Harrier;
  - (c) removal of barriers to UK exports: in particular, discriminatory import duty on scotch whisky (compared to bourbon and rye); high tariffs on confectionary, biscuits and chocolate (other examples: restrictive testing procedures on pharmaceuticals, chemicals and cosmetics).

Industrial collaboration

5. Keen to see strengthening of UK relations with Japan

/through



through industrial collaboration. Areas of particular interest are high technology industries, inward investment in UK and collaboration in third markets.

6. Welcome agreement between Mr Tanaka and Mr Baker to promote co-operation eg in telecommunications, computers and robotics.

Nissan

7. Hope Nissan project will go ahead as proposed. Would be important step forward in strengthening UK/Japan collaboration.

RJ 500 aero-engine

8. Fully support collaboration between Rolls-Royce and group of Japanese companies to define and design RJ 500. (Defensive) Cannot at this stage commit ourselves to approving launch of engine until partners' proposals, including funding implications, have been fully examined. (If asked) HMG would be very happy to see extension of Rolls/Japanese partnership to include, eg one of American manufacturers if Rolls and their Japanese partners made such a proposal. It is for them to explore in the first instance.



## JAPANESE PRIME MINISTER'S VISIT TO UK, 16-18 JUNE 1981

## BACKGROUND

<u>UK/Japan trade</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>(1980/79)</u>
1. UK exports to Japan (£m)	542	606	597	(-1.5%)
imports	1283	1490	1712	(+15%)
visible balance	-741	-884	-1115	(+26%)
UK surplus on invisibles	(250)	(225)	(na)	

2. UK's visible trade deficit with Japan still increasing. This deficit our largest after that with US (£1,375 million in 1979) with which we have a much larger total volume of trade. In 1980, UK exports to Japan covered only 34.9% of our imports from Japan.

3. Japanese exports concentrated in certain sectors (notably vehicles, consumer electronics and steel). Growth of these exports contained to some extent by restraint understandings covering some 25% of Japanese exports to UK, including motor vehicles and certain consumer electronics goods.

Cars

4. Bilateral inter-industry understanding between Society of Motor Manufacturers and Traders (SMMT) and Japanese Automobile Manufacturers' Association (JAMA) kept Japanese car exports to UK between 9% and 11% from 1975 to 1979. In 1980, Japanese share of UK car market rose to 11.9%. Following latest talks this year, SMMT expected UK market shares in cars and light commercial vehicles (LVCs) held by Japan to be well below 1980 shares to compensate for 'overshoot' in 1980. However so far this year, Japanese car sales have been high (11.3% cumulative at end of May) and LCV sales higher still (17.4% at end of May).

5. Note on Japanese arguments on UK/Japan and EC/Japan trade at Annex A.

Defence sales

6. Details at Annex B.

Co-operation in high technology areas

7. During recent visit to Japan, Minister of State for Industry, Mr Baker, and Mr Tanaka, Minister for International Trade and Industry, issued joint statement of intent to promote

/co-operation



co-operation between UK and Japan in high technology industries such as computers, telecommunications equipment, biotechnology, robotics and computer aided manufacture. MITI and DOI will hold follow up meetings at least once a year, the first in September 1981. Mr Baker and officials have already invited companies to meetings to discuss prospects. MITI have not yet got down to detailed discussions with companies on likely projects. We need to prevent talks becoming an empty gesture by Japanese or being manipulated into areas which only facilitate Japanese long term strategies with little benefit to UK. Therefore important to stress that we are taking this development seriously and that co-operation is two-way process.

#### Inward investment

8. Note circulated to OD(E) at Annex C.

#### Nissan

9. Nissan project to manufacture 200,000 cars a year in UK will be largest Japanese investment in Europe, if it goes ahead. Nissan's feasibility study team currently in Japan examining information gathered in UK. Company hope to reach preliminary conclusions on whether to proceed by mid-July. Next step further discussions between Nissan and DOI. UK vehicle and component industries concerned about likely effect of project; whether Nissan's intended local content levels are high enough; and whether they will be achieved in practice and how they are to be monitored. Government is confident that these concerns can be met and that project offers important national economic benefits.

#### Collaboration on RJ 500 aero-engine project

10. Important to assure Japanese that HMG remains committed to concept of joint ventures in aerospace if of mutual benefit and commercially viable. Japanese Trade and Industry Ministry (MITI) concerned that planned expenditure cuts in Japan may affect RJ 500 project. They hope that if Prime Minister raises subject with Mr Suzuki it will ensure the project's immunity from those cuts. We too are anxious to keep Japanese in play -

/although

although not finally committed to the launch of the engines - and hope subject can be mentioned.

11. Government was unable to accept launch proposals presented by Rolls-Royce in December because of uncertainties over precise size of engine to meet market requirements and concern that company appeared to be assuming competition from only one of its two main American rivals. The UK and Japanese partners are considering these questions and meanwhile, with approval of two governments, are continuing design and development work.

12. (Not for use) Rolls have been told that HMG is unlikely to approve full launch of the RJ 500 unless they can show that one or other of main American companies will be involved. Clear that Japanese government also concerned to eliminate part of expected American competition and would like its companies to press for American participation. Japanese government have been told at official level that we would favour any such proposal. We have been careful however not to reveal our own initiative with Rolls-Royce as we do not wish to be seen to be undermining Rolls' position. HMG's final decision on whether to approve launch of the engine will also turn on commercial viability of proposals which partners put forward as well as funding implications.

## JAPANESE ARGUMENTS ON JAPAN/UK AND JAPAN/EC TRADE

1. Imbalance in visible UK/Japan trade is offset by invisible earnings.
  - A. No. Visible deficit with Japan was over £1,100 million in 1980. Invisible surplus was only some £200-250 million rather than £900 million claimed by Japanese authorities. Whereas Japan records all payments made to UK as invisible earnings, we employ more sophisticated methods whereby only income earned by UK on invisible trade transactions is recorded as part of our invisible earnings.
2. UK exporters do not try hard enough in Japanese markets.
  - A. Not true. Effort being put by UK into Japanese market disproportionately great in relation to the rewards. Japan accounts for just over 1% of total UK exports but receives 5% of British government's official export assistance. Exports to Japan Unit specifically set up to help exporters, backed up by large commercial department in British Embassy in Tokyo as well as the only government financed British Export Market Centre anywhere.
3. Japanese tariffs are low.
  - A. Though Japanese tariffs relatively low in general (3% after implementation of Tokyo round tariff cuts as compared with 4% in US and 5% in EC), such low tariffs would deserve greater credit if they lay in areas where UK goods are competitive instead of in areas where Japanese industry is strong and has little to fear from imports. Import duty on scotch whisky equivalent to about 60% advalorem, compared with tariffs of about 24.5% on bourbon whisky and 28% on rye whisky. Also tariffs ranging between 33.8% and 40% on chocolate and sugar confectionary, cakes and biscuits.
4. There are no Japanese non-tariff barriers.
  - A. European companies encounter not only strong domestic competition but also a deterring and at times impenetrable combination of group-affiliation, exclusive trade financing, interlocking directorships, and the absence of independent  
/dealerships.



dealerships. Also a mass of administrative regulations which generally only major exporters employing good Japanese staff can successfully cope with.

5. Japan cannot afford to import more manufactures from Europe and also depends on external sources of oil and raw materials.

A. Japan not alone in depending heavily on imported energy and raw materials. So do Germany and Italy for instance.

Commercial Relations and Exports Division 2  
Department of Trade

## DEFENCE SALES

Sea Harrier (British Aerospace)

1. Japanese Navy at present have no requirement for V/STOL aircraft but this could change if Navy given a wider role (a delicate question politically in Japan). Sea Harrier would be very suitable aircraft.

Helicopters (Westlands Ltd)

2. Japan's new generation ASW (anti-submarine) helicopter due to come into service from 1982. Interest expressed in Sea King replacement. Potential value some hundreds of millions of pounds.

LAPADS/AQS901 (Marconi Avionics)

3. Helicopter/aircraft mounted systems for detection of submarines. Being promoted for update of current ASW helicopter and, in longer term, new generation ASW. Potential value about £20 million.

SMLA (Rolls-Royce)

4. Introduction of this engine into service in UK (in type 22 or 23 Frigates) brought forward by RN to help sales to Japan. Contract expected to be signed this month. Japanese have been reassured as to RN's commitment to the SMLA. Value some £50 million plus.

MK 10L Ejection Seats (Martin Baker Ltd)

5. Being promoted for new Japanese jet trainer (MTX). Value upwards of £5 million.

Torpedoes (Marconi Space and Defence Systems) (MSDS)

6. MSDS had been promoting Stingray to meet Japan's short term requirement for a lightweight torpedo and had also been involved in initial technical discussions with longer term aim of incorporating Stingray technology in development of an indigenous torpedo. Japan has decided to purchase the US Mk 46 torpedo in preference to Stingray and MSDS now considering pulling out of the new torpedo development. Subject could be sensitive.

FH 70 (International Military Services)(IMS)

7. FH 70 gun has been provisionally selected by the GSDF (Army) in preference to the US M198. This awaits endorsement

/by the

by the Japanese Defence Agency. Contract will be worth some £60 million.

## MAJOR DEFENCE SALES TO DATE

1971	adour aero engines (Rolls-Royce)	£50 million plus
1977	olympus/tyne gas turbines (Rolls-Royce)	£30 million plus
	gas turbine control system (Hawker Siddeley)	)
1978	inertial navigation system (Ferranti)	£7 million

Defence Sales 3  
Ministry of Defence



ANNEX C

## JAPANESE INWARD INVESTMENT

1. The first Japanese direct investment in manufacturing in the UK took place in 1967 (YKK Fasteners) and currently there are some 23 Japanese companies engaged in manufacturing activities in the UK: 12 in England, 7 in Wales and 4 in Scotland providing total direct employment of around 5,000 the bulk of it in Assisted Areas. The total value of the direct investment in manufacturing is believed to approach £100 million.
2. In accordance with the principle of free competition amongst UK manufacturers, in furtherance of efficiency and international competitiveness, HMG does not discriminate against companies of any origin. Foreign companies in the UK are entitled to the same benefits and have the same responsibilities as British companies. Foreign companies now own some 20% of British manufacturing industry. Beside the 1,500 US-owned and 120 German-owned manufacturing establishments Japanese inward investment remains small. It would be inappropriate to consider policy towards Japanese inward investment in isolation from inward investment policy generally.
3. Interest among Japanese companies in investing in manufacturing projects in the UK has been increasing and the Nissan project, if it goes ahead, will be by far the largest Japanese investment in manufacturing in the UK (indeed, in Europe), providing direct employment not far short of the total so far provided by Japanese manufacturing companies already established here.
4. Much of the production of this manufacturing investment by Japanese companies may be considered as additional and since it is often related to the European market it is likely that had it not taken place in the UK, not only would UK imports have been higher but UK exports would have been lower. There have also been benefits, for example in the introduction of new technology and production and management techniques, which are even more difficult to quantify.
5. Desirable Japanese investment in manufacturing is likely to take place in industries in which:
  - (a) imported Japanese products are making large in-roads into the UK;
  - (b) Japanese companies are more technically advanced than UK companies and the latter show little promise of catching up.
  - (c) it appears probable that Japanese investment will go to other Community countries if it does not come to the UK;

/(d)

- (d) Japanese companies are advanced in some aspects and UK are advanced in others and joint ventures could improve competitiveness of both sides.

6. These investments offer the following advantages:

- (a) the introduction of new technology and new production practices to fill gaps in the UK industry and to provide an example from which UK industry can benefit;
- (b) import substitution, an increase in exports and a balance of payments benefit;
- (c) increased employment opportunities, particularly in the Assisted Areas;
- (d) the strengthening of indigenous industries supplying plant and components.

7. To date Japanese investment has been mainly in consumer electronics, but also in a variety of other products, for example zip-fasteners, ballbearing and fishing tackle. In general the performance of these plants has been encouraging and the investment has been 'desirable' according to the criteria set out in paragraph 5.

8. On the other hand, investment in some sectors could bring Japanese competition more effectively to the doorstep of UK industry displacing jobs elsewhere in the UK, could increase component imports and could expand the Japanese market share without significant import substitution benefits. There is also the risk, associated with all inward investment but not yet borne out in Japanese investment in the UK, that the operation of overseas subsidiaries could be cut back and replaced by capacity in Japan at times of slack demand in the Japanese market.

9. It is also necessary to consider the wider aspect of whether Japanese investment would be located elsewhere in the European Community, if not in the UK, which would allow continued imports into the UK without restriction or duty and with none of the benefits associated with investment.

10. This short paper has concentrated on Japanese investment in manufacturing activities but it should not be overlooked that considerable Japanese investment has also taken place in the services sector, notably in banking and insurance but also in distribution and marketing.

11. It remains essential to monitor the effect of Japanese inward investment and to be discriminating in the type of project encouraged. However the benefits to the economy so far appear to outweigh cost to British industry. No change of policy is therefore recommended.

Department of Industry

JAPANESE ARGUMENTS ON JAPAN/UK AND JAPAN/EC TRADE

1. The imbalance in visible UK/Japan trade is offset by invisible earnings.

A - No. Visible deficit with Japan was over £1100 million in 1980. The invisible surplus was only some £200/250 million rather than the £900 million claimed by the Japanese Authorities. Whereas Japan records all payments made to the UK as invisible earnings, we employ more sophisticated methods whereby only the income earned by the UK on invisible trade transactions is recorded as part of our invisible earnings.

2. - UK exporters do not try hard enough in the Japanese markets.

A - Not true. The effort being put by the UK into the Japanese market is disproportionately great in relation to the rewards. Japan accounts for just over 1% of total UK exports but receives 5% of British Government's official export assistance. The Exports to Japan Unit was specifically set up to help exporters, backed up by the large Commercial Department in the British Embassy in Tokyo as well as the only Government financed British Export Market Centre in the world.

3. - Japanese tariffs are low.

A - Though Japanese tariffs are relatively low in general (3% after the implementation of the Tokyo round tariff cuts as compared with 4% in the US and 5% in the EC), such low tariffs would deserve greater credit if they lay in areas where UK goods are competitive instead of in areas where the Japanese industry is strong and has little to fear from the imported sector. The import duty on Scotch Whisky is equivalent to about 60% advalorem, compared with tariffs of about 24.5% on Bourbon Whisky and 28% on Rye Whisky; and there are tariffs ranging between 33.8% and



40% on chocolate and sugar confectionery, cakes and biscuits.

4. There are no Japanese non tariff barriers.

A - European companies encounter not only strong domestic competition but also a deterring and at times impenetrable combination of group - affiliation, exclusive trade financing, interlocking directorships, and the absence of independent dealerships. There are also a mass of administrative regulations which generally only major exporters employing good Japanese staff can successfully cope with.

5. Japan cannot afford to import more manufactures from Europe and also depends on external sources of oil and raw materials.

A - Japan is not alone in depending heavily on imported energy and raw material. So do Germany and Italy for instance.

JAPANESE PRIME MINISTER'S VISIT TO UK, 16-18 JUNE 1981

BRIEF NO 2: EC/JAPAN

POINTS TO MAKE

1. Japanese government must appreciate urgent need for action on trade imbalance. Regrettable lack of progress at EC/Japan high level consultations (Brussels, 1 June). Particular concern throughout EC over car imports as result of Japan/US agreement. Welcome reported Japan/FRG agreement on cars as a step in the right direction. But does not go far enough. Community has called for EC-wide restraint measures.
2. Problem of EC/Japan imbalance is compounded by concentration of Japanese export effort in sensitive industrial sectors and impenetrable domestic market. This is putting the open trading system under increasing strain. Matter of legitimate concern to all developed countries. Discussion at Ottawa Summit a necessary part of review of world trade.
3. Preservation of open world trading system at time of severe recession requires major effort from us all. UK, together with EC partners, has successfully resisted protectionist pressures so far. But cannot rule out possibility of EC-wide action against Japanese imports unless Japan makes appropriate contribution. Export restraints have important part to play, and must not be undermined (eg cars, light commercial vehicles).
4. In addition Japanese government needs to make determined effort to ensure that there really is an increase in Japanese imports of manufactures from other industrialised countries. Removal of formal import barriers (eg whisky tariff) important but not in itself sufficient. Direct action possible through public purchasing (eg defence equipment from UK) and private industry should be actively encouraged to buy from abroad. We know Americans share our concern over this and Japan has given commitments in the past (eg Ushiba/Haferkamp understanding of March 1978 - see Annex).



5. (If Japanese argue surplus with EC needed to balance Japan's deficit with raw material producers) Japan not alone in depending heavily on imported raw materials. Japanese current account already moving back into balance.
6. (If Japanese point to EC deficit with US) EC imports from US more diverse than imports from Japan and US imports from EC vastly larger than Japan's. Problem with Japan is concentration of exports in a few highly sensitive sectors and nature of Japanese market.
7. (If Japanese argue EC has no common policy and Commission no mandate to negotiate) Get impression that Japanese use remaining French and Italian restrictions on their imports as a pretext to do nothing. Risky game. EC has firmly put forward a common approach and would look carefully at any Japanese proposals. But the main priority is satisfactory response from Japan to call for reduction of trade imbalance.
8. (If Japanese argue they have lower 'average' tariff than EC) Zero tariffs on raw materials are of no interest to UK and EC partners. We are concerned about tariff peaks (whisky, confectionary) and non-tariff barriers.

## POLITICAL CO-OPERATION

9. UK wishes to strengthen EC/Japan political links. An important part of overall relationship between Europe and Japan. But that relationship inevitably affected by problems over trade.
10. Japanese co-operation with Europe and the West has been useful in the case of Iran and Afghanistan. Hope Japan will also join in any action agreed by the Europeans if there is Soviet intervention in Poland.
11. (Defensive: if Mr Suzuki suggests new machinery for Japanese/European consultations) Willing to consider any practical proposals; but let us make maximum use of regular informal contacts between Embassies and among officials. Will stay in close touch with Japanese Embassy during UK Presidency.



12. (Defensive: if Mr Suzuki mentions 'Gymnich Formula') The 'Gymnich Formula' does not mention the US by name, no reason why it should not apply to Japan or any other country.

## JAPANESE PRIME MINISTER'S VISIT TO UK, 16-18 JUNE 1981

## BACKGROUND

1. This Brief and Brief No 3 <sup>(Cpm's brief on bilateral economic issues)</sup> reflect recent discussion by Minister of 4 June (OD(E)81, 7th meeting).

EC/Japan trade imbalance

2. Japanese exports to EC have risen sharply since 1975. Community's trade deficit has increased from less than £1,500 million in 1975 to over £4,000 million in 1980. EC imports from Japan, already up by 29% in 1980 compared with 1979, have increased by 31% in period January-April 1981 compared with same period in 1980; and the EC's deficit increased by 46% in period January-April 1981.

Foreign Affairs Council statement

3. Since November 1980 Foreign Affairs Council has issued series of statements on relations with Japan. February Council introduced surveillance of imports of cars, colour TVs and tubes, and certain machine tools and called for discussion of trade with Japan at Ottawa Summit. Council agreed Community should seek commitments that there should be no trade diversion to EC as result of Japan/US arrangement on cars and that there should be 'analogous measures' for EC as a whole. This formula deliberately chosen to allow some flexibility over interpretation. Germans and Danes were not prepared to agree to any specific limit being set on EC imports of Japanese cars. UK, like France and Italy, was concerned to ensure that this call for restraint on exports to EC market as a whole should not be taken to imply a willingness to accept anything less effective than existing national measures. If implemented, the SMMT/JAMA understanding should mean that the Japanese take only 10% of a reduced UK car market this year to compensate for going as high as 11.9% in 1980. This would be better result than a US/Japan-type formula based on average sendings in 1979 and 1980. But to end May, Japanese took 11.35% of UK car market (see Brief No 3).

Japanese response

4. Japanese response remains disappointing. Commission

/described



described results of latest round of high level consultations with Japanese (Brussels, 1 June) as 'pretty near zero'. Only move Japanese appeared prepared to consider was some degree of 'export moderation' on cars for Benelux and FRG but not EC as a whole (Suzuki reported to have agreed in Bonn that in 1981 Japanese car exports to FRG should be no more than 10% higher than in 1980).

Japanese balance of payments

5. Japanese had current account deficit in 1980 of around \$9 billion. In first quarter of this year deficit was only \$1 billion; in April and May current account was in surplus. (See briefs at ~~Plays C and D~~)  
Ottawa Summit: American attitude

6. Japanese now appear reluctantly to accept that there will be discussion of their trade performance at Ottawa Summit as part of review of world trade. US attitude important because of greater political and economic leverage with Japan. (US imports from Japan double EC figure.) While Americans have shown no enthusiasm for discussion of bilateral trade problems at Ottawa, they do think it important to open up Japanese market for imports. US Trade Representative Brock made this point to Mr Biffen on 29 May. We believe that by placing renewed emphasis on need for Japan deliberately to increase imports of manufactures (eg through public purchasing) EC more likely to get Americans to take helpful line at Ottawa.

Restraints on Japanese exports to EC

7. Export restraint by Japan remains important in short term. EC does not have a common policy on imports from Japan and Japanese make this a pretext for their failure to make concessions. Most member states retain national quotas which antedate EC membership. Italy and France have most. UK has none but informal inter-industry understandings cover about one quarter of our total imports. Statement by November 1980 Foreign Affairs Council suggested that discussions on liberalising EC access for Japanese imports could form part of a 'wide-ranging economic dialogue' but that, for this to take place, early and effective action by Japan to reduce trade

/imbalance



imbalance would be essential.

Political co-operation

8. Suzuki may hope to deflect criticism of Japanese trade performance by concentrating discussion on development of close political relations between Japan and Europe. While there can be no question of letting him get away with this, it would be unwise to give Japanese impression that we are uninterested in co-operating with them on political questions. In particular, if there is Soviet intervention in Poland and Western response includes trade sanctions, Japanese co-operation will be vital. Japanese may need some persuading to join West in action on Poland since they have no strong national interests in the country or emotional links with it; and because Japanese impression of post-Afghanistan action remains that they paid heavier price than anyone else (France and FRG signed major contracts with Soviet Union in 1980 and US decision to resume grain sales was unwelcome surprise to Japanese government).

9. Suzuki may suggest machinery for European consultation with Japan. Anything he proposes will need to be considered on its merits, but our view in general that new machinery unnecessary and that close contacts can be maintained effectively through existing channels. In particular Suzuki may refer to 'Gymnich Formula'. This is arrangement under which the Ten keep US informed about developments in political co-operation. The Formula itself (agreed at a meeting of Foreign Ministers in Schloss Gymnich in 1974 following a disastrous period in Europe/US relations) states no more than that Presidency can brief US on any topics where the Ten authorise them to do so. In practice it is used as a fig leaf to cover whatever level of briefing Presidency wishes to give the US. FCO officials have already told Japanese Embassy that they will keep them informed about European political co-operation during UK Presidency.

EXTRACT FROM USHIBA/HAFERKAMP UNDERSTANDING, 24 MARCH 1978

'... Mr Haferkamp stressed the importance of Japan increasing the share of manufactures in its imports.

Mr Ushiba stated that the Japanese government would continue to take all appropriate steps to increase imports of manufactures and expected that the total volume of imports of manufactures would increase substantially. Mr Ushiba further expected that the share of these imports in Japan's total imports, which has been distorted since the sharp rise of oil prices would increase steadily and return within a reasonable period of years to a more normal level under current international economic circumstances. ...'

RESTRICTED

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EXPORT CREDITSPoints to Make

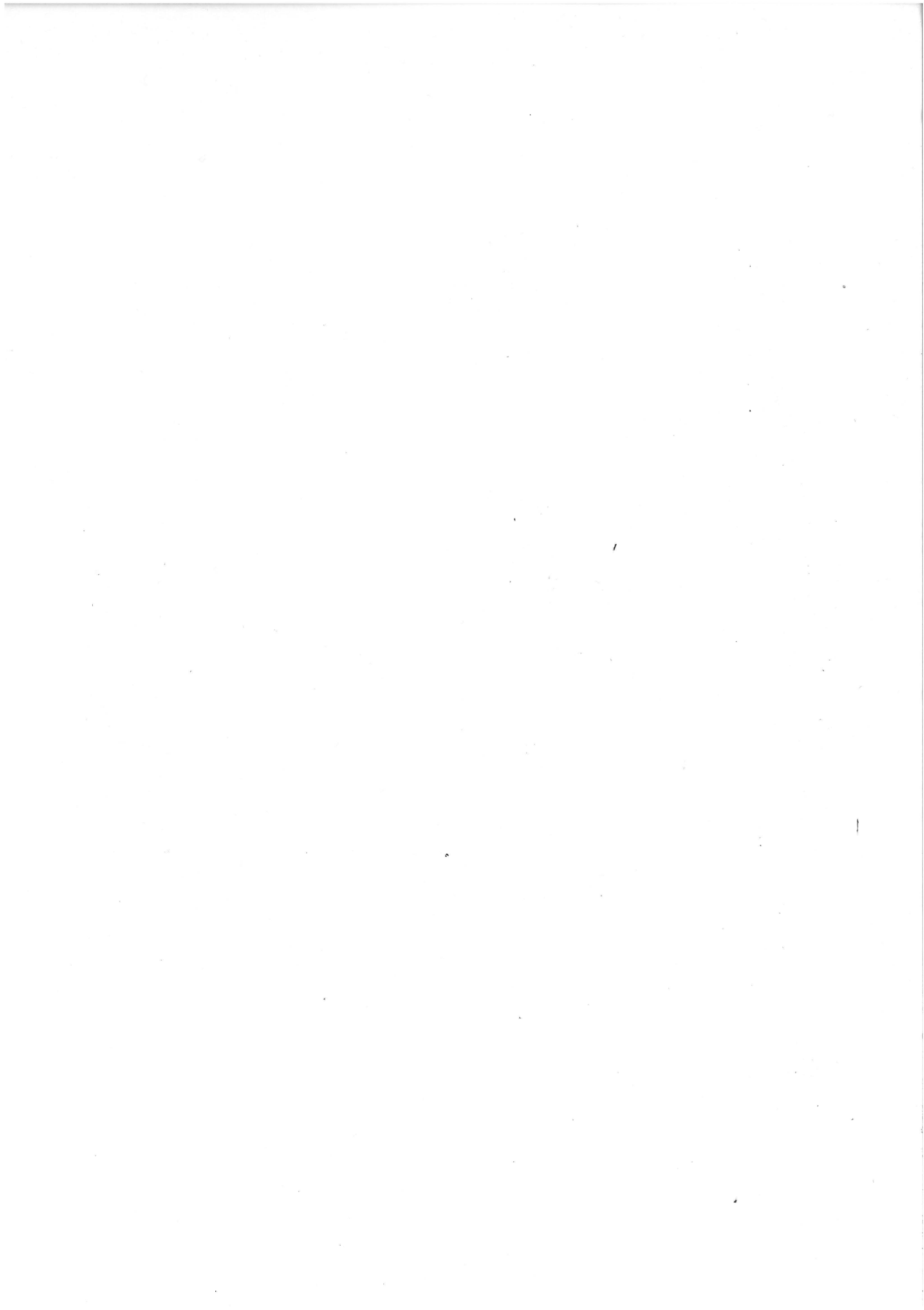
1. Very important to preserve Consensus as international discipline on credit terms. Compromise necessary on all sides if agreement to be reached. But sacrifices worth making to avoid a credit war from which only recipients stand to gain.
2. Appreciate Japanese position and problem caused for them by pressure for increases in Consensus minimum rates at a time when their own interest rates are going down. But very difficult for us - and colleagues in Community - to accept arrangements which appear to give Japanese exporters specially favourable treatment.
3. If finance for Japanese exporters were to be provided at rates below the Consensus, we would need to demonstrate to our own exporters that they could offer matching facilities. Thus, adequate access to yen financing at comparable interest rate levels for foreign exporters is very important. Hope Japanese authorities can respond positively on this point.

Background

4. The Japanese Government have made it clear that they are not prepared to agree to an increase in the present level of Consensus minimum rates, unless they themselves are allowed to provide finance at rates below the new Consensus level, reflecting their low domestic market rates. Under the Consensus, it has been tacitly accepted that countries such as Germany and Switzerland can lend at sub-Consensus rates where only "pure cover" facilities are provided (ie. credit insurance, but no official support of the interest rate). What is different about the Japanese situation is that the bulk (60-70%) of their export finance is provided through a state institution (Japanese ExIm bank) and thus involves the provision of officially supported finance in the normally accepted sense.

5. The Americans, who have supported the Japanese position in the international negotiations, have suggested that low interest rate countries like Japan should be allowed to charge their market rates, on the basis that other countries could also finance in those currencies





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at market rates. But, given the closely regulated nature of the Japanese ~~financial~~ markets, we remain sceptical about the possibilities of UK exporters achieving adequate access to yen financing to enable them to match low rate Japanese credit offers. Various compromise ideas are now under consideration within the Community; in the meantime, it is desirable to take every opportunity to press the Japanese on the need for more satisfactory assurances on access to yen financing for overseas banks and exporters.

AEF3 Division  
15 June 1981

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JAPANESE PRIME MINISTER'S VISIT TO UK, 16-18 JUNE 1981

BRIEF NO 4: OTTAWA SUMMIT AND RELATIONS WITH DEVELOPING COUNTRIES

POINTS TO MAKE

1. Look forward to full discussion of macro-economic problems.
2. We support US determination to reduce their inflation and control monetary growth. Essential that the world's main reserve currency should be strong.
3. As Japan has shown, interest rates will come down as inflation does. Lower rates cannot be artificially engineered. But fiscal policy in high inflation countries should be tight enough to support monetary objectives and prevent unnecessarily high interest rates.
4. Macro-economic discussion must also include trade issues (see Brief No 2). Impossible to discuss our common interests without frank examination of current difficulties affecting us.
5. Also hope for full discussion of difficulties facing developing countries. But important not to give any impression of ganging up before Mexico Summit.
6. Welcome Japanese intention to increase aid. Appreciate Japanese response to Zimbabwe.
7. Summit also provides opportunity for political discussions at a particularly difficult time.



## JAPANESE PRIME MINISTER'S VISIT TO UK, 16-18 JUNE 1981

## BACKGROUND (may be drawn on freely)

1. Agenda for Ottawa Summit (19-21 July) likely to include:
  - world economy
  - trade (including EC-Japan and East-West trade)
  - relations with developing countries
  - political discussions
  - energy
2. Japan concerned about effect of high interest rates, especially those in US which, though volatile, show little sign of coming down. Governor of Bank of Japan recently expressed doubts whether interest rates of 20% or more were needed to combat inflation. At Vancouver Preparatory Group meeting Japanese said too much attention was paid to money supply. However, interest rates in Japan (around 7%) are way below those elsewhere and yen has not been under any great pressure.
3. The issue will almost certainly be a major one at Ottawa. Chancellor Schmidt has said he will raise it. US are taking a firm line. Wiedenbaum has said the Administration welcomes opportunity to discuss the question but US interest rate policy is not a subject for negotiation at an international meeting.
4. Japanese opposed to discussion of EC-Japan trade at Ottawa (see Brief No 2).
5. In recent years Japan's line on relations with developing countries increasingly independent of US and generally favourable towards the third world. At Vancouver Summit Preparatory meeting Japanese favoured a call for substantial increases in aid. Japan does not share our reservations about the Global Negotiations. She will attend Mexico Summit.
6. Japanese aid has increased substantially in recent years. About 60% concentrated on East and South East Asian countries within her commercial sphere of influence. Aid rose from \$1,424 million in 1971 (0.21% of GNP) to \$3,304 million in 1980 (0.32% of GNP). Japanese recently announced

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that aid in 1981-85 is planned to be double total for 1976-80 and that they will aim to raise the GNP percentage.

7. We have been urging Japan to give more to Zimbabwe. Following a recent visit to Tokyo by Mugabe, Japan announced an aid programme of \$27 million for the current year.

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## INDUSTRIAL ADJUSTMENT POLICIES IN JAPAN

Japanese industry's competitiveness in world markets rests on its ability to secure continually rising productivity and to adapt to changing conditions. This is aided by active industrial policies. These are based on close communication between Government and industry in identifying market opportunities and areas of technical change. Policy is implemented vigorously through a series of fiscal incentives and financial controls.

2. In the immediate post-war years priority was concentrated on heavy industry. In the late-1950s and in the 1960s attention was moved to lighter, capital-intensive industries such as consumer electrical goods. In the latest period since the 1973-74 oil price increases, policy has been directed to encouraging high technology industries such as computers, aircraft and nuclear energy.

### Institutions

3. The formulation of industrial policy is concentrated in the Ministry of International Trade and Industry (MITI) and the Ministry of Finance (MOF). The Government's role consists to a large extent of the usual processes of consensus and administrative guidance. These processes are aided by Japanese institutional arrangement : Companies depend heavily on the banks for finance (though this dependence is now gradually diminishing). The banks are supervised by the Ministry of Finance and the Bank of Japan. The Ministry of Finance and the Bank of Japan maintain close contact with MITI which decides industrial priorities.

4. The policies are worked out in consultation with industrialists, bankers, academics and the unions. All are represented on Policy Advisory Councils set up to define the problems and possibilities of each major industry and recommend appropriate policies. They report to the Government, mainly MITI which is advised on the procedures for implementing policy by the Industrial Structure Council. The latter is in some ways not unlike the NEDC. Indeed many of the procedures adopted by the



Japanese can be found in similar form throughout the Western world. What distinguishes the Japanese is their success in identifying both declining and growth areas and a degree of ruthlessness in dealing with problems once they have been recognised.

#### Industrial structure

5. In policy planning MITI has tended to anticipate industrial change rather than react to it. It has looked for a mix of competition and oligopoly among producers, aiming to avoid excessive competition, but concentrating on fewer, lower-cost producers. At the same time it has sought to establish entities larger enough to incorporate advanced technology. The main determinants of industrial policy, however, have been market prospects and the aim has been to accelerate rather than to work against market forces. To this end a system of financial and fiscal incentives, subsidies and penalties has been designed which are central to the implementation of industrial policy.

#### Financial and fiscal measures

6. Financial and fiscal support for industrial policy distinguishes between declining industries and new industries. For declining industries, such as textiles and ship-building, financial support has been given under the Stabilisation Law for Structurally Depressed Industries, which established a fund in 1978 with capital of Yen 10 billion of which Yen 8 billion was contributed by Government and Yen 2 billion by private banks. Subsidies are given to finance the scrapping of plant. Banks receive guarantees on the commercial obligations of depressed industries. Special depreciation allowances and government finance are available for diversification. Tax allowances, e.g. reduced corporation tax are given for part of the cost of eligible plant and equipment. Subsidies are provided for re-training and re-locating staff. Unemployment benefit is paid for one year rather than 6 months to workers laid off from structurally depressed industries.

7. In the case of new industries, government financing has taken the form of grants, subsidised loans (mainly by the Japan Development Bank, but partly also by the Small Business Finance Corporation and by Ex-Im Bank for Exporting), direct subsidies and selective taxation measures. Grants, e.g. from MITI's Agency for Industrial Science and Technology, are made for basic research. Cheap loans are made for the purchase of equipment to manufacture priority goods, e.g. integrated circuits. Subsidies are given for the development of designated important technology, e.g. computer data processing. Tax measures include accelerated depreciation in, for example, the electronics field to encourage the use of robots.

Response to technical change and higher oil prices in the 1970s

8. The 1973 oil crisis exposed Japan's dependence on energy-intensive heavy industries. At the same time, other sectors were losing competitiveness as a result of the strengthening yen and lower labour costs abroad. These developments encouraged the adoption and rapid implementation of a comprehensive package of supply management policies. The aims have been to reduce production costs, to eliminate excess capacity in industries with declining competitiveness and to promote new, high technology, energy-efficient, labour-saving industries. Between 1973 and 1979 Government spending to assist industrial rationalisation and development rose at an annual average rate of 18 per cent. It now totals around £12 billion a year. The policies have been highly successful.

(i) Lower production costs: Between 1973 and 1980 the labour force in manufacturing was cut by 11 per cent (900,000 jobs) while manufacturing output rose by 22 per cent. In the same period output per manhour increased by 39 per cent. Unit labour costs have been flat since 1975. These developments reflected rationalisation of production and heavy investment in labour saving equipment - particularly the use of robots and numerically-controlled machine tools.

(ii) Energy efficiency: Between 1973 and 1980 energy and raw material consumption per unit of output fell by over 10 per cent. Investment for raw material and energy conservation rose from 5 per cent to around 35 per cent of total investment in plant and machinery. Since 1978 the Government has encouraged specified forms of energy and labour saving investment through the accelerated depreciation scheme (25 per cent allowance in the first year) and through exempting from Corporation Tax income equivalent to 10 per cent of the investment.

Since 1974, the Government has allocated about £100 million for the development of new energy sources and the Japanese Development Bank (State-run) has lent a further £100 million on highly concessional terms. The aim is to reduce dependence on imported oil to 50 per cent of total energy consumption by 1990 (in 1973 the figure was 80 per cent in 1979 around 70 per cent).

(iii) Run-down of old industries: The industries most affected have been textiles, chemicals (mainly fertilisers) aluminium, shipbuilding and open-hearth steel. Collectively those industries, through voluntary schemes, shed a third of their workforce (250,000 jobs) between 1975 and 1977. Since 1978 under the aegis of the Stabilisation Fund the shipbuilding, aluminium and chemical fertiliser industries have shed a third of their remaining capacity and the other sectors some 15 per cent. By 1979 all the industries involved had returned to profitability.

(iv) Development of new industries: There are highly specific development plans covering from areas - computers, data processing, aircraft and aircraft engines and nuclear energy. Government assistance has taken the form mainly of sizeable subsidies for research and development and concessionary finance for the purchase (nuclear energy) or leasing (computers) of domestically made equipment. Under these schemes the production capacity of the four industries has more than doubled since 1974 and their technology has risen to internationally competitive levels.





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JAPANESE PRIME MINISTER'S VISIT TO EUROPE

1. MR SUZUKI LEFT TOKYO TODAY FOR HIS EUROPEAN TOUR, HIS FIRST VENTURE TO EUROPE AS PRIME MINISTER OR IN ANY OFFICIAL CAPACITY.
2. HIS POSITION AS PRIME MINISTER IS DENTED BUT INTACT. HE WILL BE RELIEVED TO HAVE GOT THROUGH THE DIET SESSION WHICH ENDED ON 6 JUNE WITHOUT MORE SERIOUS DAMAGE. THE DISPUTE OVER THE RESULTS OF HIS WASHINGTON TRIP IN EARLY MAY WHICH LED TO MR ITO'S RESIGNATION AS FOREIGN MINISTER HAVE SCARRED HIS CREDIBILITY AS AN INTERNATIONAL OPERATOR IN JAPANESE AS WELL AS OTHER EYES AND REVEALED HIS LACK OF EXPERIENCE IN THIS FIELD. THE UNTIMELY STATEMENT BY FORMER AMBASSADOR REISCHAUER ABOUT US NUCLEAR-ARMED SHIPS IN JAPANESE WATERS WAS A FURTHER TEST OF HIS POLITICAL SKILLS, BUT AFTER SOME INITIAL HESITATION MR SUZUKI HAS STONEWALLED REASONABLE SUCCESSFULLY IN THE FACE OF OPPOSITION ATTACKS. HIS NEXT TESTS ARE IN THE AUTUMN: A DEBATE ON ADMINISTRATIVE REFORM IN SEPTEMBER AND AN EXPECTED CABINET RESHUFFLE IN NOVEMBER. FOR THE SUMMIT SEASON MR SUZUKI'S POLITICAL POSITION IS REASONABLY SECURE AND THE EXCURSIONS AND ALARMS OF THE PAST FEW WEEKS ON THE POLITICAL STAGE SHOULD DIE AWAY AS THE SUMMER SETS IN.
3. ECONOMICALLY THE JAPAN WHICH MR SUZUKI PRESIDES OVER IS IN A HEALTHY, ALTHOUGH NOT EBULLIENT, CONDITION - INFLATION UNDER CONTROL (LESS THAN 7%), NEGLIGIBLE UNEMPLOYMENT AND RAPID MOVEMENT FROM A LARGE CURRENT ACCOUNT DEFICIT TO A POSITION CLOSE TO EQUILIBRIUM. BUT THE MAIN MOTOR OF ECONOMIC GROWTH CONTINUES TO BE EXPORTS. THE GOVERNMENT'S HOPE THAT INCREASED PERSONAL CONSUMPTION STIMULATED BY LOWER INFLATION WOULD MORE THAN COUNTER-BALANCE THE DEFLATIONARY IMPACT OF THE PUBLIC SECTOR CUTBACKS ON DOMESTIC DEMAND HAS NOT BEEN FULFILLED.
4. DOMESTICALLY MR SUZUKI'S MAIN CONCERN IS WITH GOVERNMENT FINANCE. HE HAS INVESTED CONSIDERABLE POLITICAL CAPITAL IN ACHIEVING A REDUCTION IN THE LARGE BUDGET DEFICIT BY MEANS OF CUTS IN PUBLIC EXPENDITURE AND ADMINISTRATIVE REFORM WITHOUT RESORT TO INCREASED TAXATION. VERY TIGHT LIMITS HAVE BEEN SET ON GENERAL GOVERNMENT EXPENDITURE FOR FY 1982. DEFENCE AND AID WILL RECEIVE FAVOURABLE TREATMENT, BUT NOT SUFFICIENT TO INCREASE SUBSTANTIALLY THE LOW PROPORTION OF GNP EXPENDED ON THEM (0.9 AND 0.3%).

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5. INTERNATIONALLY, MR SUZUKI WILL SHARE OUR CONCERN ABOUT HIGH US INTEREST RATES. UNTIL RECENTLY THESE HAVE BEEN SEEN BY JAPAN AS NECESSARY TO OVERCOME INFLATION, BUT ARE NOW CAUSING INCREASING ANXIETY. ONE RESULT HAS BEEN THE YEN HAS WEAKENED SUBSTANTIALLY AGAINST THE DOLLAR (THOUGH NOT AS MUCH AS STERLING) AND THIS IS LIKELY EVENTUALLY TO LEAD THROUGH INTO DOMESTIC INFLATION. IT COULD ALSO IN TIME LEAD TO AN EVEN STRONGER COMPETITIVE POSITION FOR JAPANESE EXPORTS.

6. DURING THE EUROPEAN TOUR MR SUZUKI WILL BE SEEKING TO RE-ESTABLISH HIS CREDIBILITY. HE WILL BE SENSITIVE BUT DETERMINED AND ON HIS METTLE. THE COMBINATION WILL MAKE HIM NOT AN EASY VISITOR.

PARA 3 CWA HAS NOT YET BEEN FULFILLED.

PLEASE SEE MIFT.

FCO PASS SAVING OTHER EC ADDRESSEES

CORTAZZI

(REPEATED AS REQUESTED)

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JAPANESE PRIME MINISTER'S VISIT

1. DEVELOPMENTS HERE IN THE LAST FORTNIGHT HAVE REINFORCED THE VIEWS SET OUT IN MY TELNO 336 ON THE WAY TO HANDLE MR SUZUKI DURING THE TALKS IN LONDON. HE HAS BEEN HEAVILY BRIEFED IN THE PAST WEEK BUT STILL HAS LITTLE OR NO FEEL FOR EUROPEAN PROBLEMS AND ATTITUDES. THERE ARE SOME INDICATIONS OF A HARDENING OF THE JAPANESE ATTITUDE ON THE ECONOMIC SIDE. HENCE THE ACTION WHICH I TOOK LAST WEEK WITH MR TANAKA THE MITI MINISTER (MYTELNO 368).

2. AT A MEETING WITH EUROPEAN CORRESPONDENTS LAST WEEK MR SUZUKI REPEATED HIS VIEW THAT THE JAPANESE MARKET WAS "IN NO WAY CLOSED" AND THAT EC COUNTRIES SHOULD MAKE EFFORTS TO EXPAND THEIR EXPORTS TO JAPAN, WHILE AT A FURTHER PRESS CONFERENCE LAST NIGHT HE TENDED TO DISMISS THE TRADE ISSUES AS MATTERS TO BE DISCUSSED BY THE COMPETENT MINISTER AND OFFICIALS.

3. MR SUZUKI AND THE JAPANESE PRESS ARE APPROACHING THE EUROPEANS VISIT SOMEWHAT APPREHENSIVELY AND ECONOMIC ASPECTS WILL ACCORDINGLY REQUIRE PARTICULARLY CAREFUL HANDLING. IT WILL BE IMPORTANT NOT TO HECTOR MR SUZUKI ON THIS SINCE HE WOULD PROBABLY FEEL BOUND TO REACT SHARPLY IN VIEW OF HIS PRESENT UNCERTAIN FRAME OF MIND. EQUALLY HOWEVER WE SHOULD NOT HAVE TO LISTEN TO LECTURES FROM HIM AND MUST BE READY TO REBUT THE FACILE ARGUMENTS ON TRADING ISSUES WHICH HE IS CURRENTLY INCLINED TO TROT OUT. OUR OBJECTIVE MUST BE TO GET HIM TO RECOGNISE THE EXISTENCE OF A PROBLEM AND SECURE HIS COOPERATION IN TRYING TO SOLVE IT. WE WANT TO STOP THE EXCHANGE OF ARGUMENTS WHICH GETS US NOWHERE.

4. WE WANT TO LEAVE THE JAPANESE AT THE HIGHEST LEVEL IN NO DOUBT ABOUT OUR ECONOMIC CONCERNS AND THE REASONS

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FOR THEM, TO PERSUADE THEM TO THE SECURITY OF OUR  
CASE AND MOVE THEM A STEP OR TWO IN THE RIGHT  
DIRECTION OVER PRACTICAL ISSUES.  
MR SUZUKI IS MORE LIKELY TO BE CONVINCED BY  
SPECIFIC PROPOSALS THAN BY GENERAL STATEMENTS OF  
GRIEVANCES. I SUGGEST THEREFORE THAT AFTER A FIRM  
PRESENTATION OF THE GENERAL CASE FOR JAPANESE  
RESTRAINT ON EXPORTS AND HELP OVER IMPORTS WE  
SHOULD SEEK HIS HELP ON ONE OR TWO SPECIFIC ITEMS  
IN THE HOPE THAT THE JAPANESE GOVERNMENT MIGHT BE  
BROUGHT AT THIS STAGE TO TAKE SOME STEPS WHICH  
WOULD BE OF BENEFIT TO OUR TRADING RELATIONSHIP.

5. THESE MIGHT INCLUDE THE FOLLOWING:-

A) INSTRUCTIONS TO MINISTRIES TO FACILITATE  
IMPORTS PARTICULARLY AT THE GRASS ROOTS  
(PARA 4 (E) (II) OF MY TELNO 336) (WE UNDERSTAND  
THAT MITI OFFICIALS ARE CONSIDERING THIS POSSIBILITY).  
B) REDUCTIONS IN TARIFFS ON SCOTCH WHISKY, BISCUITS,  
CHOCOLATE AND SUGAR CONFECTIONERY.

C) HELP IN THE PROMOTION OF THE SALE OF CAR  
COMPONENTS AND THE BAE 146.

6. ON CARS, FOLLOWING THE JAPANESE AGREEMENT WITH THE  
CANADIANS AND THE LIKELY AGREEMENT WITH THE BELGIANS  
, WE NEED ASSURANCES ON NON-DIVERSION OF JAPANESE  
CARS FROM THE AMERICAN MARKET AND NO WORSENING OF  
THE SITUATION IN THE EUROPEAN MARKET IN 1981. (THESE  
WHICH ARE OF GENERAL INTEREST TO THE EC WILL DOUBTLESS  
FEATURE PROMINENTLY IN THE POINTS TO MR SUZUKI IN  
BRUSSELS). THE MAIN UK INTEREST WOULD SEEM TO BE TO  
EMPHASISE THE IMPORTANCE OF METICULOUSLY OBSERVING  
THE INDUSTRY TO INDUSTRY ARRANGEMENTS FOR JAPANESE  
CAR EXPORTS TO THE UK. THIS WILL ENTAIL A REDUCTION  
IN JAPANESE CARS BEING SENT TO THE UK MARKET WHICH  
WILL BE SIGNIFICANT IN POLITICAL TERMS BUT NOT IN  
ECONOMIC TERMS TO JAPAN (PERHAPS LESS THAN 20,000  
CARS, TAKING INTO ACCOUNT THE REDUCTION IN THE  
TOTAL SIZE OF THE UK MARKET THIS YEAR).

7. MR SUZUKI IS MORE LIKELY TO TAKE THIS MESSAGE  
KINDLY IF IT IS COUPLED WITH A GENERAL WELCOME FOR  
CLOSER POLITICAL RELATIONS AND IF WE EMPHASISE OUR  
INTENTION TO PURSUE THIS POSITIVELY IN OUR FORTHCOMING  
PRESIDENCY. AS SEEN FROM HERE IT IS VERY MUCH IN  
OUR INTEREST TO ENSURE THAT JAPAN PLAYS ITS PROPER PART  
AS A "MEMBER OF THE WESTERN CAMP" (A PHRASE NOW GENERALLY  
USED IN JAPAN). MR SUZUKI IS ONE OF THE LEADING DOVES IN  
THE LIBERAL DEMOCRATIC PARTY AND HE HAS BEEN SPEAKING

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ABOUT THE NEED TO EMPHASISE TO THE EUROPEANS THE IMPORTANCE OF DETENTE AND A DIALOGUE WITH THE SOVIET UNION. IT WILL BE IMPORTANT TO STIFFEN HIS RESOLVE IN DEALING WITH THE SOVIET UNION. I SUGGEST THEREFORE THAT THE SOVIET MILITARY BUILD UP, POLAND AND AFGHANISTAN SHOULD FEATURE PROMINENTLY IN OUR PRESENTATION TO HIM. HE IS UNLIKELY TO HAVE ANYTHING VERY SIGNIFICANT OR NEW TO SAY ON CHINA OR SOUTH EAST ASIA THOUGH NO DOUBT FOR POLITENESS SAKE IT WILL BE NECESSARY TO LET HIM HAVE HIS SAY.

8. IT WILL BE IMPORTANT TO GET THE TONE OF PRESS BRIEFING RIGHT. ANY SUGGESTION THAT WE HAD CARPETED HIM ABOUT JAPANESE TRADING PRACTICES WOULD BE COUNTER-PRODUCTIVE. ON THE OTHER HAND IT IS IMPORTANT THAT OUR CONCERNS ON ECONOMIC ISSUES AND OUR POSITIVE STAND ON POLITICAL RELATIONS SHOULD BE BROUGHT OUT PUBLICLY.

FCO PLEASE PASS SAVING ADDRESSEES.  
CORTAZZI

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JAPANESE PRIME MINISTER'S VISIT TO LONDON

1. I HAD A TWO HOUR TALK TODAY WITH HATAKEYAMA, MR SUZUKI'S PRIVATE SECRETARY FOR ECONOMIC AFFAIRS (A MITI MAN). AT THE END HE SAID THAT RELATIONS BETWEEN THE PRIME MINISTER'S OFFICE AND THE MFA WERE STILL SOMEWHAT DELICATE AND HE HOPED THEREFORE THAT WE WOULD PROTECT NOT ONLY REMARKS ATTRIBUTABLE TO HIM BUT MORE ESPECIALLY THE POINT THAT WE WERE USING HATAKEYAMA AS A CHANNEL.

2. IN IDMMARY THE MAIN POINTS MADE BY HATAKEYAMA WERE:  
(A) A RECENT POLL (UNIDENTIFIED) HAD INDICATED TO MR SUZUKI THAT THE SINGLE MOST IMPORTANT ASPECT N THE EUROPEAN VISIT FOR THE JAPANESE WAS THAT THE PRIME MINISTER SHOULD SPEAK UP STRONGLY FOR JAPAN'S POSITION ON A VARIETY OF ISSUES, PARTICULARLY IF HE WERE ATTACKED ON TRADE MATTERS. THKIPRIME MINISTER WILL THEREFORE BE ANXIOUS TO ENSURE THAT JAPANESE PRESS REPORTS SHOW THAT HE GAVE AS GOOD AS HE GOT, ALTHOUGH HE IS NOT IN ANY WAY LOOKING FOR A ROW AND HOPES THAT ONE CAN BE AVOIDED (THIS REINFORCES OUR POINT ABOUT HIS SENSITIVE FRAME OF MIND - SEE OUR TELNO 377).

(B) MR SUZUKI WOULD BE BOUND TO REACT ADVERSELY TO A LINE OF ARGUMENT WHICH SEEMED TO SUGGEST THAGFTHE JAPANESE MARKET WAS NOT IN GENERAL TERMS AN OPEN ONE. THIS WOULD LEAD TO A STERILE DEBATE ABOUT THE RELATIVE AVERAGE TARIFF LEVELS OF EUROPE AND JAPAN, THE NUMBER OF QUOTAS RETAINED ETC, AND WOULD GET NOWHERE. ON THE OTHER HAND HE SHOULD BE MUCH MORE RESPONSIVE TO SPECIFIC IDEAS OF WAYS IN WHICH JAPAN MIGHT TRY TO HELP THE EUROPEANS TO INCREASE THEIR EXPORTS TO JAPAN.

3. I TOLD HATAKEYAMA THAT  
(A) SUZUKI'S RECEPTION IN LONDON WOULD DEPEND HEAVILY ON WHAT HE HAD TO SAY AND THE ORDER IN WHICH HE SAID IT.  
(B) IT WAS UNLIKELY THAT THERE WOULD BE ANY DIFFICULTIES ABOUT THE POLITICAL OR GENERAL PARTS OF THE CONVERSATIONS, ALTHOUGH WE WOULD BE INTERESTED TO LEARN MORE ABOUT JAPANESE VIEWS ON EAST-WEST RELATIONS ON WHICH THERE HAD BEEN HINTS OF A SLIGHTLY DOVISH TENDENCY IN ONE OR TWO RECENT MINISTERIAL STATEMENTS.  
(C) THE UK WAS SUFFERING FROM THE TWIN PROBLEMS OF A VERY SEVERE RECESSION AND THE NEED TO RESTRUCTURE MUCH OF HER INDUSTRY. IT WOULD BE IMPORTANT FOR MR SUZUKI TO ACKNOWLEDGE THESE PROBLEMS AND PERHAPS TO STATE, IN PRIVATE AND IN PUBLIC, THAT JAPAN WAS PREPARED TO PLAY HER PART.

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(D) APART FROM REITERATING JAPAN'S UNDERTAKING NOT TO EXPORT "TORRENTIALLY" IN ANY SECTOR AND REFERRING TO THE RESTRAINT AGREEMENTS FOR CARS AND CONSUMER ELECTRONICS WHICH HAD BEEN IN EXISTENCE FOR SOME YEARS, IT WOULD BE HELPFUL IF SOME PUBLIC STATEMENT COULD BE MADE TO INDICATE THAT JAPANESE GOVERNMENT OFFICIALS FROM TOP TO BOTTOM SHOULD ENSURE THAT WHEREVER POSSIBLE THEY WOULD FACILITATE IMPORTS. A GESTURE ON CONFECTIONERY TARIFF AND WHISKY TAX WOULD ALSO GO DOWN WELL, BUT WE WERE GENERALLY LOOKING FOR MUCH BIGGER ITEMS THAN THIS.

(E) NONE OF OUR POINTS WOULD INVOLVE ANY DRAMATIC CHANGE ON JAPAN'S PART NOR ANY RADICAL RESTRUCTURING OF JAPANESE INDUSTRIAL SECTORS OR POLICIES. WE WERE SIMPLY LOOKING FOR A RESPONSIVENESS WHICH HAD HITHERTO BEEN GENERALLY LACKING AND INDICATIONS OF A GENUINE WILLINGNESS TO TRY TO ENSURE THAT THE PRESENT INCREASINGLY UNSATISFACTORY TRADING POSITION DID NOT GET WORSE.

(F) ALL OF THIS WOULD BE DONE IN THE INTERESTS OF PRESERVING THE FREE TRADING SYSTEM, A POINT WITH WHICH MR SUZUKI WOULD DOUBTLESS WISH TO MAKE SOME SUBSEQUENT PLAY, PARTICULARLY WITH THE JAPANESE PRESS.

4. HATAKEYAMA GENERALLY REACTED WELL AND UNDERTOOK TO PUT THESE POINTS TO THE PRIME MINISTER. HE HAD THREE MAIN CONCERNS:

(A) JAPAN HAD BEEN WARY OF ACKNOWLEDGING THE EUROPEAN (AND UK) PROBLEMS BECAUSE OF THE FEAR THAT THIS MIGHT LEAD TO DEMANDS THAT JAPAN SHOULD PLAY THE PRINCIPAL ROLE IN TRYING TO DEAL WITH THEM.

(B) A WILLINGNESS ON THE PART OF JAPAN SERIOUSLY TO DISCUSS WAYS OF ASSISTING WITH EUROPEANS' PROBLEMS WOULD HAVE TO BE CAREFULLY CIRCUMSCRIBED, OTHERWISE THE EUROPEANS MIGHT THINK THAT JAPAN WAS PREPARED TO DO MORE THAN SHE COULD IN FACT DELIVER AND THE FINAL RESULT WOULD BE EVEN MORE FRUSTRATING THAN THE PRESENT SITUATION.

(C) THE IDEA OF AN ADMINISTRATIVE ORDER TO OFFICIALS TO EXPEDITE IMPORTS WAS PROBABLY A STARTER BUT IT WOULD HAVE TO BE CAREFULLY PHRASED IF THE IMPRESSION WERE NOT TO BE GIVEN THAT JAPANESE OFFICIALS WUD HITHERTO SOUGHT TO ACT AS A BRAKE ON IMPORTS.

5. WHILE THERE IS NOTHING STARTLINGLY NEW IN THIS, THE CONVERSATION REINFORCES THE VIEW THAT MR SUZUKI IS AT LEAST HALF BRACED FOR A HARD DISCUSSION ON ECONOMIC MATTERS BUT COULD REACT REASONABLY POSITIVELY IF THE POINTS ARE PUT TO HIM ON THE BASIS OF A COOPERATIVE EFFORT RATHER THAN CONFRONTATION.

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ECONOMIC DISCUSSIONS BETWEEN JAPAN AND THE EC.

1. THE JAPANESE ARE NOW CONSIDERING A NUMBER OF IDEAS, SOME TENTATIVE FOR ECONOMIC DISCUSSIONS WITH THE EC THIS AUTUMN. THE MAIN CURRENT IDEAS ARE FOR:

(A) A JAPAN-EC SYMPOSIUM, TO BE HELD IN NOVEMBER PROBABLY IN TOKYO. WE UNDERSTAND THAT OFFICIALS WITH PRIME MINISTER SUZUKI IN HAMBURG SAID ON 10 JUNE THAT HE MAY PROPOSE THIS DURING HIS PRESENT VISIT TO EUROPE. THE PROPOSED AGENDA FOR THE SYMPOSIUM IS: (I) ECONOMIC MANAGEMENT IN JAPAN AND EC, (II) BILATERAL INTERCHANGE OF TECHNOLOGY AND CAPITAL, AND THIRD COUNTRY COOPERATION, (III) MANAGEMENT-LABOUR RELATIONS, (IV) COOPERATION IN THE DEVELOPMENT OF UNDER-DEVELOPED COUNTRIES (V) EXCHANGE OF INFORMATION AND IDEAS IN SELECTED AREAS (THE JAPANESE MAY RAISE FIFTH GENERATION COMPUTERS AND THE YXX AIRCRAFT. MITI IS PROMOTING A SEPARATE INTERNATIONAL CONFERENCE ON THE FORMER IN TOKYO THIS OCTOBER). JAPANESE PARTICIPANTS MAY INCLUDE THE MITI AND EPA MINISTERS AND BUSINESS LEADERS SUCH AS ISHIHARA AND MORITA, OF NISSAN (AND JAMA) AND SONY. THE JAPANESE HAVE BEEN THINKING OF JOINT MITI/COMMISSION SPONSORSHIP OF THE SYMPOSIUM AND OF INVITING THORN FROM THE COMMISSION (HE WOULD COME HERE FOR MUCH MORE THAN THE SYMPOSIUM IF HE CAME. THERE IS SOME DOUBT IN THE MINDS OF THE COMMISSION ABOUT WHETHER THE TIMING WOULD BE RIGHT FOR SUCH A VISIT).

(B) KEIDANREN OFFICIALS ARE DEBATING WHETHER TO PROPOSE A VISIT TO EUROPE BY TOP LEVEL BUSINESSMEN LED BY THEIR PRESIDENT, INAYAMA, AND MODELLED ON THE 1976 MISSION LED BY MR DOKO. INAYAMA IS ALREADY PLANNING TO LEAD A SIMILAR GROUP TO THE USA, PROBABLY IN OCTOBER, AND MIGHT COME ON TO EUROPE AFTERWARDS.

(C) THE KEIDANREN RECENTLY AGREED IN PRINCIPLE AMONGST THEMSELVES TO SEND THEIR CHIEF OFFICIAL, HANAMURA, TO EUROPE 11-24 SEPTEMBER WITH A GROUP OF CHIEF OFFICIALS FROM BUSINESS ASSOCIATIONS, TO PROMOTE THE EC-JAPAN BUSINESS DIALOGUE. THEY PLAN TO VISIT COPENHAGEN, DUSSELDORF, COLOGNE, VIENNA, BRUSSELS, PARIS AND LONDON. ATTENDANTS ARE NOT YET DECIDED BUT ARE LIKELY TO INCLUDE TAKAI OF EIAJ, NAKAMURA OF JAMA, AND THE TELECOMMUNICATIONS TRADE ASSOCIATION. THEY WILL APPROACH CBI ONCE THEY KNOW WHO IS LIKELY TO BE ON THE JAPANESE SIDE, TO PROPOSE A MEETING WITH COUNTERPART ORGANISATIONS IN UK UNDER CBI AUSPICES ON 23 SEPTEMBER.

2. IN PRINCIPLE THESE ARE WELCOME DEVELOPMENTS. THEIR MAIN AIM IS NO DOUBT TO IMPROVE PUBLIC RELATIONS BUT THEY OFFER AN OPPORTUNITY TO BRING HOME OUR CONCERNS TO KEY DECISION-MAKERS IN JAPAN AND TO DEEPEN THE EC-JAPAN DIALOGUE AT SEVERAL LEVELS. IT IS DIFFICULT TO SEE HOW A SINGLE EC-WIDE SYMPOSIUM CAN BE TURNED TO MUCH IMMEDIATE



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AND PRACTICAL BUSINESS ADVANTAGE FOR US BUT IT COULD BE USEFUL IN BRINGING SENIOR JAPANESE ONCE AGAIN FACE-TO-FACE WITH THEIR EUROPEAN COUNTERPARTS, BUILDING ON THIS MONTH'S MINISTERIAL VISITS. THE BILATERAL MEETINGS WITH EITHER OF THE KEIDANREN GROUPS MAY GIVE OPENINGS TO FOLLOW UP WITH MORE SUBSTANTIVE BUSINESS DISCUSSIONS. THIS COULD USEFULLY SUPPLEMENT THE MEETINGS BETWEEN DOI AND MITI OFFICIALS AND MINISTERS ALREADY PLANNED FOR SEPTEMBER. SUBJECT TO THE VIEWS OF THOSE CONCERNED IN LONDON WE WILL ENCOURAGE THESE PROPOSALS AS OPPORTUNITY OFFERS.

3. FCO PLEASE ADVANCE COPIES TO FOSTER CRE2 DOT AND GANE ICA DOI.

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IRENE RIPLEY

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