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Chancellor (Lawson) Papers:

Visits and Bilaterals Between British
and Japanese Ministers.

DD's: 25 Years

Phyllis

2/2/96.

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FCS/87/253

CHANCELLOR OF THE EXCHEQUER

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REC.	27 NOV 1987
ACTION	MR H.P. EVANS
COPIES TO	PS/CST PS/EST PS/PMG PS/EST SIR G. LITTLE MR ANSON SIR T. BURNS MR MONCK MR BYATT MR BURNER MR MOUNTFIELD MR S.W. MATTHEWS MR SAVAGE

*I agree with X
 But why for happy
 Council to paper
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 That's so
 analysis, for
 example, of a
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 Japan, which
 was a practice for
 decision to Japan's
 dialogue,
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 nature
 of the LBP's
 electoral
 success*

1. I am sending you with this letter a paper prepared by FCO officials on policy towards Japan. I strongly endorse the paper's theme that we need to make further efforts to develop a more serious and constructive relationship with Japan. I should welcome an opportunity to have a brief word with you about the ideas in the paper and our relations with Japan before I go there in January. My Private Secretary will be in touch with yours to find a suitable moment.

2. I am writing in similar terms to David Young.

*Autonomous goals
 inputs. We
 discuss - the need to
 put WTB's more fully
 into the CMT context*

(GEOFFREY HOWE)

Foreign and Commonwealth Office
 26 November 1987

*highly
 attached to
 Japan's
 protection
 of its
 consumer
 goods
 market
 (a
 high
 level
 of
 capital
 controls)*

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POLICY ON JAPAN

Summary

1. Japan's global interests are gradually leading her to take a more active role internationally. Our relations with Japan have hitherto been focussed largely on trade problems. We shall need to continue to fight our corner on trade and economic issues, both bilaterally and through the EC. But if we are to develop serious relations with an ally of increasing power we need to improve the range and quality of exchanges with Japan in every field.

Japan's Position in the World

2. The consistent success of her economy has made Japan a major economic power. Japan, which in 1960 accounted for 2% of the industrial world's GNP, now accounts for 15.3% (cf USA 45.5, FRG 7.2, UK 5.2). Japan's manufacturing sector is second only to the United States in size and is probably the most modern in the world.

3. Japan accounts for 10.6% of world exports and 6.1% of imports, making her the world's third largest exporter (after the FRG and US) and fourth largest importer (after the US, FRG and UK). Japan is the largest importer of coal and oil and is a leading purchaser of raw materials. She is the largest exporter of manufactured goods (having recently overtaken the FRG) and has the world's largest merchant fleet (flags of convenience apart).

4. Japan's economic dynamism will continue. The massive appreciation of the Yen (67.4% against the dollar, 39% against sterling in two years) means that exports of manufactured goods are, at least for the time being, no longer the main driving force behind Japan's growth. There will be increasing emphasis on technology, financial services and investments abroad. Industry funded R & D spending in Japan is growing at roughly twice the rate of other OECD

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countries. Japanese technology will be increasingly important strategically.

5. Japan is probably the largest creditor nation in the world. The appreciation of the yen will accelerate the trend towards direct investment abroad. In 1975 Japanese direct investment abroad was worth \$2.8 bn; in 1986 \$22 bn. Indirect investment will add further to Japan's overseas interests. Seven of the ten largest banks in the world are now Japanese.

6. Japan is the second largest donor of official development aid, after the USA (roughly three times the UK level.) She is the largest donor to multilateral institutions. However Japanese aid is low as a proportion of GDP: 0.28% in 1986 compared with 0.33% for the UK and an OECD average of 0.36%.

7. The Japanese defence effort, though limited for constitutional reasons, is now substantial: in absolute terms Japanese defence spending is roughly equal to that of the FRG. She plays a discreet but important role in assisting the US 7th Fleet in the Pacific.

8. Japanese foreign policy activity is still hesitant but has increased in recent years. She is helpful to the West in a number of ways; in particular she aims to counter Soviet influence in Asia and the Pacific. The Japanese themselves are increasingly aware that the simplified picture of an American dominated world on which their foreign policy has been based no longer holds good; at the same time they are becoming more conscious of their own weight in international affairs.

9. These major developments lead to the important conclusion that Japan is likely to take more active political role in the world. Her global economic and financial interests will give her a stake in

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peace and political stability; her resources will give her the muscle to contribute to it if she chooses.

Strategic Objectives

10. In the light of this it is important that:

10.1 Japan should continue to belong to, and should contribute more effectively to, the Western political and security system.

The Western system would be weaker if Japan were to play a semi-neutral role, was receptive to Soviet pressure or was closely linked to China. Whether or not Japan adopts a more positive defence policy, she will have much to contribute strategically in terms of technology and economic power.

10.2 Japan should play a full and responsible role in managing the world economy.

Problems with Japan stem from the fact that despite her economic weight her integration into the world economic system is incomplete. One aspect of this is her low propensity to import manufactured goods (2.7% of GDP in Japan; cf UK-15% and USA-5.2%). Neither Europe's, nor the United States' bilateral deficit with Japan need in itself be a problem; but persistent high surpluses (like persistent deficits) can be destabilizing. At the same time the combination of a persistent surplus with Japan's reputation as a closed market attracts a protectionist response. The frustrations often involved in trying to secure improvements add to this. The need to let imports compete more fairly with Japanese products is understood by some political and industrial leaders, but we need to get the message through to the bureaucracy and manufacturing industry, where a cultural preference for buying Japanese still prevails. Moreover, the

risk that continuing trade barriers (whether exaggerated or not) may inspire protectionism and thus damage the world economy as a whole is still insufficiently appreciated in influential Japanese circles.

The Japanese Government increasingly recognises its responsibilities in the world economy and is beginning to play a constructive role in G5 and G7: the appreciation of the yen and the tax changes recently enacted in Japan (though less than we or Nakasone wanted) are steps towards dealing with the structural causes of the surplus. More will be needed. It is in our interest that the Japanese economy should continue to be dynamic and creative but Japan's weight in the world economy needs to be matched by a more outward looking, orderly and constructive role in the world system.

10.3 Bilaterally, we should benefit from the development of the Japanese economy through increased exports, inward investment and industrial collaboration. And Japan will continue to be an important source of high quality products of interest to both British industry and consumers.

Implications for British Policy

11. These objectives require a long term approach. Influence needs to be exerted on Japan in a continuing, consistent and predictable manner: this has not always been so in the past. Where appropriate we should work with the United States and EC partners.

/Japan's

Japan's role in the Western Political system

12. We and other European countries need to improve the quality and quantity of our dialogue with Japan on political and strategic questions. Steps towards this should include:

12.1 broadening contacts at Ministerial level: we should invite Sir J Whitehead to identify a dozen or so senior and influential figures - including senior industrialists (who are often more interesting and articulate than Japanese politicians) - who could be encouraged to call on Ministers (and even the Prime Minister) when passing through London.

12.2 more contact at official level: we should consider regular meetings of PUS's or Political Directors and should aim to establish systematic contacts on particular problems: aid to Africa, the Pacific etc. The DUS (Econ) now visits Tokyo annually : we should make a habit of inviting his opposite number back. His opposite numbers in the DTI and HMT also have regular contacts with Japanese opposite Numbers. Contact with domestic Ministries in Tokyo is important; all too often they reflect inward looking attitudes that cause problems.

12.3 consideration of whether we should try to develop multilateral political fora involving the Japanese. Decisions on international political affairs are increasingly taken in groups but Japan belongs to few of them. The current troika meetings between Japan and the twelve in the Political Cooperation framework are inadequate; Summit Seven meetings are infrequent and focus primarily on economic questions. But integrating Japan in the world political system is essentially a multilateral problem. One possibility would be to increase between-Summit activity, for example by holding meetings of Summit 7 Foreign Ministers at six monthly intervals between Summits to deal exclusively with political matters.

/Japan's

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Japan's role in the multilateral economic system

13. Japan is a member of all the important institutions : the Summit Seven, the Group of 5, the IMF and IBRD. Although the Japanese contribution is often constructive it is not commensurate with Japanese economic strength. We should

13.1 urge the Japanese to take a stronger role in the IMF It is absurd that their quota should be only the fifth largest and we should be prepared to seek a special increase in the Japanese quota at the next review. Japan could also contribute more to international institutions by putting forward good quality candidates for posts in these organisations.

13.2 press the Japanese to make a more positive contribution on North-South questions. They could and should contribute more in the aid field especially by untying more aid and increasing the proportion of grant aid and loans on soft terms. (There may be scope for Anglo-Japanese cooperation here).

13.3 press the Japanese for a more positive contribution to preserving and extending the free trade system (from which they benefit as much as any country). Through the EC, and in the GATT, if appropriate, we should seek the elimination of discriminatory trade practices in manufactured goods. We should be sure that we choose targets which are of genuine importance to the UK and where Japanese practices are unfair. We should encourage the Commission to take anti-dumping measures where these are appropriate. (There is no harm in being seen as leaders of the pack in Europe provided the Japanese also understand that our long term commitment is to free trade). The other side of this coin is that we should be prepared to give credit to Japan where barriers are eliminated or where they are illusory. But in the long term people will be convinced of the openness of the Japanese market only when

they see Japanese imports of manufactured goods at higher levels. We should ensure that the Japanese understand this.

13.4 Japanese agriculture is heavily protected and we should press Japan to liberalise as a way of relieving tensions with the United States and as a contribution to a general movement towards agricultural liberalisation.

Bilateral Relations

14. Bilaterally we should launch an extended campaign in our relations with Japan:

14.1 An important element in this will be Ministerial visits. The Foreign Secretary visits Japan in January 1988. The Secretary of State for Trade and Industry plans a visit in March and the Minister of Agriculture in September. We should aim for a visit by the new Japanese Prime Minister before the Toronto Summit.

14.2 Increasing exports will depend on British companies having the marketing skills and commitment to take advantage of the more favourable exchange rate. British exports to Japan are already £1.2 bn, growing at 20% pa recently (nominal sterling terms 1985-6). Our invisibles surplus is roughly £1.5 bn. The DTI are planning to launch a campaign in industry to emphasise the opportunities in the Japanese market. Sir J Whitehead is in touch with the Institute of Directors about a major seminar on Japan for industrial leaders. Ministerial, and possibly Prime Ministerial, involvement in this campaign will be crucial.

14.3 E(CP) is reviewing all our Voluntary Restraint Arrangements including those with Japan. These were instituted mainly in the 1970s. VRAs are outside the GATT framework and are controversial internationally. They weaken our hand when we urge the Japanese to open their markets.

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14.4 The campaigns by the DTI and regional bodies to promote Japanese investment in the UK have been successful: £1bn and 21,000 jobs in manufacturing; 10,000 jobs in financial services. We are the main destination for Japanese investment in Europe and should aim to preserve that position.

14.5 Under the auspices of the Japan 2000 group the Royal Society, with assistance from the Cabinet Office scientific secretariat are making a study of scientific and technical collaboration with Japan. Preliminary findings will emerge in January 1988.

14.6 We shall be able to compete better with Japan if we can improve Japanese studies in this country. It will be increasingly important for industrial and academic workers in scientific and technological fields to be able to access Japanese research.

Parliament and the Public

15. Domestically we need a greater public and Parliamentary appreciation in the UK that the UK/Japan relationship goes wider than troublesome trade disputes, and that there is a UK interest in working with Japan on a range of political, financial and economic issues. This message would not only be worthwhile in its own right, but would assist the Government on the occasions when we will still need, whether directly or through the EC, to demand action on market opening questions that continue to trouble us. It would therefore be helpful if Ministers could find opportunities to refer, publicly and privately, to the wider reasons for strengthening our relationship with Japan; and, on the economic and commercial front, to talk when appropriate about the positive developments (eg increasing UK exports, positive movement on the Japanese surplus) as well as the areas on which we are still seeking action from Japan.

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15.1 There is an established programme of Parliamentary exchanges but there are still too few MPs who take Japan seriously. We should encourage visits of substance in both directions.

15.2 A useful element in broadening our contacts with Japan is the work of the 2000 Group. We should continue to give Lord Jenkin every support, including financial, and should be prepared to look at ways of developing this useful private sector forum further.

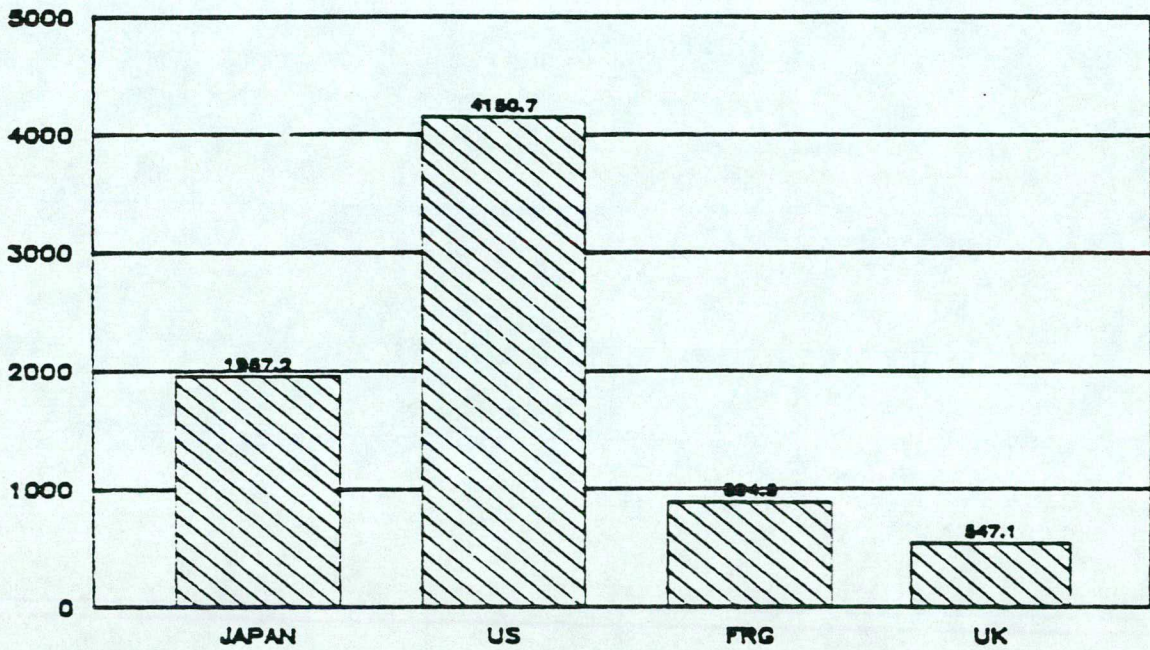
POLICY ON JAPAN: ANNEX

PART A: JAPAN: KEY STATISTICS

1. GDP

In 1986 Japan had the second largest GDP in the non-communist world, more than three times that of the UK.

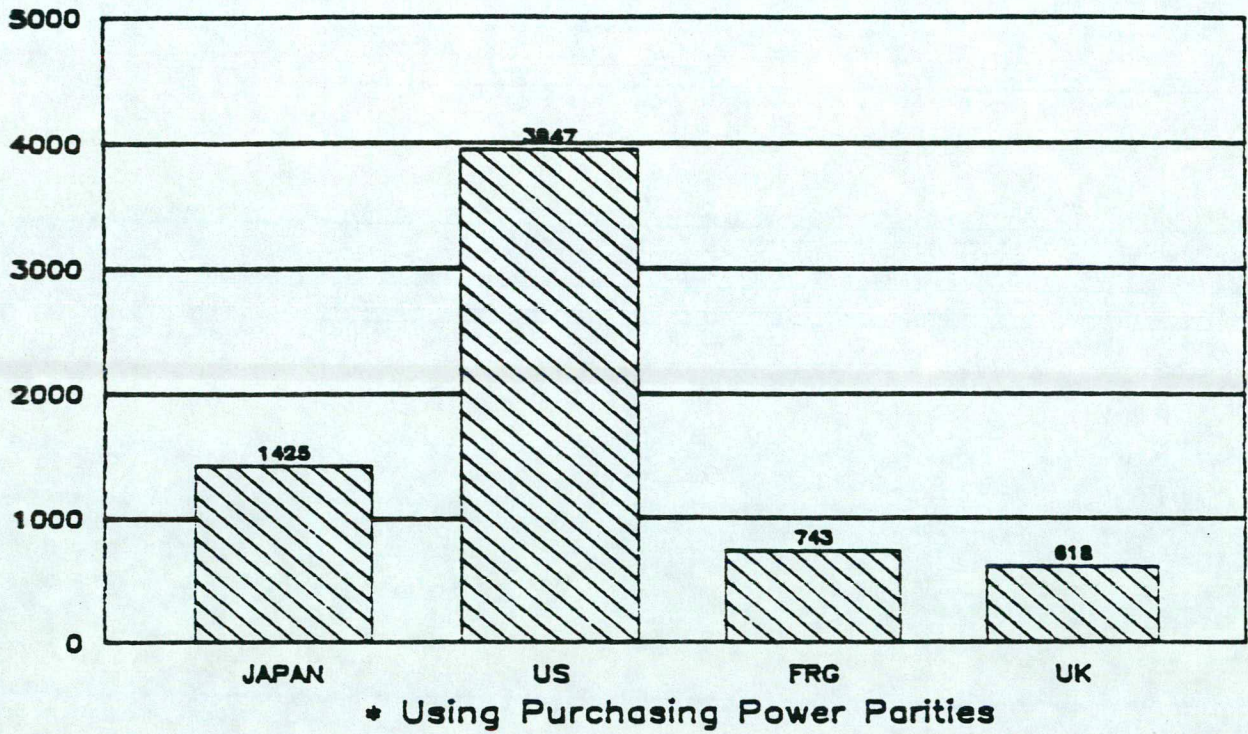
Table (1) GDP 1986
(US\$ bn)



(Source: OECD main economic indicators)

The above comparison is in US \$ terms at 1986 exchange rates and reflects the strength of the yen. Purchasing power parity figures (which remove the distorting effects of widely fluctuating exchange rates) give the comparison shown overleaf:

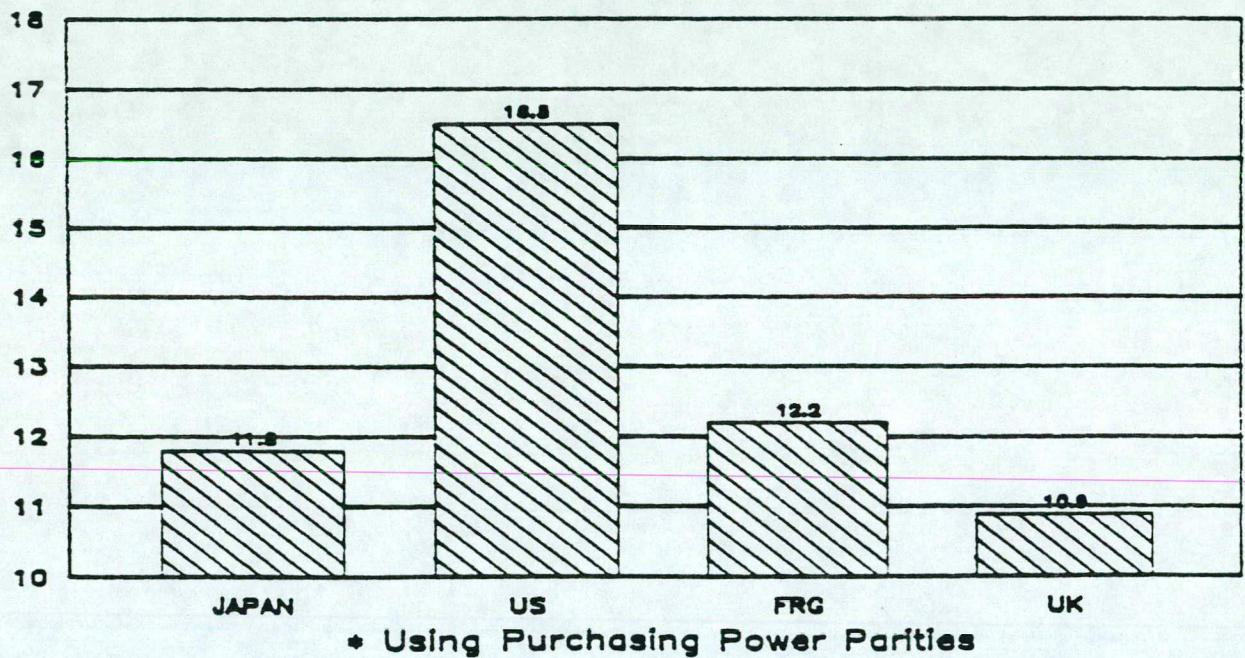
Table 2 GDP*
(1985 US\$ bn)



(Source: OECD National Accounts; 1985 are latest available figures)

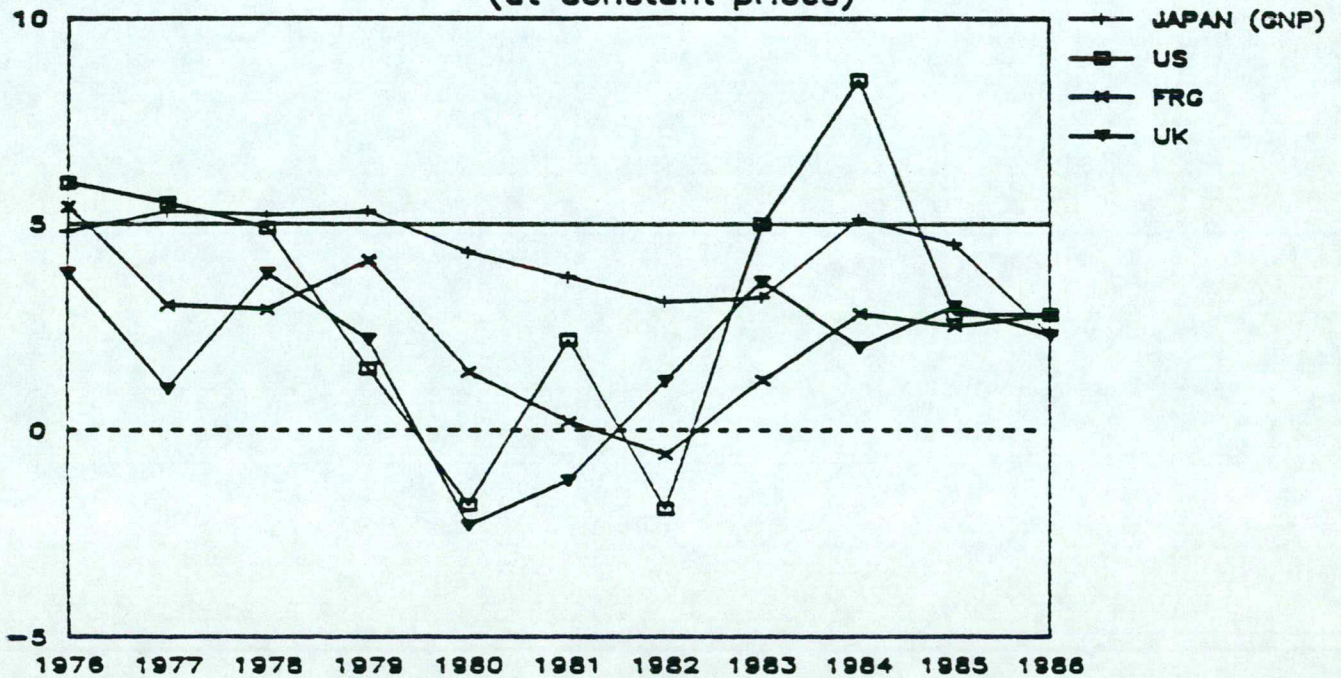
These give the following per capita GDP figures:

Table 3 GDP per head*
(1985 US\$ thousands)



Although the rate of growth of Japan's GDP has slowed from the high levels of the 1960s and early 1970s it averaged 4.4% between 1976 and 1985, higher than any other leading developed country (Source: Bank of Japan, comparative statistical analysis):

Table (4) GDP GROWTH RATE 1976-86 (% p.a.)
(at constant prices)

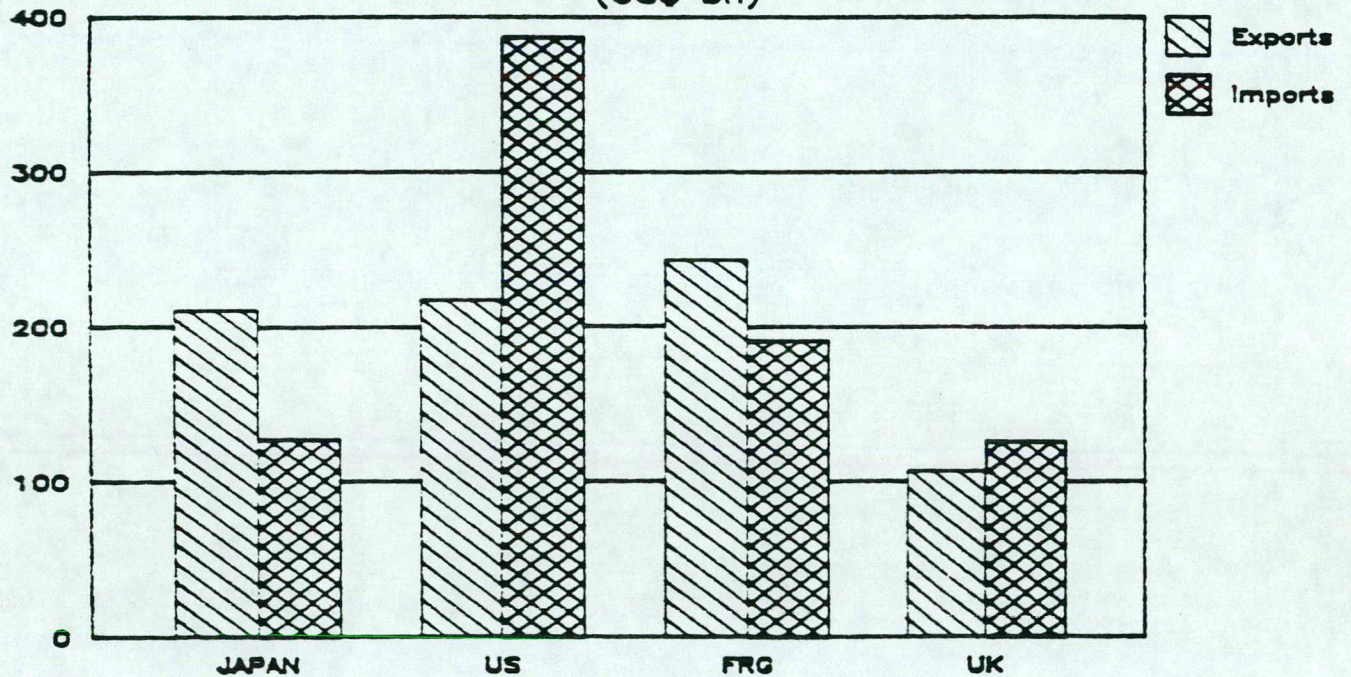


(Source: IMF-IFS 1986 yearbook)

2. TRADE

In 1986 Japan was the world's third largest exporter and fourth largest importer, accounting for 10.6% of total world exports and 6.1% of total world imports. As a percentage of GNP trade is lower in Japan than in the case of European countries, reflecting in part Japan's size:

Table (5) TRADE 1986
(US\$ bn)

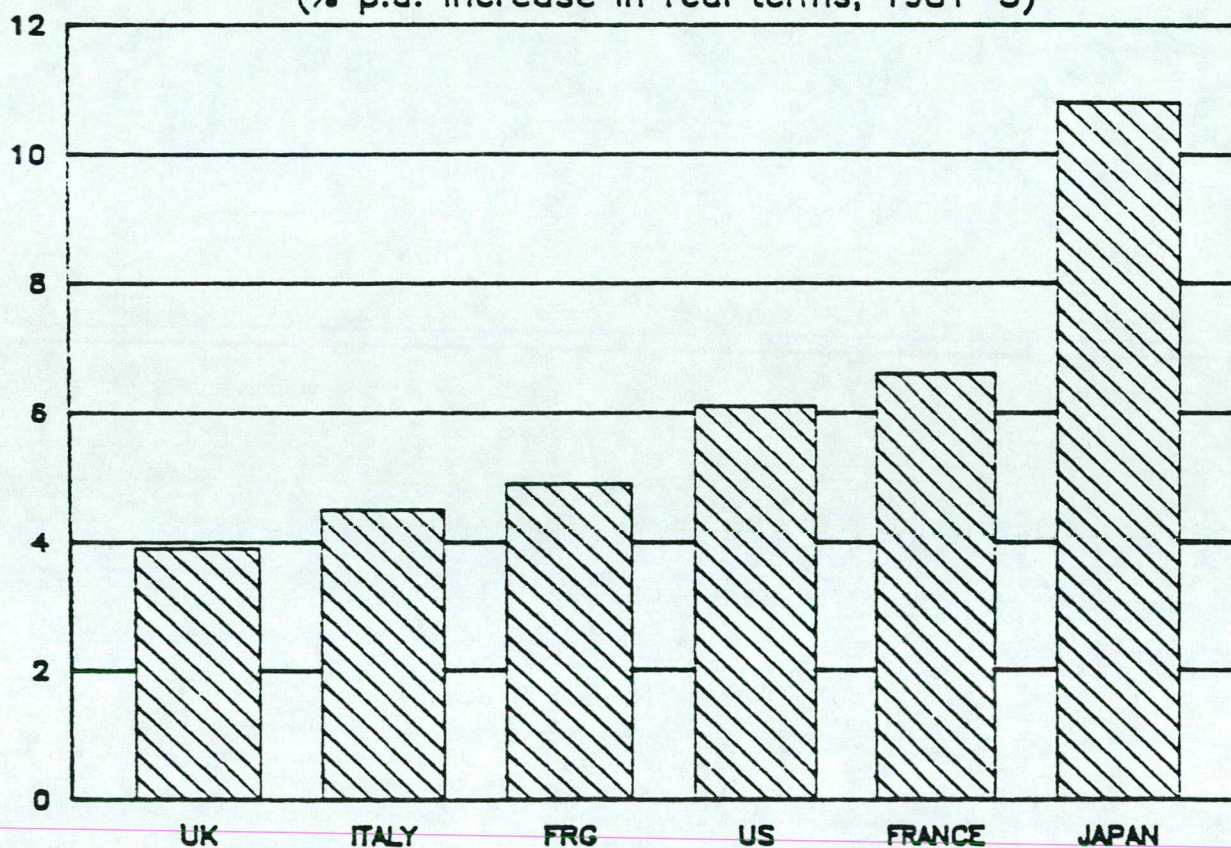


(Source: IMF/Directory of Trade Yearbook 1987)

3. RESEARCH AND DEVELOPMENT

Japan's economic dynamism is underpinned by a high level of investment in Research and Development (R & D). Expenditure on R & D in 1986 was second only to the US and represented almost 3% of GNP (80% of this was funded by private industry). Unlike most of Japan's competitors almost all R & D is in the civilian sector. The rate of growth of Japan's industry-funded R & D expenditure is almost double that of her leading competitors:

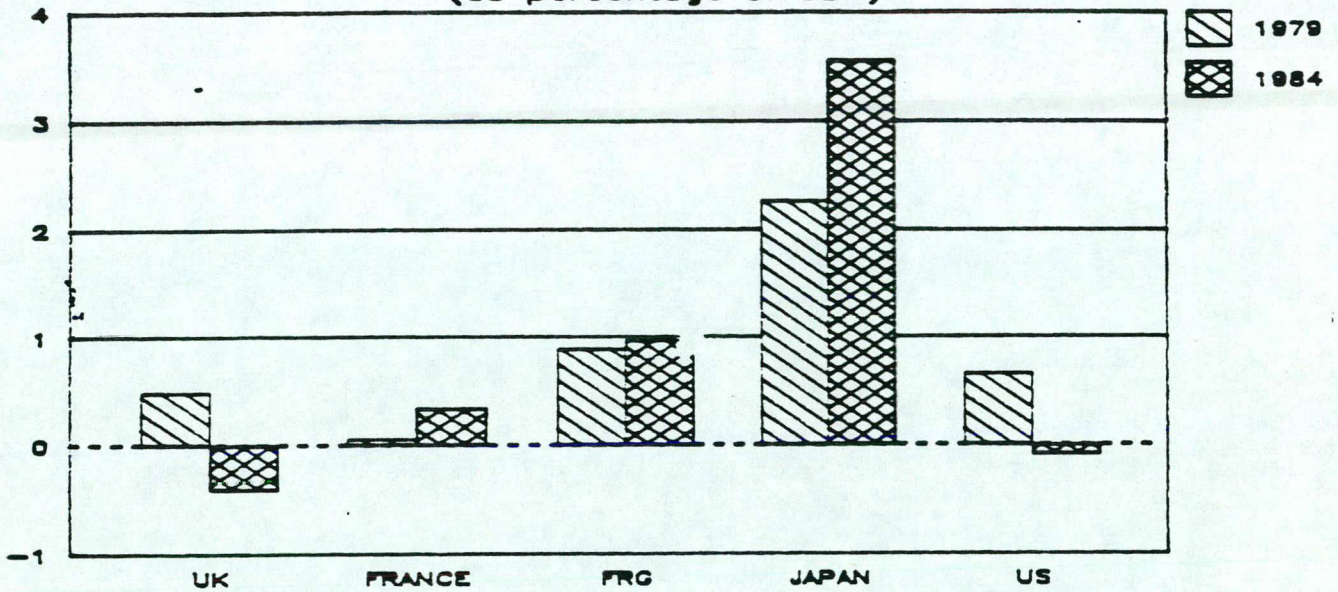
Table (6) INDUSTRY-FUNDED R&D
(% p.a. increase in real terms, 1981-5)



(Source: OECD)

High investment in R & D has given Japan a leading position in the field of high technology:

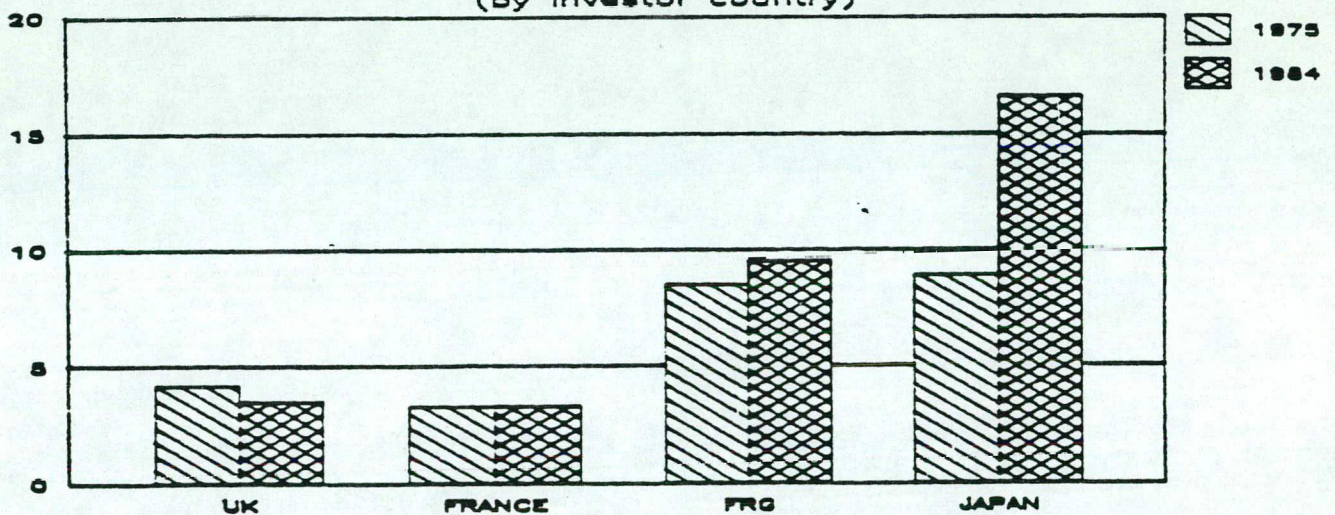
Table (7) HIGH TECH TRADE BALANCE
(as percentage of GDP)



(Source: OECD)

and has led to Japan taking the lead in the registration of new technology:

Table (8) PERCENT OF US PATENTS
(by Investor country)

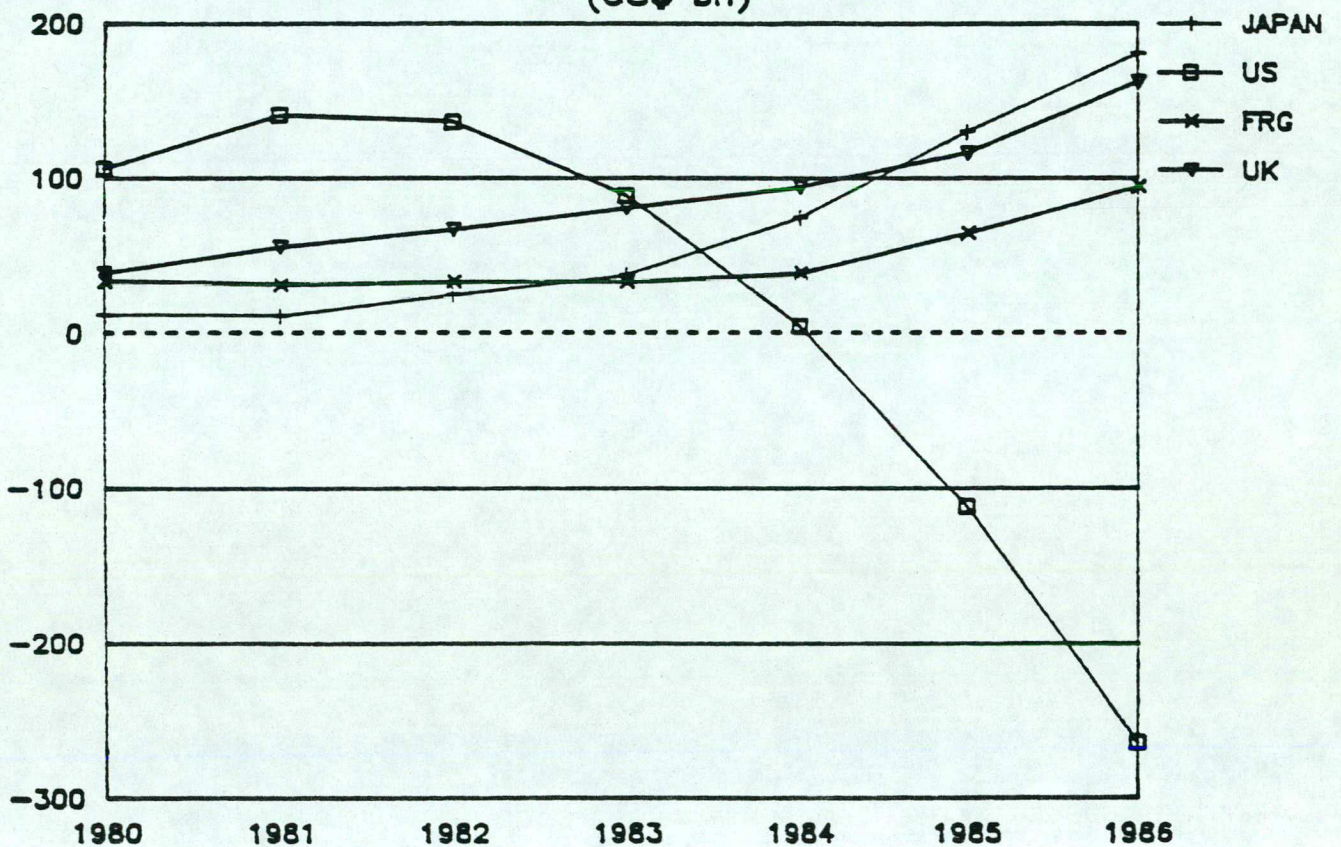


(Source: DTI)

4. FINANCIAL ROLE

Japan's growing current account surpluses have increased her influence in the World Financial System. Japan is now the largest creditor nation in the world (although it should be borne in mind that the figures are uncertain):

Table (9) NET OVERSEAS ASSETS
(US\$ bn)



(Source: HM Treasury)

7 of the 10 largest banks in the world are Japanese:

<u>Leading World Banks</u>	<u>Assets</u> (US \$ Billion)
1. Dai-ichi Kangyo (Japan)	241
2. Fuji (Japan)	213
3. Sumitomo (Japan)	206
4. Mitsubishi (Japan)	205
5. Sanwa (Japan)	193
6. Citicorp (US)	191
7. Norin Chukin (Japan)	162
8. Industrial Bank of Japan (Japan)	162
9. Credit Agricole (France)	154
10. Banque Nationale de Paris (France)	142

(Source: BIEC)

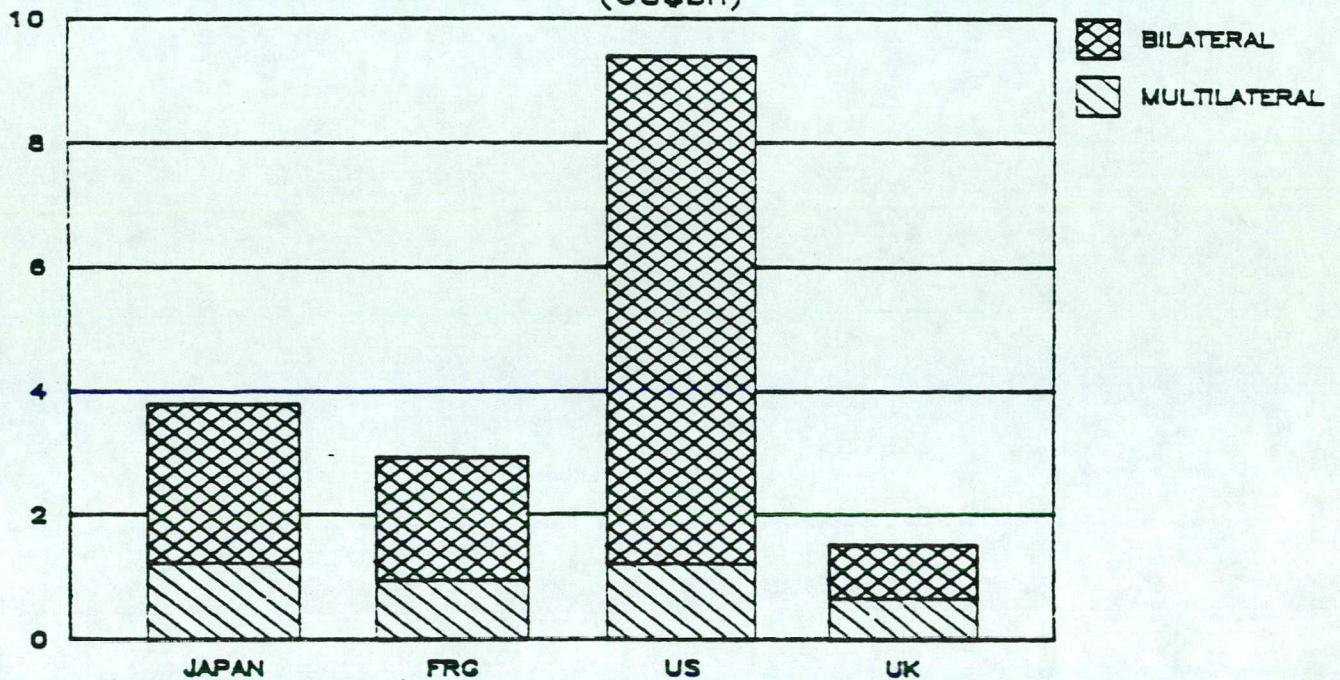
In 1986 Japanese Banks accounted for almost one third (32.8%) of all cross-border lending in (23% In 1984). The use of the yen as an international reserve currency has increased sharply (although it remains in third place, well behind the US dollar and the Deutschmark). Between 1977 and 1986 the share of countries' foreign exchange reserves held in yen grew from 2.5% to 7%.

(Source: IMF)

5. ODA

In 1985, Japan's official development assistance (ODA) was only 0.28% of GNP. But her ODA budget is already the second largest in the world after the US and she has pledged to double spending on ODA from 1985 levels (in nominal US dollar terms) by 1990. In practice, the rise in the value of the yen since 1985 and the prospect of steady growth in nominal GNP mean that this target could be achieved without an increase in the GNP percentage. In 1985 Japan overtook the US as the largest donor to multilateral institutions with donations of US \$1240. Japan pays the second highest contribution to the UN.

Table (10) BREAKDOWN OF AID 1985
(US\$bn)



(Source: OECD)

6. DEFENCE

The Japanese interpret their constitution as allowing them only defensive forces. Japan's defence policy is based on a Security Treaty with the US, under the terms of which the US have important bases in Japan. The main commitment of the Japanese Self Defence Forces (JSDF) is, in the event of war, to defend three strategic straits in the Sea of Japan, thus blocking the Soviet Pacific fleet's exit to the Pacific Ocean. Since 1976, Japanese Governments had imposed an arbitrary ceiling of 1% of GNP on defence spending but the FY 1987 budget set expenditure at 1.004% of forecast GNP, an important symbolic breakthrough. By 1984 Japan's defence budget was already the ninth largest in the world.

PART B: JAPAN/UK RELATIONS

TRADE

1. UK exports to Japan grew by more than 18% in nominal sterling terms in 1986 to reach £1.2 billion. The rate of growth in the first nine months of 1987 has been even faster, with exports showing an increase of 25% over the same period in 1986. Imports from Japan are also rising, but at a slower rate and the ratio of imports to exports is falling (now 3.6:1). The UK had a deficit of £3.7 billion out of total visible trade in 1986 of £6.1 billion. But the UK enjoyed a significant surplus on invisibles, probably of around £1½ billion.

2. Principle British exports are chemicals, pharmaceuticals, industrial equipment (including medical equipment, scientific and measuring equipment, software and a range of high-technology products), whisky and woollen textiles (for which Japan is Britain's largest overseas market). In addition to the well-known export successes such as Unilever and Wedgwood, other notable achievements including Chance Pilkington, which has 70% of the Japanese photochromic lens market.

3. Export promotion is coordinated by the Exports to Japan Unit (EJU) of the DTI. Japan accounts for over 10% of the BOTB budget for outward missions and trade fair joint ventures and for 45% of the BOTB store promotion budget. Following an independent study which confirmed the need for an information campaign to correct negative and confused images of Japan and to encourage British industry to adopt a committed, strategic approach to the market, the BOTB's Japan Trade Advisory Group (JTAG) is considering launching such a campaign in the Spring of 1988.

4. VRAs. There are currently seven inter-industry VRAs with Japan, covering:

- Colour TVs
- Industrial Trucks
- Pottery
- Stainless Steel Cutlery
- Machine Tools
- Special Steels
- Vehicles

The government plans to withdraw support from the VRAs on colour TVs at the end of 1987, and on industrial trucks, at the end of 1988. The remaining VRAs are under review.

JAPANESE INVESTMENT

5. Manufacturing. It is only 15 years since the first Japanese manufacturing company set up a plant in the UK. But there are now 60 Japanese companies manufacturing, or committed to do so in the UK. Japanese investment in the UK now totals around 1 billion pounds (representing about one third of all Japanese investment in Europe). About 21,000 jobs have been created.

6. Presence in the City. Japanese Banks are the largest single foreign sector in the UK banking market. Their assets have grown from under 10% of all the banking business by banks in the UK in 1975 to 26% now. They account for 5% of all sterling loans and advances compared with 0.5% ten years ago, and for nearly 40% of total foreign currency business in the UK compared with some 14% in 1977. (Foreign currency business represents nearly 90% of total Japanese assets in London). Japanese companies in the non-manufacturing sector in the UK (mainly in the City) now employ between 10,000 and 15,000 local staff.

CULTURAL RELATIONS

7. The British Council has an annual budget for Japan of almost 5 million pounds. It runs two libraries in Toyko and in Kyoto and has an extensive English language

teaching programme. The Council's activities include the promotion of exchanges of academics and other specialists. The Council has also provided support for a programme of scientific projects between the Japanese Ministry of Education, Science and Culture, the Royal Society, the Science and Engineering Research Council and other British scientific bodies.

8. There are now 4 universities with Japanese degree courses and a further 4 which offer Japanese studies as part of a course. The 2000 Group has commissioned a study of the situation regarding Japanese studies in higher education in the UK. Only a handful of schools in the UK offer Japanese Studies.

9. Japanese sponsorship of the Arts in the UK is substantial. The Keidanren is likely to make a major donation to the British Museum for a projected permanent Japanese gallery. The Toshiba gallery at the V & A opened on 17 December 1986. Nomura has just given the Tate £1.5 million for a new gallery.

10. The number of Japanese tourists visiting the UK has increased by 25% since 1981 and the British Tourist Authority expect a considerably faster rate of growth in coming years. In 1986 206,000 Japanese visited the UK (this includes businessmen), and spent an estimated £101 million. The number of British passport holders visiting Japan was 142,000, of whom approximately 60,000 were from the UK.

UK/JAPAN REGULAR CONTACTS

11. The frequency of ministerial and high-level official contact is considerably less than that with other major partners (in part reflecting geographical distance) but has been increasing. Regular bilateral talks include:

- Meetings between the Secretary of State and the Japanese Foreign Minister (in principle every year).
- Annual meetings of the UK/Japan 2000 Group

DTI/MITI talks (annual)

Financial Services talks (six-monthly)

Political/Military talks (in practice, approximately every 18 months)

Planning Talks (in principle, every 2 years)

Aid talks (occasional)

In addition to these bilateral contacts there are regular talks between the EC and Japan at Ministerial level and at political director level.

12. A large number of members of the Japanese Diet visit the UK each year. (1984: 206; 1985: 143; 1986: 91; and over 100 in the first six months of 1987). These Dietmen usually travel in groups as part of a European tour. Many British MPs travel to Japan each year, often on private visits. In addition there are normally one or two Parliamentary Select Committee visits to Japan each year. The IPU arrange visits in each direction approximately every 5 years. Six members of the British IPU Group will be visiting Japan in November 1987.

PART C: UK/JAPAN TRADE RELATIONS: CURRENT ISSUES

BILATERAL ISSUES

CABLE AND WIRELESS

1. Two consortia have now submitted applications for an international telecoms licence: ITJ, an all Japanese consortium, and IDC, the consortium in which C & W has a leading share with C Itoh. IDC's application - unlike ITJ's - envisages the laying of a new optical fibre cable linking Japan to the US. The licences will now be appraised by a Standing Committee of advisers who will make their recommendation to the MPT. It is difficult to assess the time table.

2. Following considerable pressure the Japanese government agreed in May to consider separate applications for licences. When merger talks between ITJ and IDC broke down in August Mr Nakasone wrote to the Prime Minister assuring her that the Japanese Government would assess the application from the consortium including C & W in a fair, transparent and prompt manner. Tension has eased for the present and C & W's prospects look good.

FINANCIAL SERVICES

3. The UK is content with progress made in respect of Securities Branch Licences and Investment Management Licences in the past two years. The main outstanding issue between the UK and Japan is membership of the Tokyo Stock Exchange (TSE) where the UK has 6 candidates for the new exchange, when expanded. The Japanese are well aware of the UK's insistence that all qualified candidates are admitted. The outcome in terms of numbers of seats is as yet uncertain.

oilateral nature and the implicit price setting in third markets, opened GATT proceedings against the Japanese. A Panel has been set up to consider the issue, but it is too soon to say when it might report.

ANTI DUMPING

7. Following pressure from European industry for action to be taken to prevent the circumvention of anti-dumping remedies by the establishment of "screwdriver" assembly operations, the Commission took appropriate powers this summer. They have recently begun investigations under this legislation against Japanese suppliers of typewriters and weighing scales, involving mainly UK-based Japanese firms in Europe. The UK agreed that the openings should take place on the grounds that there was prima facie evidence in favour of such a step, but we have some sympathy with the firms to be investigated and would be happy to discuss matters further with them.

DTI

OCTOBER 1987

DT2AAW

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FROM: J M G TAYLOR
DATE: 10 December 1987

MR H P EVANS

cc: PS/CST
PS/FST
PS/PMG
PS/EST
Sir P Middleton
Sir G Littler
Mr Anson
Mr Mountfield
Mr Walsh
Mr Cropper
Mr Tyrie
Mr Call

CHANCELLOR'S BILATERAL WITH THE FOREIGN SECRETARY

Thank you for the briefing you prepared for this meeting.

2. I understand that discussion covered a number of subjects, including the prospects for a G7, the KIO interest in BP, the SAF, and the Foreign Secretary's visit to Japan. There is no follow up action on any of these, though the Chancellor and the Foreign Secretary will have a fuller discussion about Japan nearer the visit.

A handwritten signature in dark ink, appearing to be 'JMG' or similar initials.

J M G TAYLOR



DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET

TELEPHONE DIRECT LINE 01-215 5422
SWITCHBOARD 01-215 7877

Secretary of State for Trade and Industry

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10 December 1987

The Rt Hon Sir Geoffrey Howe QC MP
Secretary of State for Foreign and
Commonwealth Affairs
Foreign and Commonwealth Office
Downing Street
LONDON SW1A 2AL

14/12

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Geoffrey

I was most interested to read the paper on Japan enclosed with your letter of 26 November, and will certainly be pleased to discuss its implications with you.

I strongly support the thought that we, both bilaterally and through the Community, could profitably seek to develop a wider and deeper relationship with Japan, going well beyond one primarily turning upon trade conflict. For my part I am well aware of the negative impact of the latter upon the image of the Japanese market in the eyes of potential UK exporters, whom we need strongly to encourage to tackle the opportunities there. Not only is the market itself wealthy, growing rapidly and increasingly open to imports, but for many UK companies an ability to match Japanese competition, not least in third markets, is likely to be the key to their profitable survival. On the other hand I have little doubt that, both unilaterally and within the EC, we shall have to continue to press Japan very hard on some aspects of market opening, notably agriculture. Achievement of the right balance will be all-important.

At our meeting it might be helpful to consider specific areas of mutual interest to the EC and Japan upon which a more positive relationship could be developed, as distinct from further issues on which we want Japan effectively to make concessions to our way of thinking. It is encouraging to hear that they are feeling less dependent on the US, but I am not sure that they are necessarily prepared to do more to build up their relations with Europe unless we can offer them some positive reasons for so doing. There is the further complication that the Japanese policy making process involves a wide spread of different interests, inside and



outside Government, so that the development of the necessary dialogue is likely to be resource intensive.

Despite these problems, however, I share your objective and look forward to our discussion. By the time of our visits to Japan in the New Year the Takeshita Government should have had time to settle in, and after my return it might be helpful for us to meet again and consider how to tackle the Community on the way forward.

I am copying this letter to Nigel Lawson.

A handwritten signature in cursive script, appearing to read 'John Young', is written over the typed name.

LORD YOUNG OF GRAFFHAM



FROM: J M G TAYLOR
DATE: 31 December 1987

BF 6/1

MR S MATTHEWS

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Mr Anson
Sir G Littler
Sir T Burns
Mr Monck
Mr Byatt
Mr Burgner
Mr Mountfield
Mr H P Evans
Mr Savage

JAPAN

The Chancellor has seen the Foreign Secretary's minute to him of 26 November, enclosing a paper by FCO officials on policy towards Japan.

2. He agrees with the paper's theme that we need to make further efforts to develop a more serious and constructive relationship with Japan. But he thinks that the paper itself, though correct so far as it goes, is pretty superficial. There is no analysis, for example, of the internal political pressures in Japan, which will in practice be decisive for Japan's future development, including the nature of the LDP's electoral power base etc. On a more detailed level, there is no mention of the distinction between Japan's highly protectionist attitude to consumer goods imports and its much more liberal attitude to capital (and most intermediate) goods imports. Nor is there any discussion of the need to inject NTB's more fully into the GATT context.

3. The Chancellor would be happy to have a word with the Foreign Secretary, as suggested. But it may not be possible to fit this in before the Foreign Secretary's departure for Japan. I should be grateful, therefore, if you could provide a draft reply.

A handwritten signature in dark ink, appearing to be 'JMG'.

J M G TAYLOR

PS
ATTN: 31/12

Ch
Content with draft letter?

FROM: S W MATTHEWS

DATE: 4 JANUARY 1988

- 1. SIR G LITTLE
- 2. CHANCELLOR

5/1

- cc PS/Chief Secretary
- PS/Financial Secretary
- PS/Paymaster General
- PS/Economic Secretary
- Sir P Middleton
- Mr Anson
- Sir T Burns
- Mr Byatt
- Mr Monck
- Mr Burgner
- Mr Evans
- Mrs Lomax
- Mr Mountfield
- Mr Ilett
- Mr Walsh
- Mr Savage
- Mr Tyrie

MATTHEWS
7
CHEX
4/1

I think worth writing before the Foreign Secretary leaves. I have redrafted and attached a clean version. I have given Forsythwaite (who accompanies Sir G. Howe on this visit) a fairly full oral account of the Q7 discussions before Christmas.

5/1

OK in 8/11

FOREIGN SECRETARY'S VISIT TO JAPAN

Mr Taylor's notes of 10 and 31 December recorded that you planned to discuss policy toward Japan with the Foreign Secretary before his visit there in January. As he is due to depart on 7 January, this may not now be possible and you may wish therefore to write instead. A draft letter is attached.

2. The FCO paper on Japan sent to you by Sir Geoffrey Howe on 26 November argued that Japan's importance in the world economy will continue to increase and that the UK should make further efforts to develop a constructive relationship. Unstated, but implicit, was the view that disputes over particular issues should not be escalated in the way that has sometimes occurred in recent years. In commenting on the FCO paper, Lord Young, in his letter of 10 December, accepted these arguments, but noted that we would still have to press Japan very hard on some aspects of market opening.

3. The attached draft letter focuses on Japan and the world economy, and access to Japanese markets. The Japanese have just published their draft budget for fiscal year 1988 (which starts April 1988). We will let you have our assessment of it as soon as possible. At first sight it appears consistent

Reporting tel. immediately behind this minute.

with the letter of the Japanese budgetary^a commitment in the G7 Statement, but it is not an expansionary budget. Government borrowing is expected to be lower than in the current fiscal year (1987-1988). The Government's target of GNP growth of about 3.8 per cent looks satisfactory on the assumption that it implies real domestic demand growth of about $4\frac{3}{4}$ per cent and thus further reduction in the Japanese current amount surplus in volume terms.

SM.

S W MATTHEWS

Pre type final

DRAFT LETTER TO THE FOREIGN SECRETARY

Copy: Secretary of State for Trade and Industry

JAPAN

As we shall not be able to discuss your paper on Japan before you leave for Tokyo, I am offering a few points in this letter.

I support the theme of your paper on the need for a more serious and constructive relationship with Japan - and I would add a more intimate and thorough understanding of how their economy and their society work. One general point which I hope you may be able to explore is the nature of the internal political pressures which are likely to be decisive in future development, including the LDP's electoral power base, etc.

Although we have had no recent G7 or other face-to-face meetings with the Japanese, we had plenty of direct and indirect contact by telephone before the pre-Christmas G7 statement, and I think our views and those of the Japanese were in close accord throughout.

Japanese macro-economic performance in 1987 has been ^{distinctly} better than was at one time feared. Their supplementary budget, although late, seems to have had a good effect. Their domestic demand has been well maintained and, although their ^{expenditure} ~~output is~~ also showing remarkable resilience, their foreign trade surplus seems to have been falling a little.

The Japanese undertaking in the context of G7 discussions was in effect to keep up the momentum. The Budget and forecasts they have just published for 1988-89 seem to do this. The Budget may not inject additional expansionary influence, but higher levels

of public works expenditure are being carried forward. The real GNP growth forecast of 3.8% looks satisfactory if it goes with a growth of real domestic demand in the 4.5% - 5% range. Strong domestic demand growth will be needed for several years to bring the current surplus to more acceptable levels.

The quite helpful Japanese macro-economic policy does still need to be reinforced by a wide range of structural reforms, both to bolster domestic demand and to facilitate its translation into more buoyant imports. For example, the strength of investment in housing and infrastructure encouraged by fiscal measures has been accompanied by an enormous surge in land prices: this poses obvious risks of constraint on further expansion - and it seems to owe a good deal to excessive land regulation and agricultural support.

I am sure you will be pressing generally for further substantial moves by the Japanese to open up their markets. Apart from specific U.K. interests I think this should be particularly addressed to agriculture, construction and services.

In the financial field a good deal of progress has been made in the direction of more liberal markets and easier foreign access to them, but they move slowly through a jungle of domestic interests and traditions. The recent move to bring the interest received on most small savings within the tax net was quite a political hurdle whose importance lies in the fact that it opens the way to further moves towards market-determined interest rates for retail deposits and indirectly to a system in which foreign banks can more readily compete. We welcome this. We also of course welcome the steps

taken in the last three years or so to open the Tokyo markets to UK and other foreign securities houses and investment managers. The recent widening of Tokyo Stock Exchange membership was a part of this progress, but ^{IV SK.71} ~~that does~~ leave unfinished business which is very important to us: immediately we are most anxious that room should be found this year for recently but highly qualified firms, of which Barclays (BZW) is the notable example; we look forward also to the day when rationing will cease to be applied.

I ~~shall~~ look forward to the report of your visit. I am copying this letter to David Young.

RESTRICTED

112522
MDHIAN 2199

PS/CHANCELLOR

H.M. TEASURY.

RESTRICTED

FM TOKYO

TO IMMEDIATE FCO

TELNO 003

OF 040802Z JAN 88

AND TO PRIORITY WASHINGTON, PARIS, BONN, OTTAWA, ROME, UKDEL OECD

JAPAN: DRAFT BUDGET OF SY 1988

SUMMARY

1. AN EXPANSIONARY BUDGET, DESIGNED TO BE CONSISTENT WITH A 3.8% GROWTH RATE. BUOYANT REVENUES PERMIT REDUCTIONS IN DEFICIT FINANCING. INCREASES IN DEFENCE (5.2%) AND ODA (6.5%). BUDGET WELCOMED BY INDUSTRY.

GENERAL

2. THE GOVERNMENT HAS ANNOUNCED AT YEN 56.7 TRILLION (#244 BILLION) DRAFT BUDGET FOR FY 1988, WHICH WILL BE PRESENTED TO THE DIET IN JANUARY. UNLIKE LAST YEAR, WHEN THE GOVERNMENT EVENTUALLY HAD TO ABANDON ITS PROPOSALS FOR AN INDIRECT SALES TAX, THIS YEAR'S BUDGET IS RELATIVELY UNCONTINGENTIOUS AND LOOKS LIKELY TO COME INTO EFFECT ON SCHEDULE IN APRIL. THE STRENGTH OF THE ECONOMY AND THE RESULTING BUOYANCY OF TAX REVENUES HAS ENABLED THE GOVERNMENT TO PRESENT A BUDGET WITH AN OVERALL 1.2% INCREASE IN GENERAL ACCOUNT EXPENDITURE, TO MAINTAIN DOMESTIC DEMAND AND TO MEET INTERNATIONAL COMMITMENTS: WHILST AT THE SAME TIME MAKING FURTHER PROGRESS TOWARDS ELIMINATING BOND ISSUES TO COVER CURRENT SPENDING. ONLY MINOR TAX REFORMS ARE PLANNED FOR IMPLEMENTATION IN 1988. WITH THE ISSUE OF AN INDIRECT SALES TAX DEFERRED UNTIL THE NEXT YEAR.

3. THE DRAFT BUDGET IS 4.8% HIGHER THAN THE INITIAL FY 1987 BUDGET BUT ACTUALLY 2.5% BELOW THE LIKELY OUTTURN FOR FY 1987, WHICH INCLUDES TWO SUPPLEMENTARY BUDGETS OF ABOUT YEN 2 TRILLION EACH. (THE SECOND SUPPLEMENTARY BUDGET HAS STILL NOT PASSED THE DIET: IT WILL BE PRESENTED ALONGSIDE NEXT YEAR'S BUDGET THIS MONTH). HOWEVER, AS IN PREVIOUS YEARS, A SUPPLEMENTARY BUDGET LATER IN THE FISCAL YEAR WILL ALMOST CERTAINLY BE USED TO ADJUST THE FISCAL STANCE IF ECONOMIC CONDITIONS WARRANT IT.

EXPENDITURE

TELNO
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4. AFTER ALLOWING FOR DEBT SERVICE AND TRANSFERS TO LOCAL AUTHORITIES, GENERAL EXPENDITURE TOTALS YEN 33.0 TRILLION, 1.2% UP OVER THE INITIAL FY 1987 BUDGET: THIS IS THE FIRST PLANNED ANNUAL INCREASE IN GENERAL EXPENDITURE FOR 6 YEARS, ALTHOUGH IT TOO IS LIKELY TO BE SLIGHTLY BELOW THE FY 1987 OUTTURN. DEFENCE SPENDING SHOWS THE LARGEST YEAR ON YEAR INCREASE OF 5.2% TO YEN 3.7 TRILLION. THIS REPRESENTS 1.013% OF GNP, SO THAT THE INFORMAL 1% LIMIT ON DEFENCE SPENDING WILL BE BREACHED FOR THE SECOND CONSECUTIVE YEAR. SOCIAL SECURITY SPENDING RISES BY 2.9% TO YEN 10.4 TRILLION, MAINLY BECAUSE OF THE AGEING OF THE POPULATION. ODA RISES BY 6.5%, TO YEN 0.7 TRILLION, BUT THE GOVERNMENT POINTS OUT THAT IN DOLLAR TERMS THE INCREASE IS ABOUT 29% OVER THE INITIAL FY 1987 PROVISION, AND GRANT AID IS TO BE INCREASED BY 9%. PUBLIC WORKS SPENDING IS BUDGETED AT YEN 7.2 TRILLION, 19.9% UP ON THE INITIAL 1987 BUDGET, BUT 2.5% BELOW THE LIKELY 1987 OUTTURN. THE INCREASE IS TO BE FUNDED WHOLLY BY AN ALLOCATION OF 61.2 TRILLION FROM THE PROCEEDS OF THE NTT SHARE SALE.

FILP

5. THE FISCAL INVESTMENT AND LOAN PROGRAMME IS ALLOCATED A RATHER LOWER OVERALL INCREASE (1.3%) FOR PUBLIC WORKS EXPENDITURE, BECAUSE OF THE 20% INCREASE IN THE MAIN BUDGET. HOWEVER, THE GOVERNMENT AGENCIES INVOLVED IN THE DOLLAR 20 BILLION RECYCLING PROGRAMME ALL RECEIVE INCREASED ALLOCATION, WITH FILP LENDING FOR EXIM BANK DUE TO RISE BY 50%.

REVENUE

6. STRONG ECONOMIC GROWTH IS EXPECTED TO LEAD TO AN INCREASE OF 9.5% IN TAX REVENUES (TO YEN 45.0 TRILLION), AFTER ALLOWING FOR YEN 0.25 TRILLION OF NET TAX CUTS (SEE BELOW). NON-TAX REVENUES WILL RISE BY 15.1%, MAINLY THE RESULT OF THE PROCEEDS OF THE NTT SHARE SALE MENTIONED ABOVE. AS A RESULT, THE GOVERNMENT'S OVERALL BORROWING REQUIREMENT FOR THE GENERAL ACCOUNT WILL FALL BY 15.8% (TO YEN 8.8 TRILLION): OF THE TOTAL DEFICIT BONDKSC WHICH COVER CURRENT SPENDING, ARE DOWN BY YEN 1.8 TRILLION TO YEN 3.2 TRILLION, THUS ALLOWING THE GOVERNMENT TO DEMONSTRATE FURTHER PROGRESS TOWARDS ITS TARGET OF ELIMINATING DEFICIT-COVERING BONDS BY 1990.

TAX REFORM

7. THE GOVERNMENT HAS DECIDED TO DEFER MAJOR TAX REFORM, INCLUDING THE INTRODUCTION OF A NEW INDIRECT SALES TAX AND REFORM OF THE LIQUOR TAX UNTIL APRIL 1989. PROPOSALS ON THESE TWO MAIN ISSUES ARE

LIKELY TO EMERGE DURING SPRING OF 1988. FOR FY 1988 SOME RELATIVELY MODEST CHANGES ARE PROPOSED TO CORPORATION TAX AND ALSO TO CAPITAL GAINS TAXES ON LAND AND HOUSING (MAINLY IN AN EFFORT TO INCREASE THE SUPPLY OF LAND FOR CONSTRUCTION AND THUS TO MODERATE THE RECENT STEEP INCREASE IN LAND PRICES).

CONCLUSION

8. THE STRENGTH OF THE ECONOMY HAS MADE THE PREPARATION OF NEXT YEAR'S BUDGET A RELATIVELY EASY TASK FOR THE GOVERNMENT. THERE IS CLEARLY NO NEED AT THIS STAGE FOR THE GOVERNMENT TO ANNOUNCE MAJOR NEW STIMULATORY MEASURES, ALTHOUGH IT IS NATURALLY EMPHASISING THE SIZE OF THE INCREASES IN SPENDING PROGRAMMES OVER LAST YEAR'S BUDGET, RATHER THAN THE FACT THAT THERE IS TO BE LITTLE CHANGE IN SPENDING OVER THE FY 1987 OUTTURN. THE GOVERNMENT HAS LEFT SCOPE FOR FURTHER STIMULATORY MEASURES THROUGH SUPPLEMENTARY BUDGETS DURING THE COMING YEAR, IF NECESSARY. AT THE SAME TIME, THE BUOYANCY OF TAX REVENUES HAS ALLOWED THE GOVERNMENT TO TAKE A FURTHER STEP TOWARDS THE TARGET OF ELIMINATING DEFICIT FINANCING OF CURRENT SPENDING BY FY 1990, TO SATISFY THOSE WHOSE MAIN CONCERN IS THE RECONSTRUCTION OF THE PUBLIC FINANCES.

9. THE BUDGET HAS BEEN GENERALLY WELCOMED BY INDUSTRY, AND BY ECONOMIC COMMENTATORS AS ONE THAT IS LIKELY TO SUSTAIN A HIGH RATE OF GROWTH - ALTHOUGH THE JERC HAS NOTED THE POSSIBILITY THAT GROWTH MAY SLOW DOWN IN THE SECOND HALF OF THE FISCAL YEAR.

10. FURTHER REPORTS ON THE BUDGET, AND ON PROPOSED TAX CHANGES, WILL FOLLOW BY BAG.

11. FCO PLEASE ADVANCE TO MATTHEWS (HMT) AND WEBSTER (BANK OF ENGLAND).

WHITEHEAD

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JAPAN POLITICAL AND ECONOMIC

NNNN


PS/Chancellor - for info!



MP

6/1/88

With the Compliments
of the
Paymaster General's
Private Secretary

 11/1

Treasury Chambers,
Parliament Street,
SW1P 3AG

- PS/Chief Secretary
- PS/Financial Secretary
- PS/Paymaster General
- PS/Economic Secretary
- Sir P Middleton
- Mr Anson
- Sir G Littler
- Sir T Burns
- Mr Byatt
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- Mr Burgner
- Mr Evans
- Mrs Lomax
- Mr Mountfield
- Mr Ilett
- Mr S W Matthews
- Mr Walsh
- Mr Savage
- Mr Tyrie



MS 5 JAN 1988

I am entertained by this para. I had argued, not very coherently, in something similar during 1986, and had been Treasury Chambers, Parliament Street, SW1P politely told by HM/T 01-270 3000 officials that Whitehall already knows every thing that needed to be known

FOREIGN SECRETARY

PPS [L + / PB 10/;

JAPAN

As we shall not be able to discuss your paper on Japan before you leave for Tokyo, I am offering a few points in this minute.

I support the theme of your paper on the need for a more serious and constructive relationship with Japan - and I would add a more intimate and thorough understanding of how their economy and their society work. One general point which I hope you may be able to explore is the nature of the internal political pressures which are likely to be decisive in future development, including the LDP's electoral power base, etc.

Although we have had no recent G7 or other face-to-face meetings with the Japanese, we had plenty of direct and indirect contact by telephone before the pre-Christmas G7 statement, and I think our views and those of the Japanese were in close accord throughout.

Japanese macro-economic performance in 1987 has been distinctly better than was at one time feared. Their supplementary budget, although late, seems to have had a good effect. Their domestic demand has been well maintained and, although their exports are also showing remarkable resilience, their foreign trade surplus seems to have been falling a little.

The Japanese undertaking in the context of G7 discussions was in effect to keep up the momentum. The Budget and forecasts they have just published for 1988-89 seem to do this. The Budget may not inject additional expansionary influence, but higher levels of public works expenditure are being carried forward. The real

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 Mr Walsh
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 Mr Tyrrie

JAPAN



Treasury Chambers, Parliament Street, SW1P
 01-270 3000

FOREIGN SECRETARY

6/1/88

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I look forward to the report of your visit. I am copying this minute to David Young.

N.L.

N.L.

6 January 1988

CONFIDENTIAL

123435
MDHIAN 2582

PS/CHANCELLOR

H.M. TREASURY.

CONFIDENTIAL

FM TOKYO

TO IMMEDIATE FCO

TELNO 19

OF 070712Z JAN 88

INFO PRIORITY HM TREASURY, DTI, WASHINGTON, UKREP BRUSSELS,

INFO PRIORITY UKDEL OECD

INFO SAVING PARIS, BONN, UKMIS GENEVA

YOUR VISIT TO JAPAN: THE POLITICAL PREOCCUPATIONS OF TAKESHITA'S
GOVERNMENT

SUMMARY

1. TAKESHITA'S PERFORMANCE IN HIS FIRST TWO MONTHS IN OFFICE HAS ATTRACTED BOARD-BASED SUPPORT. PASSAGE OF THE BUDGET AND TAX REFORM ARE AT THE TOP OF THE DOMESTIC POLITICAL AGENDA FOR 1988. THE GOVERNMENT ARE ATTEMPTING TO PREPARE THE GROUND CAREFULLY ON TAX REFORM, PRIOR TO SUBMISSION OF A BILL LATER IN THE YEAR. MANAGING THE RELATIONSHIP WITH THE US IS THE MOST PRESSING, AND POTENTIALLY EXPLOSIVE FOREIGN POLICY CONCERN. THE JAPANESE ARE APPREHENSIVE THAT WHAT MAY BE NECESSARY TO SATISFY THE AMERICANS WILL CAUSE DIFFICULTIES AT HOME AND WITH JAPAN'S NEIGHBOURS. THE SEARCH FOR AN APPROPRIATE MORE DETAILED INTERNATIONAL ROLE FOR JAPAN CONTINUES.

DETAIL

2. THE TAKESHITA GOVERNMENT HAS GOT OFF TO A SMOOTH, IF UNSPECTACULAR, START. TWO MONTHS AFTER ASSUMING OFFICE TAKESHITA'S CABINET CONTINUES TO BENEFIT FROM THE GROUND SWELL OF PUBLIC SUPPORT WHICH NORMALLY GREETES A NEW GOVERNMENT IN JAPAN. TAKESHITA ENJOYS A HIGHER LEVEL OF PUBLIC CONFIDENCE THAN THE MAJORITY OF HIS PREDECESSORS DID AT A COMPARABLE STAGE. HE RECEIVED HIGHEST MARKS FOR THE CHARACTERISTICS WHICH MOST DISTINGUISH HIM FROM NAKASONE: HIS COMMON-TOUCH, HIS SKILL AT CONSENSUS BUILDING, HIS DISLIKE OF CONFRONTATION AND HIS PERSONAL MODESTY. TAKESHITA DISPLAYED THESE QUALITIES IN FULL MEASURE DURING THE LATE AUTUMN EXTRAORDINARY SESSION OF THE DIET AND THE YEAR-END POLITICAL BARGAINING OVER THE FINAL DETAILS OF THE BUDGET FOR FISCAL 1988. TAKESHITA'S NON-ASSERTIVE STYLE OF LEADERSHIP LEFT HIS CRITICS WITHIN HIS OWN PARTY AND IN THE OPPOSITION LITTLE SCOPE TO ATTACK THE POLICIES OF THE NEW GOVERNMENT. THERE IS HOWEVER CRITICISM IN SOME QUARTERS OF TAKESHITA'S INCLINATION TO KEEP HIS OWN COUNSEL AND PREVARICATE, ALTHOUGH THESE ARE STILL EARLY DAYS.

PAGE 1
CONFIDENTIAL

3. THE NEW YEAR WILL BRING A STIFFER SERIES OF CHALLENGES. TAKESHITA WILL HAVE TO SET OUT IN MORE DETAIL THAN HITHERTO HIS FOREIGN AND DOMESTIC POLICY PRIORITIES IN A MAJOR SPEECH TO THE DIET ON 22 JANUARY WHICH MARKS THE RESUMPTION^{OF} AT THE DIET SESSION. PASSAGE OF THE BUDGET WILL BE THE MAIN TASK OF THAT SESSION. BUT TAKESHITA'S PRINCIPAL DOMESTIC OBJECTIVE FOR 1988 WILL BE TO PILOT THROUGH PARLIAMENT A MAJOR REFORM OF THE JAPANESE TAX SYSTEM. THE POLLS DEMONSTRATE THAT PUBLIC OPINION ATTACHES GREATEST IMPORTANCE TO PROGRESS IN THIS AREA. AFTER LAST YEARS SALES TAX FIASCO (WHEN NAKASONE WAS FORCED TO WITHDRAW HIS PROPOSALS) TAKESHITA IS TAKING NO CHANCES. RATHER THAN ATTEMPT TO IMPOSE HIS OWN BLUEPRINT, TAKESHITA IS ENCOURAGING HIS PARTY AND THE GOVERNMENTS TAX COUNCIL TO COME FORWARD DURING THE NEXT COUPLE OF MONTHS WITH PROPOSALS FOR A NEW INDIRECT TAX CAPABLE OF ATTRACTING WIDESPREAD PUBLIC SUPPORT. A TAX REFORM BILL WOULD THEN BE INTRODUCED EITHER AT THE TAIL END OF THE ORDINARY SESSION OF THE DIET IN LATE SPRING OR IN AN EXTRAORDINARY DURING THE SUMMER. ACCORDING TO THIS SCHEDULE, LEGISLATION WOULD BE PASSED BY THE AUTUMN. ANY DELAY OF SUCH POTENTIALLY POLITICALLY UNPOPULAR LEGISLATION COULD MAKE IT DIFFICULT FOR TAKESHITA TO EXERCISE THE OPTION OF HOLDING A DOUBLE ELECTION FOR THE UPPER AND LOWER HOUSES OF THE DIET IN JUNE 1989 ON THE SUCCESS OF WHICH HIS OWN SECOND TWO YEAR TERM AS PRIME MINISTER MIGHT EVENTUALLY DEPEND.

4. THERE IS SOME DOMESTIC DISSATISFACTION THAT THE STANDARD OF LIVING OF THE MAN IN THE STREET DOES NOT MATCH UP TO JAPAN'S POSITION (ACCORDING TO THE LATEST DOLLAR BASED FIGURES) AS THE OECD COUNTRY WITH THE SECOND HIGHEST GNP PER CAPITA. THE ALMOST DOUBLING OF HOUSE PRICES PARTICULARLY IN THE TOKYO AREA IN THE LAST YEAR IS A REAL SOURCE OF GRIEVANCE FOR MOST JAPANESE URBAN DWELLERS. BUT SO LONG AS REAL INCOMES CONTINUE TO GROW FASTER THAN IN THE RECENT PAST, SUCH DISCONTENT IS UNLIKELY TO HAVE SIGNIFICANT POLITICAL REPERCUSSIONS. PROVIDED THAT TAX REFORM IS NOT ONCE AGAIN DERAILED. THE MAIN POLITICAL THREATS TO THE TAKESHITA GOVERNMENT IN 1988 ARE LIKELY TO COME FROM ABROAD. THE JAPANESE GOVERNMENT ARE CONCERNED ABOUT THE SIGNS OF STRAIN IN JAPAN'S EXTERNAL RELATIONS, PARTICULARLY WITH THE UNITED STATES.

5. THE JAPANESE ARE CONCERNED ABOUT THE WEAKENING OF U S ECONOMIC LEADERSHIP AND ALSO ABOUT THE DAMAGE CAUSED TO THEIR OWN SUPREMELY IMPORTANT POLITICAL RELATIONSHIP BY MAJOR DISPUTES OVER SEMICONDUCTORS, COCOM, FOREIGN ACCESS TO JAPANESE PUBLIC WORKS PROJECTS AND AGRICULTURE. THE LATTER TWO IN PARTICULAR OVERHANG TAKESHITA'S

VISIT TO WASHINGTON ON 13 JANUARY. THE GOVERNMENT. LDP POLITICIANS AND SENIOR OFFICIALS ARE STILL SOLIDLY PRO-AMERICAN AND LOOKING FOR WAYS 'TO HELP' THE ADMINISTRATION, BUT THERE IS PERCEPTIBLE GROUND-SWELL OF MORE OPENLY CRITICAL, AND AT TIME CHAUVANISTIC. ATTITUDES TOWARDS THE US WHICH MIRROR ANTI-JAPANESE ATTITUDES IN CONGRESS. THE TRADITIONAL JAPANESE HABIT OF YIELDING GLACIALLY TO FOREIGN PRESSURE IS BECOMING LESS ACCEPTABLE ABROAD AT A TIME WHEN SPEEDING UP THE PACE OF ADJUSTMENT HAS ALSO BECOME LESS ACCEPTABLE IN JAPAN, PARTICULARLY AS AGRICULTURE AND THE CONSTRUCTION INDUSTRY ARE PART OF THE BEDROCK OF LDP SUPPORT. THE MFA, CAUGHT BETWEEN THESE CONTRARY FORCES, OF COURSE, FEELS THIS MOST.

6. THE PRINCIPAL FOREIGN POLICY PREOCCUPATION OF THE JAPANESE YOU WILL MEET WILL BE HOW TO MANAGE RELATIONS WITH THE UNITED STATES IN A PRESIDENTIAL ELECTION YEAR. THEY ARE CONCERNED THAT AMERICAN DISSATISFACTION WITH THE STATE OF THE ECONOMIC RELATIONSHIP WILL LEAD TO RENEWED PRESSURE, ESPECIALLY FROM CONGRESS, FOR JAPAN TO ASSUME POLITICAL AND MILITARY ROLES WHICH WOULD CREATE CONTROVERSY AT HOME AND CONCERN AMONG HER NEIGHBOURS. IN ORDER TO PREEMPT SUCH PRESSURE. THE JAPANESE GOVERNMENT HAVE ALREADY ANNOUNCED A NEW DOLLARS 2 BILLION AID FUND FOR ASEAN AND HAVE INCORPORATED IN THE BUDGET FOR FISCAL 1988 PROVISIONS TO RAISE SIGNIFICANTLY JAPAN'S SHARE OF THE SUPPORT COSTS OF AMERICAN TROOPS STATIONED IN JAPAN. JAPANESE ODA IS ALSO PROJECTED TO INCREASE BY 6.5% TO YEN 701 BILLION (ABOUT \$3 BILLION) NEXT FISCAL YEAR. (IN ABSOLUTE TERMS THIS PUTS JAPAN IN SECOND PLACE AMONG AID DONORS BUT JAPANESE AID AS A PROPORTION OF GNP STILL RANKS 14TH AMONG DAC MEMBERS.) THESE STEPS HAVE BEEN WELCOMED BY THE US ADMINISTRATION BUT THE JAPANESE ARE UNCERTAIN WHETHER THEY WILL BE SUFFICIENT TO SATISFY CONGRESS.

7. THE MFA ARE WORRIED THAT JAPAN WILL BE PRESSED TO DO MORE IN THE MILITARY SPHERE AT A TIME WHEN THE PROSPECTS FOR EAST/WEST RELATIONS HAVE BRIGHTENED. JAPANESE PUBLIC OPINION REMAINS MORE SCEPTICAL THAN THAT IN OTHER SUMMIT COUNTRIES ABOUT THE SIGNIFICANCE FOR SOVIET FOREIGN POLICY OF GORBACHEV'S REFORMS. THIS COULD CHANGE RAPIDLY IF THE SOVIET UNION WERE TO LAUNCH A 'CHARM OFFENSIVE' ON JAPAN. YOUR JAPANESE INTERLOCUTORS WILL THEREFORE BE INTERESTED NOT ONLY TO EXCHANGE ASSESSMENTS OF THE PROSPECTS FOR GORBACHEV'S REFORM PROGRAMME BUT TO EXPLORE WAYS JAPAN CAN CONTINUE TO BE INVOLVED

IN THE EAST/WEST ARMS CONTROL AND DISARMAMENT PROCESS NOW THAT AN INF AGREEMENT HAS BEEN REACHED. THIS WOULD PREVENT JAPAN BEING LEFT ON THE SIDELINES IF EAST/WEST RELATIONS CONTINUED TO IMPROVE.

8. TAKESHITA IS CONSCIOUS THAT HIS LACK OF DIRECT EXPERIENCE IN FOREIGN AFFAIRS IS HIS ACHILLES HEEL. HIS VISIT TO MANILA EARLY IN DECEMBER TO MEET ASEAN LEADERS HAS PROVIDED THE ONLY OPPORTUNITY SO FAR FOR PERSONAL DIPLOMACY. YOUR TALKS WITH FOREIGN MINISTER UNO, WHO ACCOMPANIED TAKESHITA TO MANILA, WILL BE HIS FIRST FORMAL CONSULTATIONS WITH A FOREIGN MINISTER REPRESENTING ONE OF THE SUMMIT COUNTRIES. YOU WILL FIND THAT BOTH TAKESHITA AND UNO INCREASINGLY RECOGNISE THAT JAPAN MUST CONTRIBUTE MORE TO MAINTAIN AN INTERNATIONAL POLITICAL AND ECONOMIC SYSTEM OF WHICH SHE IS ONE OF THE PRINCIPAL BENEFICIARIES. BUT BEYOND THAT THERE IS CONSIDERABLE UNCERTAINTY ABOUT WHAT IN PRACTICAL TERMS JAPAN SHOULD BE DOING.

9. MIFT CONTAINS SOME SUGGESTIONS FOR THE ECONOMIC POLICIES WE SHOULD BE URGING THE JAPANESE TO ADOPT.

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THE JAPANESE ECONOMY AND ECONOMIC POLICY

SUMMARY

1. SPECTACULAR ABILITY TO ADJUST AND STIMULATORY FISCAL POLICIES HAVE BROUGHT ABOUT STRONG GROWTH, LED BY DOMESTIC DEMAND. WE SHOULD GIVE CREDIT FOR PROGRESS SO FAR, BUT JAPAN NEEDS TO DO MUCH MORE TO STIMULATE IMPORTS BEFORE HER SURPLUS WILL DECLINE TO A TOLERABLE LEVEL. DEOPITE THE DANGERS TO HERSELF FROM FURTHER YEN APPRECIATION OR A CRISIS IN THE US ECONOMY, JAPAN STILL NEEDS TO BE PERSUADED THAT HER RESPONSIBILITY AS THE MOST DYNAMIC OF THE FIRST-LEAGUE ECONOMIES, AND HER OWN SELF-INTEREST, REQUIRES THIS.

DETAIL

2. JAPAN ENTERED 1987 WITH THE DOLLAR AT 158 YEN, A MILDLY DEFLATED ECONOMY, AND UNDER STRONG CRITICISM FROM HER PARTNERS FOR HER GROWING TRADE SURPLUSES. JAPAN WENT INTO 1988 WITH THE YEN AS ^{AT} 122 TO THE DOLLAR (ALTHOUGH IT HAS BEEN VERY VOLATILE IN RECENT DAYS) AND YET, PARADOXICALLY, SOMEWHAT COMPLACENT.

3. AS I HAVE DESCRIBED IN MY ANNUAL REVIEW, 1987 WAS A YEAR OF SPECTACULAR ADJUSTMENT BY THE JAPANESE ECONOMY IN WHICH PREDUCTIONS OF THE DEMISE OF LAGRE PARTS OF MANUFACTURING INDUSTRY UNDER THE IMPACT OF A 100 PER CENT APPRECIATION AGAINST ITS MAJOR TRADING CURRENCY PROVED AGAIN TO BE PREMATURE. THERE IS NOW A STRONG DOMESTIC-DEMAND LET^D RECOVERY UNDER WAY. THE ECONOMIC PLANNING AGENCY FORECASTS 3.5 PER CENT GROWTH THIS YEAR AND 3.8 PER CENT IN FY 1988, INVESTMENT AND INVENTORIES ARE RISING, AND WITH FORECASTS OF CORPORATE PROFITS IN BOTH MANUFACTURING AND SERVICE SECTORS AT NEAR RECORD LEVELS AGAIN IN 1988. SENTIMENT IN THE GOVERNMENT AND INDUSTRY IS PRETTY BULLISH (FURTHER DETAILS ARE IN MY TELNO 966 OF 2 DECEMBER).

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4. JAPAN ALSO FEELS BETTER PLACED INTERNATIONALLY FOR A NUMBER OF REASONS. THE GOVERNMENT CAN CLAIM WITH SOME JUSTIFICATION THAT STRUCTURAL CHANGE IS TAKING PLACE. (AS A SYMBOL OF THIS TAKESHITA HELD A MEETING WITH THE TAKAWA COMMITTEE ON 6 JANUARY AS A PRELIMINARY TO HIS VISIT TO WASHINGTON NEXT WEEK.) IN THIS FINANCIAL YEAR, DOMESTIC DEMAND WILL CONTRIBUTE 4.5 PER CENT TO GNP GROWTH, EXTERNAL DEMAND, MINUS 1 PER CENT, AND THE SAME PATTERN IS FORECAST IN 1988. EXPORT DEPENDENCY RATIOS OF MAJOR MANUFACTURERS HAVE DECLINED. MANUFACTURES NOW ACCOUNT FOR 44 PER CENT OF ALL IMPORTS (LOW OIL PRICES ARE OF COURSE A FACTOR) AND IMPORTS FROM THE EC (UP 25 PER CENT IN DOLLAR TERMS) AND S E ASIA (UP 48 PER CENT) ARE INCREASING HEALTHILY. (US UP ONLY 6.4 PER CENT). IN THE MEDIUM TERM, THE DIRECT INVESTMENT WHICH IS FLOWING INTO THE US, EUROPE AND SOUTH EAST ASIA WILL ALSO REDUCE THE TRADE IMBALANCES. BECAUSE OF HIGHER TAX AND PRIVATISATION REVENUES, THE GOVERNMENT HAS BEEN ABLE IN ITS FY 1988 BUDGET TO COMBINE ITS TARGET OF REDUCING GOVERNMENT DEPENDENCE ON DEFICIT BONDS WITH AN OVERALL 1.2 PER CENT EXPANSION OF GOVERNMENT SPENDING, CONCENTRATED IN PUBLIC WORKS, DEFENCE AND ODA (FOR BUDGET DETAILS, SEE MY TELNO 003.)

5. IN JAPANESE EYES THE OCTOBER CRASH THREW THE INTERNATIONAL SPOTLIGHT MORE ON THE US LACK OF CONTROL OVER ITS BUDGET DEFICIT AND INADEQUATE GERMAN PERFORMANCE AS CAUSES OF WEAKNESS IN THE WORLD ECONOMY. JAPAN ITSELF HAS WEATHERED THE STOCK MARKET TURBULENCE BETTER THAN OTHERS: BECAUSE THE MARKET FELL LESS, AND INDIVIDUAL HOLDINGS ACCOUNT FOR A MUCH SMALL SHARE OF DISPOSABLE INCOME, IT HAS HAD LITTLE EFFECT UPON DOMESTIC CONSUMPTION: OFFICIALS ARE EVEN RELATIVELY SANGUINE ABOUT THEIR ABILITY TO COPE WITH A DOWN TURN IN US DEMAND.

6. THE JAPANESE YOU MEET ARE LIKELY TO LEAD THEREFORE WITH THE ASSERTION THAT JAPAN IS DOING WHAT ITS PARTNERS HAVE BEEN CALLING UPON IT TO DO, AND THAT CONTINUED FISCAL SUPPORT IN THE BUDGET WILL ENABLE JAPAN TO PICK UP SOME SLACK FROM A PREDICTED FALL IN US ACTIVITY. IT WOULD BE WRONG NOT TO GIVE SOME CREDIT AND RECOGNISE THE EXTENT OF THE ADJUSTMENT MADE BY JAPANESE INDUSTRY AND ITS WORKFORCE.

7. THE MAJOR UNRESOLVED ECONOMIC PROBLEM LEFT OVER FROM 1987 IS THE QUESTION OF EXCHANGE RATE STABILITY. DESPITE ALL THE FLEXIBILITY DEMONSTRATED SO FAR, CONTINUING RAPID APPRECIATION OF THE YEN IS STILL THE MOST IMMEDIATE THREAT TO JAPANESE INDUSTRY AND EMPLOYMENT. THERE IS LITTLE CONFIDENCE IN THE U S ADMINISTRATION ON THIS ISSUE.

JAPANESE OFFICIALS PERHAPS OVER-SOLD TO THEMSELVES THE EFFICACY OF THE LOUVRE AGREEMENT BUT THEY STILL SEE THE G7 AS THE BEST NUCLEUS AT LEAST FOR SOME NEW FORM OF STABILIZING ACTION. ALTHOUGH THEY STILL ARGUE THAT EXCHANGE RATE STABILITY AT AN APPROPRIATE LEVEL WILL, GIVEN TIME, SOLVE THE PROBLEM OF THE TRADE IMBALANCES, THEY ARE ALSO BEGINNING TO SEE THAT EXCHANGE RATE ADJUSTMENTS BY THEMSELVES HAVE NOT SOLVED THE PROBLEM SO FAR AND THAT THE LEVEL OF THESE SURPLUSES REMAINS A POLITICAL PROBLEM FOR THEM IN THE U S. THEY ARE CAUGHT, AS THEY SEE IT, WITH THE RISK OF HAVING TO CONTINUE TO INVEST IN US BONDS OR, IF THEY DO NOT, OF SETTING OFF A RISE IN INTEREST RATES AND DEFLATION IN THE STATES WHICH WILL COME BACK AND HIT THEMSELVES. THIS COULD THEREFORE BE THE TIME TO SUGGEST THAT THE RESPITE THEY SEEK IN THE EXCHANGE RATES IS MORE LIKELY TO COME IF THEY DO MORE TO REDUCE THEIR OWN IMBALANCES (IE FURTHER ACTION TO RAISE CONSUMPTION AND IMPORTS) THAN THROUGH COORDINATED G7 ACTION, IMPORTANT THOUGH THAT CAN BE IN MONITORING PERFORMANCE AND SMOOTHING THE MARKET.

8. THE ESSENTIAL QUESTION TO THE JAPANESE AT THIS POINT IS STILL 'ARE YOU DOING ENOUGH?' (THEY MAY COUNTER WITH THE SAME QUESTION TO A RELATIVELY HEALTHY UK ECONOMY). BUT IT IS THE TRADE IMBALANCES WHICH ARE THE CRUX OF THE MATTER, AND WE MUST TRY TO PERSUADE THE JAPANESE THAT THEIR OWN INTEREST AS WELL AS JAPAN'S POSITION IN THE WORLD REQUIRES MUCH BOLDER AND POLITICALLY TOUGH ACTION.

9. FIRST, IT IS LEGITIMATE TO ASK WHETHER THE GOVERNMENT WILL TAKE THE NECESSARY FISCAL MEASURES TO KEEP DOMESTIC DEMAND AT A HIGH LEVEL EVEN IF AS IS QUITE LIKELY. THE CURRENT EXPANSION (HEAVILY BASED ON CONSUMPTION AND HOUSING INVESTMENT) COOLS OFF TOWARDS THE END OF FY 1988, AND WHETHER THEY WILL EXPAND FURTHER TO OFFSET ANY DROP IN US ACTIVITY. BUOYANT REVENUES THIS YEAR HAVE SO FAR MADE THIS RELATIVELY PAINLESS. IN THE LONGER TERM THEIR ABILITY TO DO SO WILL DEPEND ON THE PROPOSAL FOR A NEW INDIRECT TAX TO BE PUT TO THE DIET LATER THIS YEAR. IF THE ADJUSTMENTS MADE IN THE LAST YEAR ARE TO LEAD TO PERMANENT STRUCTURAL CHANGES, THERE MUST BE A CONTINUOUS PERIOD OF HIGH DOMESTIC-DEMAND LED GROWTH.

10 SECOND, ONE CAN QUESTION THE ^{VIRTUE (?)} VIRTUE OF HIGH DOMESTIC GROWTH POLICIES IF THEY DO NOT LEAD TO MANY MORE IMPORTS. AT PRESENT BOTH IMPORTS AND EXPORTS ARE GROWING IN DOLLAR TERMS. AND EVEN THOUGH THE LATEST AND AUTHORITATIVE PRIVATE SECTOR 5-YEAR FORECAST SHOWS IMPORTS RISING AT NEARLY 10 PER CENT PER ANNUM COMPARED WITH 4.6 PER CENT FOR EXPORTS, THE CURRENT ACCOUNT SURPLUS IS STILL

PREDICTED TO REMAIN ABOVE DOLLARS 70 BILLION THROUGHOUT THE PERIOD PARTLY BECAUSE OF THE RELATIVE SIZE OF EXPORTS OVER IMPORTS, AND PARTLY BECAUSE OF A FORECAST EMERGENCE OF A SURPLUS ON INVISIBLES REFLECTING A GROWTH IN INVESTMENT INCOME. DESPITE ALL THE POLITICAL CAPITAL INVESTED IN THEM, THE CURRENT ARGUMENTS ABOUT OPENING JAPAN'S CONSTRUCTION AND AGRICULTURE MARKETS ARE ABOUT SYMBOLIC WEDGES IN THE DOOR, AND WILL NOT MUCH CHANGE THE TRADE FIGURES. TO DO THE LATTER WILL REQUIRE BROADER ACTION, WHICH WOULD HAVE TO BE ENCOURAGED ADMINISTRATIVELY, TO INCREASE THE INCOME AND PRICE ELASTICITY OF IMPORTS - PRIMARILY BY BY-PASSING COMPLEX AND RESTRICTIVE DISTRIBUTION MECHANISMS. THIS IS AN ARGUMENT WHICH HAS TO BE ADVANCED AS A GENERAL PROPOSITION^N NOT ON BEHALF OF SPECIFIC UK EXPORTS WHERE THE JAPANESE MIGHT TRY TO COUNTER-ATTACK. THE REFORM OF DISTRIBUTION MECHANISMS IS RECOMMENDED IN THE AEKAWA REPORT AND SUPPORTED BY SOME LIBERAL ECONOMISTS HERE. BUT THE SYSTEM AS A WHOLE IS SEEN AS A SOURCE OF EMPLOYMENT: MECHANISMS ARE VARIED AND SPECIALIZED. PRESSURE FOR SUCH REFORM HAS TO BE MADE TO COME FROM CONSUMERS. WE CAN HELP A LITTLE BY EMPHASIZING^S THE IMPORT/CONSUMER PRICE GAPS.

10. THIRDLY, WHILE THE GOVERNMENT'S MAIN CONTRIBUTION SO FAR TO FULFILLING THE PRESCRIPTIONS OF THE MAEKAWA REPORT HAS BEEN ITS NON-INTERFERENCE WITH THE EFFECTS OF YEN APPRECIATION AND ITS RECENT MORE EXPANSIONARY BUDGETS, IT HAS GONE SLOW ON ADMINISTRATIVE ACTION IN MANY AREAS OF MARKET OPENING AND COMPETITION, WAGE AND LABOUR POLICY, LAND AND AGRICULTURAL POLICY WHICH COULD AGAIN INCREASE CONSUMPTION, IMPORTS AND LIVING STANDARDS. THE ORIGINAL GOAL OF STEADILY REDUCING THE CURRENT ACCOUNT SURPLUSES TO A LEVEL CONSISTENT WITH INTERNATIONAL ECONOMIC HARMONY STILL SEEMS A WAY OFF. JAPAN SHOULD MAYBE RECONSIDER THE POLITICAL AND EXCHANGE RATE ADVANTAGES FOR ITSELF OF MAKING A MORE CONCRETE COMMITMENT TO PROGRESSIVE REDUCTION OF ITS DOLLAR SURPLUS.

11. FOR ALL ITS^S STRENGTH THE JAPANESE ECONOMY STILL LOOKS VULNERABLE TO FOREIGN SHOCKS IN 1988. THE POINT WHICH VOLCKER MADE DURING A RECENT VISIT HERE WAS THAT THE EFFECTS OF THE PROTECTIONIST TRADE BILL IN CONGRESS ON JAPAN WOULD BE INSIGNIFICANT BESIDE THE COSTS FOR JAPAN OF A FURTHER JUMP IN THE YEN OR OF A US RECESSION, AND THAT THE US COULD, IF IT^{THE} INTERNATIONAL SITUATION GOT MUCH WORSE, SIMPLY PUT UP THE TRADE SHUTTERS: THEREFORE JAPAN SHOULD NOT WAIT UNTIL THE US TOOK ITS OWN NECESSARY DEFICIT CUTTING MEASURES.

12. EVEN IN ECONOMIC MATTERS JAPAN IS NOT EQUIPPED FOR, AND DOES

NOT SEEK, A NUMBER ONE ROLE. SHE IS MUCH HAPPIER IN SECOND PLACE,
BUT AS CIRCUMSTANCES AND HER OWN INDUSTRY PROPEL JAPAN MORE TOWARDS
THE FRONT OF THE PACK SHE IS COMMING TO REALISE, ALBEIT MORE SLOWLY
THAN WE MIGHT LIKE, THAT SHE MUST BEAR PART -EVEN A DISPROPORT-
IONATE PART - OF THE BURDEN OF MAINTAINING THE OPEN TRADING SYSTEM.
THAT IS, I SUGGST, THE MESSAGE WE WISH TO REINFORCE.

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UK/JAPAN FOREIGN MINISTERIAL TALKS: 11 JANUARY: IRAN/IRAQ

SUMMARY

1. UNO INDICATES THAT IN VIEW OF CONTINUED IRANIAN INTRANSIGENCE JAPAN WOULD SUPPORT THE INTRODUCTION OF ENFORCEMENT MEASURES IF OTHERS IN THE SECURITY COUNCIL SO AGREED. (JAPANESE OFFICIALS DREW BACK SLIGHTLY AFTERWARDS). BUT JAPANESE DESIRE REMAINS TO AVOID ACTION IN THE SHORT TERM WHICH MIGHT DRIVE IRAN FURTHER AWAY FROM THE WESTERN CAMP.

DETAIL

2. IN A SHORT EXCHANGE ON THE GULF AT THE UK/JAPAN FOREIGN MINISTERIAL TALKS ON 11 JANUARY THE SECRETARY OF STATE STRESSED THE NEED TO MOVE QUICKLY ON ENFORCEMENT MEASURES AT THE UN, WHILE AT THE SAME TIME MAINTAINING THE UNITY OF THE FIVE PERMANENT MEMBERS. IT WAS NECESSARY TO DEAL WITH IRAN WITH CARE, BUT EQUALLY IMPORTANT FOR THE REST OF THE WORLD TO BE UNIFIED IN A FIRM APPROACH TO BRING THE TWO SIDES TO A CEASEFIRE. COUNTRIES SHOULD RESIST THE TEMPTATION TO SEEK UNILATERAL ADVANTAGE IN THEIR BILATERAL RELATIONS WITH IRAN OR IRAQ WHICH MIGHT CUT ACROSS PEACE KEEPING EFFORTS WITHIN THE UN. JAPAN ENJOYED A PRIVILEGED POSITION OF ACCESS TO BOTH THE IRAQI AND IRANIAN GOVERNMENTS, AND HAD A VITAL ROLE IN BRINGING PRESSURE TO BEAR ON BOTH SIDES. SINCE JAPAN WAS LIMITED IN THE MILITARY ROLE SHE COULD PLAY, HER EFFORTS IN THE DIPLOMATIC AND ECONOMIC SPHERES WERE ALL THE MORE IMPORTANT.

3. FOREIGN MINISTER UNO ACCEPTED THAT JAPAN'S EFFORTS AS PRESIDENT OF THE SECURITY COUNCIL TO RECONCILE THE POSITIONS OF IRAN AND IRAQ AND TO PERSUADE THEM TO ACCEPT SCR 598 HAD BORNE LITTLE FRUIT. HE HAD MADE IT PLAIN TO THE IRANIAN FOREIGN MINISTER WHEN THE LATTER HAD VISITED TOKYO THAT IRAN'S CONTINUED

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FAILURE TO IMPLEMENT SCR 598 MEANT THAT JAPAN HAD NO CHOICE BUT TO SUPPORT ANY MOVE TOWARDS ENFORCEMENT MEASURES BY THE SECURITY COUNCIL. UNO WAS CONCERNED, HOWEVER, THAT THE IMPOSITION OF SANCTIONS AGAINST IRAN MIGHT PUSH HER FURTHER AWAY FROM THE WEST AND HE ARGUED FOR A CAREFULLY CONSIDERED LONG TERM APPROACH IN DEALING WITH THE IRANIAN REGIME. JAPAN WOULD CONTINUE TO PRESS IRAN HARD TO IMPLEMENT SCR 598.

4. THE SECRETARY OF STATE AND FOREIGN MINISTER UNO AGREED THE NECESSITY FOR THE UK AND JAPAN TO KEEP IN VERY CLOSE TOUCH ON THIS SUBJECT.

5. FOLLOWING THE MEETING JAPANESE OFFICIALS SHOWED SOME SENSITIVITY ABOUT UNO'S STATEMENT THAT JAPAN WOULD 'SUPPORT' ENFORCEMENT MEASURES, MAINTAINING THAT THE JAPANESE POSITION WAS THEY WOULD 'CONSIDER' SUCH MEASURES.

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UK/JAPAN FOREIGN MINISTERIAL TALKS: 11 JANUARY: EAST/WEST
RELATIONS

SUMMARY

1. THE SECRETARY OF STATE AND FOREIGN MINISTER UNO AGREED ON THE NEED TO DAMP DOWN EXCESSIVE PUBLIC EUPHORIA ABOUT GORBACHEV'S INITIATIVES. JAPANESE POSITION STRONGLY COLOURED BY THE NORTHERN TERRITORIES ISSUE. AGREEMENT ON CONTINUED ROLE FOR NUCLEAR DETERRENCE FOLLOWING INF AGREEMENT.

DETAIL

2. IN THE DISCUSSION OF EAST/WEST RELATIONS AT THE FOREIGN MINISTERIAL TALKS ON 11 JANUARY, THE SECRETARY OF STATE BRIEFED FOREIGN MINISTER UNO IN DETAIL ON HIS PERCEPTIONS OF SOVIET POLICY UNDER GORBACHEV. TH SECRETARY OF STATE LAID PARTICULAR STRESS ON THE NEED BY WESTERN GOVERNEMNTS TO DAMP DOWN EXCESSIVELY OPTIMISTIC PUBLIC REACTION TO GORBACHEV'S MORE OPEN STYLE. IN ASSESSING GROBACHEV'S POLICIES WE SHOULD BE OPEN MINDED BUT OUR APPROACH SHOULD BE TEMPERED WITH VIGILANCE AND A SENSE OF REALISM.

3. ON DISARMAMENT, THE SECRETARY OF STATE SAID THAT WESTERN EUROPEAN COUNTRIES GENERALLY AGREED THAT THE INF AGREEMENT WAS A PROMISING STEP TOWARDS THE REMOVAL OF UNNECESSARY NUCLEAR WEAPONS. BUT WE BELIEVED THAT NUCLEAR DETERRENCE WOULD REMAIN FOR THE FORSEEABLE FUTURE AN ESSENTIAL PART OF WESTERN DEFENCE STRATEGY.

4. FOREIGN MINISTER UNO FULLY AGREED THE NEED FOR VIGILANCE BY WESTERN GOVERNMENTS IN ENSURING THAT PUBLIC OPINION WAS NOT SEDUCED BY GORBACHEV'S PLAUSIBLE PRESENTATIONS. IT WAS A WIDELY HELD VIEW IN JAPAN THAT THE CAPITALIST SYSTEM HAD DEMONSTRATED ITS SUPERIORITY OVER THE SOCIALIST SYSTEM, AND THE JAPANESE PUBLIC WERE UNLIKELY TO BE EASILY TAKEN IN. UNO SPOKE WITH DEPTH

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OF FEELING ABOUT THE CONTINUED SOVIET OCCUPATION OF THE NORTHERN TERRITORIES, MAINTAINING THAT THERE WAS NEITHER HISTORICAL NOR LEGAL BASIS FOR THE OCCUPATION, AND STRESSING THAT THE JAPANESE WOULD NOT CONTEMPLATE SIGNATURE OF A PEACE TREATY WITH THE SOVIET UNION UNTIL ALL FOUR TERRITORIES HAD BEEN RETURN TO JAPAN. HE PERCEIVED NO SIGN OF FLEXIBILITY IN THE SOVIET POSITION. UNTIL THE ISLANDS WERE RETURNED, JAPANESE FEELINGS TOWARDS THE SOVIET UNION WOULD REMAIN COOL. HE ASKED THE SECRETARY OF STATE TO CONVEY THE JAPANESE POSITION TO SHENARDNADZE WHEN THEY MET IN FEBRUARY.

5. ON NUCLEAR DISARMAMENT UNO SAID THAT THE JAPANESE GOVERNMENT ALSO ACCEPTED THE IMPORTANCE OF NUCLEAR WEAPONS IN WORLD PEACE IN THE POST-WAR PERIOD. JAPAN REGARDED NUCLEAR WEAPONS AS A NECESSARY EVIL. THE JAPANESE WOULD OF COURSE CONTINUE AT THE SAME TIME TO SUPPORT FURTHER AMERICAN INITIATIVES TO REDUCE THE OVERALL TOTAL OF NUCLEAR WEAPONS IN THE WORLD AND TO MAKE PROGRESS ON THE REDUCTION OF CHEMICAL AND CONVENTIONAL WEAPONS.

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FROM PRIVATE SECRETARY

SECRETARY OF STATE'S CALL ON THE JAPANESE PRIME MINISTER: 11
JANUARY

SUMMARY

1. TAKESHITA HOPES TO VISIT THE UK BEFORE THE TORONTO SUMMIT. SECRETARY OF STATE URGES JAPAN TO PLAY HER PART IN MANAGEMENT OF WORLD ECONOMY AND TO DEAL QUICKLY WITH RESIDUAL BILATERAL PROBLEMS. TAKESHITA REPEATS NEED FOR JAPAN TO MAKE SACRIFICES IN SUPPORT OF LIBERAL MARKET SYSTEM. AGREEMENT ON NEED FOR REALISM IN EAST/WEST RELATIONS.

DETAIL

2. TAKESHITA BEGAN BY THANKING THE PRIME MINISTER FOR HER CONGRATULATORY NOTE AND HER INVITATION TO VISIT LONDON. HE WOULD LIKE TO DO SO AS SOON AS POSSIBLE, AND HOPED THAT PROBLEMS WITH THE DIET WOULD NOT PREVENT HIM. THE SECRETARY OF STATE SAID THAT HE HOPED THAT TAKESHITA WOULD BE ABLE TO TAKE UP ONE OF THE DATES WE HAD SUGGESTED.

3. TAKESHITA SAID THAT AS EX-FINANCE MINISTER HE STILL HAD CLOSELY IN MIND THE PROBLEMS WHICH HAD PREOCCUPIED HIM IN HIS EARLIER ROLE. HE WAS GLAD THAT THE PROBLEMS OF PARTICIPATION OF BRITISH FIRMS ON THE TOKYO STOCK EXCHANGE HAD BEEN RESOLVED. THE ISSUE OF ALCOHOL TAXES REMAINED: HE AND UNO BOTH CAME FROM FAMILIES WHO WERE PRODUCERS OF SAKE AND COULD WELL SYMPATHISE WITH THE FEELINGS OF SCOTCH WHISKY PRODUCERS.

4. THE SECRETARY OF STATE SAID THAT WE WERE VERY GLAD THAT THE JAPANESE HAD AGREED TO CERTAIN BRITISH FIRMS PARTICIPATING IN THE TOKYO STOCK EXCHANGE, BUT HE HOPED THAT THE TWO FURTHER UK COMPANIES WHO WISHED TO DO SO WOULD ALSO BE ADMITTED. ON THE LIQUOR TAXATION QUESTION, IT WAS VERY IMPORTANT TO MAKE PROGRESS

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QUICKLY SO THAT THIS COULD BE SEEN AS A SYMBOL OF A NEW DYNAMISM. IN GENERAL HE BELIEVED THAT OUR BILATERAL RELATIONSHIP WAS MOVING TOWARDS A MORE MATURE BASIS. HE AND MR UNO HAD AGREED ON THE NEED TO DEVELOP A NEW DYNAMIC, PLAIN-SPEAKING PARTNERSHIP. TAKESHITA SAID THAT ''DYNAMIC PARTNERSHIP'' WAS ALREADY BECOMING A CATCHPHRASE IN TOKYO AS A RESULT OF THE SECRETARY OF STATE'S PRESS CONFERENCES.

5. THE SECRETARY OF STATE SAID THAT TAKESHITA'S FORTHCOMING VISIT TO THE UNITED STATES WAS OF GREAT IMPORTANCE AND HE HAD OUR GOOD WISHES. THE GOOD MANAGEMENT OF THE TRIANGULAR RELATIONSHIP BETWEEN EUROPE, JAPAN AND THE UNITED STATES WAS CRUCIAL. TAKESHITA AGREED. THE PRESERVATION OF HARMONY BETWEEN THE THREE BLOCS WHICH TOGETHER MAKE UP 60% OF THE WORLD'S GNP WAS A VITAL OBJECTIVE.

6. HE ALSO INTENDED TO DISCUSS THE INF AGREEMENT AND EAST/WEST RELATIONS WITH PRESIDENT REAGAN. HE RECALLED THAT JAPAN HAD MADE IT CLEAR AT WILLIAMSBURG THAT THEY WOULD ACT IN CONCERT WITH THE WESTERN ALLIANCE: THAT WOULD BE HIS STARTING POINT FOR HIS DISCUSSION. THERE WAS SOME TENDENCY IN JAPANESE PUBLIC OPINION TO THINK THAT DETENTE HAD ARRIVED AGAIN, AND HE TOOK EVERY OPPORTUNITY TO URGE REALISM.

7. THE SECRETARY OF STATE SAID THAT THE INF AGREEMENT WAS AN IMPORTANT STEP, BUT IT WAS VERY IMPORTANT TO KEEP A LONG TERM PERSPECTIVE. THERE WOULD BE MANY UPS AND DOWNS AND WE NEEDED TO KEEP OUR COOL.

8. ON ECONOMIC QUESTIONS, THE UNITED STATES HAD MADE A START ON TACKLING THE FEDERAL BUDGET DEFICIT, BUT THE OTHER DEVELOPED COUNTRIES WOULD NEED TO MANAGE THEIR OWN ECONOMIES WELL IF WE WERE TO SUSTAIN US EFFORTS IN THIS DIRECTION. WE WOULD HAVE TO WORK HARD TO HEAD OFF PROTECTIONISM. JAPANESE MEASURES TO ACHIEVE DEMAND-LED EXPANSION WERE EXTREMELY IMPORTANT AND NEEDED TO BE KEPT UP. TAKESHITA OBSERVED THAT THE PRIVATISATION OF DOMESTIC COMMUNICATIONS HAD BEEN A GREAT HELP IN PROVIDING THE REVENUE FOR JAPANESE DEMAND STIMULUS. JAPAN WAS BEGINNING TO REAP THE BENEFIT OF THIS. THE SECRETARY OF STATE SAID THAT THE NEXT STAGES OF TAX REFORM IN JAPAN WERE EXTREMELY IMPORTANT. WE LOOKED FORWARD TO A MOVE TO A BROADLY BASED SALES TAX WHICH WOULD HELP EXPAND THE JAPANESE ECONOMY.

9. THE SECRETARY OF STATE STRESSED THE CHALLENGE OF DEALING WITH

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AGRICULTURAL PROTECTIONISM AND SURPLUSES, ESPECIALLY IN THE
CONTEXT OF THE GATT ROUND. TAKESHITA SAID THAT HE HAD SPOKEN TO
THOSE RESPONSIBLE FOR AGRICULTURE IN HIS OWN PARTY EARLIER THE
SAME MORNING FOLLOWING A MASS MEETING OF INTERESTS OPPOSED TO
AGRICULTURAL REFORM. HE HAD REPEATED THAT JAPAN, AS THE GREATEST
BENEFICIARY OF THE FREE ECONOMIC SYSTEM, WOULD HAVE TO ENDURE
A CERTAIN AMOUNT OF PAIN IN SUPPORT OF THAT SYSTEM, AND HE HAD
ASKED HIS LDP SPOKESMAN TO PLAN SOME SPEECHES IN THAT SENSE.

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MY TELNOS 19 AND 20: JAPANESE PRIME MINISTER'S VISIT TO THE UNITED STATES

1. SUMMARY

TAKESHITA'S AIM IS TO ESTABLISH A GOOD RELATIONSHIP WITH PRESIDENT REAGAN AND THE U S ADMINISTRATION AND TO INTRODUCE GREATER STABILITY INTO THE US-JAPAN RELATIONSHIP. HE WILL SEEK TO SHOW THAT JAPAN IS ALREADY CONTRIBUTING SUBSTANTIALLY TO THE WORLD ECONOMY AND STABILITY, IN ACCORDANCE WITH JOINTLY DEFINED GOALS. JAPANESE CONCESSIONS LIKELY ON CONSTRUCTION PROJECTS D AGRICULTURAL ITEMS. DIFFICULT HAND FOR TAKESHITA TO PLAY DOMESTICALLY.

DETAIL

2. FOREIGN MINISTER UNO DEPARTS TODAY FOR TALKS WITH SHULTZ IN ADVANCE OF PRIME MINISTER TAKESHITA'S MEETING WITH PRESIDENT REAGAN ON 13 JANUARY. THE VISIT IS SEEN HERE AS A DIFFICULT TEST OF WHETHER TAKESHITA CAN ACHIEVE A PERSONAL RELATIONSHIP WITH AMERICAN LEADERS AKIN TO THAT OF HIS PREDECESSOR AS WELL AS COPE WITH AMERICAN CRITICS OF JAPAN'S CONTINUING TRADE IMBALANCE.

3. THE MFA REGARD THE PRIME OBJECTIVE AS BEING TO DEMONSTRATE THAT PERSONAL COOPERATION BETWEEN THE TWO HEADS OF GOVERNMENT CAN BE EFFECTIVE IN SOLVING PROBLEMS IN THE BILATERAL RELATIONSHIP AND IN THE WORLD ECONOMY. TAKESHITA WILL STRESS THAT US-JAPAN RELATIONS ARE HIS GOVERNMENT'S FIRST DIPLOMATIC PRIORITY, AND THAT THEIR BILATERAL COOPERATION IS VITAL TO THE FUTURE OF THE WORLD ECONOMY. HE WILL EMPHASISE, AS UNO DID IN OUR OWN BILATERAL TALKS TODAY, JAPAN'S CONTRIBUTION TO THE WORLD ECONOMY THROUGH STIMULATION OF DOMESTIC DEMAND, INCREASE OF IMPORTS AND GROWING AID PROGRAMME. HOWEVER THE JAPANESE WILL STRESS THE NEED FOR CONTINUING U S EFFORTS TO REDUCE THEIR OWN BUDGET DEFICIT.

4. TAKESHITA WILL GIVE STRONG SUPPORT TO REAGAN'S EAST-WEST AND ARMS CONTROL POLICIES, INCLUDING HIS ATTITUDE TOWARDS HUMAN RIGHTS IN THE SOVIET UNION AND AFGHANISTAN. WHILE HOPING FOR EARLY

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ENTRY INFO FORCE OF THE INF TREATY, THEY WILL REPORTEDLY REGISTER JAPAN'S INTEREST IN CLOSE CONSULTATION ON SLCMS IN THE CONTEXT OF NEGOTIATION ON STRATEGIC ARMS REDUCTION. AS A GESTURE OF INDIRECT SUPPORT FOR THE ACTIVITIES IN THE GULF, JAPAN WILL OFFER TO ASSUME THE FULL BURDEN OF PAYMENT OF ALLOWANCES (OTHER THAN SALARY) TO JAPANESE EMPLOYEES IN THE MILITARY INSTALLATIONS IN JAPAN.

5. UNO'S PRIMARY REMIT SEEMS TO BE TO PAVE THE WAY FOR AGREEMENT IN PRINCIPLE ON BILATERAL TRADE PROBLEMS. THE JAPANESE ARE LIKELY TO FLOAT A PROPOSAL WHEREBY US (AND, THE MFA ASSURE US, OTHER FOREIGN COMPANIES) WILL BE PERMITTED TO PARTICIPATE UNDER NORMAL JAPANESE DESIGNATED BIDDING PROCEDURES IN CERTAIN SPECIFIED MAJOR PUBLIC WORKS PROJECTS. THEY ARE LIKELY TO INDICATE PREPAREDNESS TO ACCEPT NEXT MONTH THE GATT RULING ON 12 AGRICULTUARL ITEMS, ALTHOUGH DOMESTIC INTERESTS HAVE STILL TO BE WON ROUND AND THEY MAY PROPOSE DEROGATIONS ON COMPENSATORY MEASURES IN THE CASE OF STARCH AND PROCESSED MILK PRODUCTS.

6. OVERALL THE JAPANESE, AND PROBABLY THE AMERICAN ADMINISTRATION'S INTEREST WILL BE IN ENSURING AN ATMOSPHERIC SUCCESS ON WHICH BOTH SIDES CAN BUILD LATER, BUT CLEARLY TAKESHITA WILL HAVE TO CONCEDE SOMETHING ON SENSITIVE DOMESTIC ITEMS IN ORDER TO WIN THIS AND SATISFY CONGRESS. A FURTHER TEST FOR TAKESHITA ON HIS RETURN WILL BE TO SHOW DOMESTIC CONSTITUENCIES THAT HE HAS NOT PAID TOO HIGH A PRICE.

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UK/JAPAN FOREIGN MINISTERIAL TALKS: 11 JANUARY: WORLD ECONOMY

SUMMARY

1. UNO AGREED ON NEED TO WORK TOGETHER IN TACKLING WORLD ECONOMIC PROBLEMS. HE WAS CONCERNED TO DEFEND THE CURRENT JAPANESE CONTRIBUTION. THE SECRETARY OF STATE PRESSED FOR CONTINUING EFFORTS BY JAPAN.

DETAIL

2. UNO AGREED THAT THE WORLD ECONOMIC SITUATION REQUIRED COUNTRIES TO MAKE SACRIFICES IN THE INTERESTS OF ADJUSTMENT AND THAT THE FIRST REQUIREMENT WAS CONTINUED EFFORT BY THE US TO CONTROL ITS BUDGET DEFICIT. HE STRESSED THE CONTRIBUTION WHICH JAPAN WAS MAKING: THE RESTRUCTURING OF THE JAPANESE ECONOMY WITH MORE EMPHASIS ON DOMESTIC DEMAND, GROWING IMPORTS, EXPANSIONARY BUDGET FOR FY 1988, INCREASE IN ODA. THESE HAD BEEN WELL RECEIVED BY THE AMERICANS AND OTHERS. HE NOTED THAT US BONDS WERE LARGELY PURCHASED BY THE PRIVATE SECTOR IN JAPAN, AND THAT THE JAPANESE GOVERNMENT DID NOT HAVE MUCH INFLUENCE ON THE PROCESS.

3. THE SECRETARY OF STATE WELCOMED WHAT JAPAN HAD ALREADY DONE: NEVERTHELESS SUSTAINED EFFORTS WERE NEEDED TO LIBERALISE HER MARKETS AND INCREASE HER CAPACITY TO IMPORT, SO AS TO REDUCE THE CURRENT ACCOUNT SURPLUS. EVEN SO THE SURPLUS WOULD CONTINUE TO BE UNCOMFORTABLY LARGE, HELPED BY GREATER INVESTMENT EARNINGS. UNO ARGUED THAT MOST OF JAPANESE COMPANIES' EARNINGS OVERSEAS WERE RE-INVESTED LOCALLY AND THAT JAPANESE SURPLUSES ON FINANCIAL SERVICES AND GOODS WERE BASICALLY DUE TO THEIR DEVELOPMENT OF COMPETITIVE PRODUCTS. JAPAN'S VERY HIGH SAVINGS RATIO HAD ENABLED JAPAN TO FINANCE THE US DEFICIT.

4. THE SECRETARY OF STATE SOUGHT SUPPORT FOR THE CHANCELLOR'S INITIATIVE ON SUB-SAHARAN DEBT. THE UK AND JAPAN COULD WORK TOGETHER IN TACKLING THIRD WORLD DEBT, ON ENCOURAGING DISCIPLINE BY DEBTORS (IMF CONDITIONALITY) AND IN REDUCING AGRICULTURAL

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SURPLUSES. HE GAVE SUGAR AS AN EXAMPLE OF UNECONOMIC PRODUCTION IN THE COMMUNITY AND JAPAN THWARTING THE INTERESTS OF THE LDCS AND, IN JAPAN'S CASE, THE FREEING OF LAND FOR DOMESTIC DEVELOPMENT. THE FORMER WAS POLITICALLY DANGEROUS: TO GIVE ONE EXAMPLE IT MIGHT WELL BE HELPING THE COMMUNIST OPPOSITION TO MRS AQUINO IN THE PHILIPPINES.

5. MR UNO AGREED THAT OUR TWO COUNTRIES SHOULD KEEP IN CLOSE TOUCH ON THESE ISSUES. FOR SUB-SAHARAN AFRICA AND OTHER LESS-DEVELOPED COUNTRIES. JAPAN WAS ALREADY ALLOCATING DOLLARS 500 MILLION IN GRANT AID. WE SHOULD DISCUSS CONDITIONS FOR LOANS IN THE PARIS CLUB. HE AGREED ON THE IMPORTANCE OF DISCOURAGING PROTECTIONISM BY THE NICS BUT SAID THAT JAPAN HAD TO GIVE SOME CONSIDERATION TO THEM AS A MEMBER OF THE ASIAN PACIFIC COMMUNITY. HE ACCEPTED THAT JAPAN SHOULD QUICKEN THE PACE OF LIBERALISATION OF HER AGRICULTURAL MARKETS. THERE WERE DIFFERENCES BETWEEN THE JAPANESE AND EUROPEAN APPROACHES: JAPAN THOUGHT THE FIRST STAGE SHOULD BE TO ELIMINATE EXPORT SUBSIDIES, BUT SHE WAS PREPARED TO DISCUSS OTHER THINGS IN THE GATT. GIVEN WORLD SURPLUSES, HE WAS URGING JAPANESE FARMERS TO CREATE NEW DEMAND BY THE DEVELOPMENT OF NEW AGRICULTURAL PRODUCTS. THE SECRETARY OF STATE SAID THE KINDS OF SUBSIDY WHICH JAPAN OPERATED WERE NO LESS DISTORTING THAN EXPORT SUBSIDIES.

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UK/JAPAN FOREIGN MINISTERIAL TALKS 11 JANUARY

1. THE SECRETARY OF STATE HELD FOUR AND A HALF HOURS OF TALKS WITH FOREIGN MINISTER UNO ON 11 JANUARY. MY 5 IFTS COVER DISCUSSION OF THE MANAGEMENT OF THE WORLD ECONOMY, EAST/WEST RELATIONS, THE GULF, ASIA AND BILATERAL POLITICAL AND ECONOMIC RELATIONS.

2. THE SECRETARY OF STATE PROPOSED THAT THESE TALKS SHOULD MARK THE OPENING OF A NEW ERA OF A DYNAMIC, PLAIN SPEAKING PARTNERSHIP BETWEEN THE UK AND JAPAN. IN HIS VIEW, IN THE PAST THE SCOPE FOR SERIOUS DISCUSSION AND BILATERAL COOPERATION HAD NOT BEEN FULLY EXPLOITED. FOREIGN MINISTER UNO SHOWED SOME ENTHUSIASM FOR THIS GENERAL CONCEPT, STRESSING THAT FOR HISTORICAL AND OTHER REASONS THE UK OUGHT TO PLAY A PARTICULARLY IMPORTANT ROLE IN STRENGTHENING THE DIALOGUE BETWEEN JAPAN AND EUROPE. UNO SPOKE WITH GREATER ANIMATION AND CONFIDENCE THAN HIS RECENT PREDECESSORS. HE SHOWED HIMSELF TO BE WELL BRIEFED, DESPITE HIS SHORT PERIOD IN OFFICE, AND READY TO DEBATE ISSUES IN AN OPEN WAY. HE RESPONDED QUICKLY AND FLUENTLY TO THE SECRETARY OF STATE'S QUESTIONS AND COMMENTS.

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UK/JAPAN FOREIGN MINISTERIAL TALKS: 11 JANUARY: BILATERAL
RELATIONS

SUMMARY

1. AGREEMENT ON NEED FOR MORE REGULAR MINISTERIAL, OFFICIAL AND PRIVATE SECTOR CONTACTS. RECENT IMPROVEMENT IN RELATIONS NOTED BY BOTH SIDES. JAPAN UNDERTOOK TO PROVIDE DETAILED PROPOSALS ON WHISKY BEFORE TORONTO SUMMIT. TAKESHITA HOPED TO VISIT UK BEFORE THE SUMMIT.

DETAIL

2. THE SECRETARY OF STATE SPOKE OF THE NEED IN OUR BILATERAL RELATIONS TO SUSTAIN THE HABIT OF DYNAMIC, PLAIN-SPEAKING - WITHOUT HECTORING AND WITHOUT ANY SOFT SOAP. THERE SHOULD BE MORE REGULAR CONTACTS AT THREE LEVELS:

(A) MINISTERIAL (ANNUAL MEETINGS OF FOREIGN MINISTERS. OTHER MINISTERS EG TAMURA AND LORD YOUNG, PERHAPS AGRICULTURE)

(B) OFFICIALS (PUS/VICE MINISTERS IN BETWEEN MEETINGS OF FOREIGN MINISTERS, ECONOMIC DIRECTORS, OFFICIALS IN CHARGE OF REGIONAL ISSUES, VICE MINISTERS OF FINANCE ETC), AND

(C) PRIVATE (BUSINESSMEN, PARLIAMENTARIANS, YOUTH EXCHANGES, 2000 GROUP, TEACHERS OF ENGLISH AND JAPANESE).

WE WOULD LIKE TO SEE TAKESHITA IN THE UK BEFORE THE TORONTO SUMMIT.

3. THE QUESTIONS OF TOKYO STOCK EXCHANGE (TSE) MEMBERSHIP AND CABLE AND WIRELESS HAD BEEN GOOD EXAMPLES OF HOW NOT TO TACKLE ISSUES AT THE OUTSET. THERE HAD BEEN SATISFACTORY OUTCOMES BUT AT THE COST OF A LOT OF HIGH LEVEL DAMAGE. ALL QUALIFIED COMPANIES SHOULD BE GIVEN SEATS ON THE TSE, INCLUDING BARCLAYS AND JAMES

CAPEL. THE WHISKY ISSUE HAD GONE ON TOO LONG. IT WAS IMPORTANT TO BRING FORWARD DETAILED CHANGES SOON.

4. UNO AGREED ENTHUSIASTICALLY ON THE NEED FOR REGULAR CONTACTS AT ALL LEVELS. UK/JAPAN RELATIONS HAD IMPROVED: HE HOPED THEY COULD BE SEEN AS A MODEL FOR OTHER BILATERAL RELATIONSHIPS. HE RECOGNISED THAT JAPAN HAD A BAD REPUTATION FOR ACTING ONLY AFTER REPEATED CRITICISM. HIS INTENTION AS FOREIGN MINISTER WAS TO ACT BEFORE JAPAN WAS CRITICISED. HE SAID THERE WOULD BE A DETAILED REPLY TO OUR CONCERNS ON WHISKY BEFORE THE TORONTO SUMMIT. UNO HOPED THAT TAKESHITA COULD SUCCEED IN HIS WISH TO VISITING EUROPE BEFORE THE SUMMIT, PARLIAMENTARY SCHEDULES AND OTHER FACTORS PERMITTING.

5. UNO ASKED FOR UK'S HELP ON THE QUESTION OF ANTI-DUMPING ACTION AGAINST COMPONENTS IN THE COMMUNITY. THE UK WAS THE MAJOR RECIPIENT OF JAPANESE INVESTMENT IN THE COMMUNITY, AND JAPAN THEREFORE LOOKED TO US TO TAKE A SYMPATHETIC POSITION. THE SECRETARY OF STATE SAID THAT IT WAS IN THE INTERESTS OF INWARD INVESTMENT TO DISPOSE OF ALLEGATIONS OF QUOTE SCREWDRIVER OPERATIONS UNQUOTE. WE WANTED TO HELP COMPANIES TO ACHIEVE GOOD INVESTMENT. WHERE THERE WAS NO DUMPING, WE WOULD CERTAINLY HELP TO SEE THAT PROBLEMS DID NOT ARISE. WE WELCOMED THE EFFORTS OF COMPANIES SUCH AS KOMATSU TO INCREASE LOCAL CONTENT.

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UK/JAPAN FOREIGN MINISTERIAL TALKS: 11 JANUARY: ASIA

SUMMARY

1. A GENERAL ROUND UP ON ASIAN QUESTIONS. FOREIGN MINISTER UNO SCEPTICAL ABOUT WISH OF VIETNAMESE REFUGEES IN HONG KONG TO GO TO JAPAN, BUT WISHING TO HELP AS MUCH AS POSSIBLE.

DETAIL

2. DURING DISCUSSION ON ASIA AT THE UK/JAPAN FOREIGN MINISTERIAL TALKS ON 11 JANUARY, FOREIGN MINISTER UNO GAVE A GENERAL OVER-VIEW OF JAPAN'S PERCEPTIONS OF ASIA. THE JAPANESE WELCOMED CONTINUED CHINESE PROGRESS TOWARDS ECONOMIC MODERNISATION AND SOUTH KOREA'S MOVES TOWARDS A MORE DEMOCRATIC SYSTEM OF GOVERNMENT WITH THE CONVINCING ELECTION OF ROH TAE WOO. JAPAN WOULD CONTINUE TO SUPPORT AND ENCOURAGE SUCH POSITIVE DEVELOPMENTS IN THE REGION, WHICH HELPED MAINTAIN THE STRATEGIC BALANCE AND OFFSET SOVIET ATTEMPTS AT ENCROACHMENT.

3. SIMILARLY WITH ASEAN, JAPAN WOULD CONTINUE TO SUPPORT STEADY ECONOMIC DEVELOPMENT. UNO ALSO PLEDGED CONTINUED SUPPORT FOR PRESIDENT AQUINO.

4. THE SECRETARY OF STATE STRESSED THE NEED TO ASSIST IN THE ECONOMIC DEVELOPMENT OF ASEAN, PARTICULARLY IN THE PROVISION OF INVESTMENT CAPITAL, WHICH WOULD CREATE A BASE FOR STABLE POLITICAL DEVELOPMENT. WITHIN THE EC, THE UK HAD BEEN ACTIVE IN HELPING ASEAN BY ARGUING EG AGAINST THE INTRODUCTION OF AN OILS AND FATS TAX.

5. IN HONG KONG WE WERE PARTICULARLY CONCERNED ABOUT THE RISING NUMBERS OF VIETNAMESE REFUGEES IN CAMPS, AND URGED JAPAN TO DO MORE THAN HITHERTO TO RE-SETTLE AS MANY REFUGEES AS POSSIBLE. UNO SAID THAT JAPAN HAS RECEIVED FEW APPLICATIONS FROM THE

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REFUGEES WHO SEEMED TO PREFER OTHER DESTINATIONS, BUT THEY WOULD TRY TO TAKE AS MANY AS POSSIBLE.

6. ON THE SOUTH PACIFIC, THE SECRETARY OF STATE AND FOREIGN MINISTER UNO AGREED THAT OFFICIALS SHOULD KEEP IN CLOSE TOUCH, PARTICULARLY BECAUSE OF THE SIGNS OF SOVIET AND LIBYAN ENCROACHMENT IN THE REGION.

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FROM PRIVATE SECRETARY

SECRETARY OF STATE'S CALL ON JAPANESE FINANCE MINISTER

SUMMARY

GENERAL DISCUSSION OF MANAGEMENT OF WORLD ECONOMY. MIYAZAWA WORRIED BY AMERICAN FAILURE TO APPRECIATE THE EXTENT OF THEIR PROBLEMS ACKNOWLEDGES NEED FOR JAPAN AND OTHERS TO TAKE UP ANY SLACK ENGENDERED BY RECESSION IN THE U S. BUT LESS BULLISH IN AGRICULTURAL REFORM. MIYAZAWA SPOKE RATHER FRANKLY ABOUT THE AMERICANS AND HIS CONFIDENCE SHOULD BE RESPECTED.

2. THERE WAS A BRIEF DISCUSSION OF EAST-WEST RELATIONS. IT WAS AGREED THAT EVEN IF THE RUSSIANS WERE ABLE TO PASS TWO OF THE 'LITMUS TESTS': VERIFICATION, AND AFGHANISTAN, THE THIRD, HUMAN RIGHTS, WAS LIKELY TO REMAIN EXTREMELY DIFFICULT. MIYAZAWA WAS SCEPTICAL AS TO WHETHER MR GORBACHEV COULD IDEOLOGICALLY EVER TURN INTO A HUMANIST. HE ALSO BELIEVED THAT ONLY AN OPEN SOCIETY COULD BRING THE KIND OF OPEN ECONOMY WHICH MR GORBACHEV WANTED, AND THAT HE WAS THEREFORE NOT LIKELY TO ACHIEVE THE LATTER. THE SECRETARY OF STATE AGREED THAT IT WOULD BE A VERY DIFFICULT TASK: ON THE WHOLE WE BELIEVED IT WOULD BE BENEFICIAL IF HE MADE SOME PROGRESS IN THAT DIRECTION. IT WAS COMFORTING THAT THE WHOLE PROCESS TENDED TO CONFIRM THAT THE WESTERN SYSTEM WAS BASICALLY RIGHT. MIYAZAWA ASKED IF THERE WAS ANY PROSPECT OF CHINA OR THE SOVIET UNION ABANDONING MARXISM OR LENINISM IN THE END. THE SECRETARY OF STATE SAID THAT HE THOUGHT IT WENT DEEPER IN RUSSIA THAN CHINA. MIYAZAWA SAID THAT HE THOUGHT THERE WAS A CLEAR RISK OF EVENTUAL TURBULENCE IN THE SOVIET UNION.

3. ASKED ABOUT WORLD ECONOMY MIYAZAWA SAID THAT HE WISHED THE U S ELECTION COULD BE SOONER. WE DESPERATELY NEEDED A STRONG FIGURE IN CHARGE OF THE US ECONOMY. THE PSYCHOLOGICAL EFFECT OF WEAK LEADERSHIP WAS DISASTROUS ON WALL STREET AND THROUGH IT ON OTHER MARKETS. THE SECRETARY OF STATE SAID THAT HE HAD LONG ARGUED THAT

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THE AMERICANS MUST DO SOMETHING ABOUT THEIR TWIN DEFICITS. THE HUGE GROWTH OF THE U S OVERSEAS DEBT WOULD EVENTUALLY BRING A SERIOUS BURDEN OF INTEREST PAYMENT. THE AMERICANS HAD MOVED A LITTLE AT THE END OF THE YEAR, AND THAT WAS REALISTICALLY ALL THAT WAS LIKELY TO HAPPEN BEFORE THE ELECTION. JAPAN AND EUROPE HAD THE DIFFICULT TASK OF SUPPORTING THE WORLD ECONOMY IN THE MEANTIME. WE THEREFORE PLACED ENORMOUS IMPORTANCE ON JAPANESE DEMAND-LED EXPANSION. AT THE SAME TIME JAPAN SEEMED TO HAVE TO FINANCE THE U S DEFICIT.

4. MIYAZAWA SAID THAT THE ORDINARY US CITIZEN WAS ALMOST UNAWARE OF THE PROBLEM. THE AMERICAN ECONOMIC POSITION HAD BEEN SO STRONG THAT THEY SEEMED TO THINK THAT THEY COULD GO ON SOLVING THEIR PROBLEMS BY PRINTING PAPER INDEFINITELY. IT WAS VERY DIFFICULT TO GET ACROSS TO THEM THE DANGER THEY WERE RUNNING. THE SECRETARY OF STATE AGREED. IT WAS VITAL THAT THE NEW PRESIDENT SHOULD HAVE ROOM TO TAKE DECISIVE ACTION. MEANWHILE THE REST OF THE WORLD NEEDED TO SUSTAIN THE CONFIDENCE OF THE GLOBAL ECONOMY: THE JAPANESE BUDGETARY POSITION WOULD BE VITAL TO THIS. MIYAZAWA ACKNOWLEDGED THE NEED TO TAKE UP ANY SLACK ENGENDERED BY A US RECESSION: HE NOTED THAT JAPAN FORTUNATELY HAD SUCH A POOR INFRASTRUCTURE THAT THERE WAS SCOPE TO INJECT FINANCE INTO IT. HE RECOGNISED THAT IT WAS MORE DIFFICULT TO FIND WAYS OF DOING SO IN EUROPE. THE SECRETARY OF STATE SAID THAT HE WAS NOT SURE THAT THE BRITISH ELECTORATE WOULD ENTIRELY AGREE. BUT IT WAS TRUE THAT THE JAPANESE PER CAPITA GDP WAS NOT YET REFLECTED IN THE JAPANESE INFRASTRUCTURE.

5. THE SECRETARY OF STATE SAID THAT REFORM OF AGRICULTURAL PROTECTIONISM WAS VERY IMPORTANT. IT WOULD ENABLE JAPAN TO LIBERATE MORE LAND FOR BUILDING AND BRING LAND PRICES DOWN. WE WERE TACKLING SURPLUSES IN EUROPE: THIS WAS AS DIFFICULT FOR THE CONSERVATIVE PARTY AS IT WAS FOR THE LDP IN JAPAN. MIYAZAWA SAID THAT THERE WAS NO ENTHUSIASM IN THE FARMING COMMUNITY FOR CHANGING THE LAND USE PATTERN. THE SECRETARY OF STATE SAID THAT NEVERTHELESS THESE POLITICAL DIFFICULTIES NEEDED TO BE OVERCOME ALONG THE LINES OF THE TOKYO SUMMIT COMMITMENT. HE QUOTED THE EXAMPLE OF THE EFFECT ON THE PHILIPPINES OF JAPANESE PROTECTION OF SUGAR PRODUCERS. MIYAZAWA AGREED GENERALLY, BUT RICE PRODUCTION MIGHT HAVE TO BE THE EXCEPTION, JAPANESE FARMERS HAD BEEN TOLD TO SET ASIDE ONE THIRD OF THEIR PADDY FOR OTHER PRODUCE BUT IT WAS DIFFICULT TO FIND SUITABLE PRODUCTS. THE AMERICANS IN ANY CASE HAD NO CAUSE THEMSELVES TO COMPLAIN ABOUT JAPANESE RICE PRICES. THE SECRETARY OF STATE SAID THAT ALL SUCH PROBLEMS WERE RELATED. IF THE LDC'S WERE TO IMPROVE THEIR ECONOMICS THEY HAD NO EXPORT.

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IT WAS A DIFFICULT PROBLEM TO EVERYBODY BUT WE HAD TO KEEP UP WITH THE AGENDA. IT WAS ONLY BY STANDING TOGETHER THAT WE COULD WORK OUT OUR PROBLEMS.

6. MIYAZAWA SAID THAT THERE WAS A FEELING IN JAPAN THAT AGRICULTURE WAS SOMEHOW SACRED AND SHOULD BE AN EXCEPTION TO THE NORMAL RULES. WAS THIS NOT SHARED IN THE UK? THE SECRETARY OF STATE SAID THAT IT WAS IN FARMING CIRCLES BUT THERE WAS GENERAL PUBLIC CONCERN ABOUT THE ENVIRONMENT AND WE WERE LOOKING FOR ALTERNATIVE USES OF THE COUNTRYSIDE: AN EXAMPLE MIGHT BE THE PROVISION OF EXTRA GOLF COURSES WHICH INCREASED EMPLOYMENT. MIYAZAWA SAID THAT THE LDP HAD SO FAR SIGNALLY FAILED TO FIND ALTERNATIVE USES. THE SECRETARY OF STATE SAID IT WAS BETTER TO PAY FOR THE PROTECTION OF THE ENVIRONMENT THAN FOR SURPLUSES. WE SHOULD ASK OURSELVES WHAT WOULD HAPPEN IF THE SOVIET UNION SOLVED HER AGRICULTURAL PROBLEMS.

7. THE SECRETARY OF STATE ASKED IF MIYAZAWA THOUGHT THE WORLD COULD GET BY WITHOUT A RECESSION. MIYAZAWA SAID THAT HE THOUGHT THAT WE WOULD PROBABLY MUDDLE THROUGH WITH DIFFICULTY BUT THERE WOULD BE PLENTY OF SHOCKS AHEAD. THE PLAZA AND LOUVRE AGREEMENTS WERE A STEP IN THE RIGHT DIRECTION. HE WONDERED HOW THE PROCESS OF COOPERATION IN ECONOMIC MANAGEMENT COULD BE TAKEN FORWARD. THE SECRETARY OF STATE THOUGHT THAT WE HAD TO CONTINUE TO GROPE FOR A CONCERTED APPROACH TO ECONOMIC STABILITY. THERE SHOULD BE A CONCERTED INSIGHT BY THE TOP LEADERS. IT WOULD HELP IF INDIVIDUAL COUNTRIES WERE THEMSELVES TAKING COURAGEOUS STEPS IN THE RIGHT DIRECTION: THE PROSPECTIVE JAPANESE MOVE TO A SALES TAX WAS IMPORTANT. AND WE NEED TO GET OVER TO THE AMERICANS THAT THEY COULD NOT WALK TALL FOR EVER ON BORROWED MONEY. MIYAZAWA SAID THAT HE DOUBTED INDEED WHETHER THE DEUTSCHMARK AND THE YEN COULD SUSTAIN THE DOLLAR INDEFINITELY.

8. MIYAZAWA SAID THAT HE WAS STRUCK BY OUR EVIDENT FEAR OF A GROWTH IN PROTECTIONISM. THE SECRETARY OF STATE SAID THE SOME JAPANESE ATTITUDES HAD AN IMPORTANT PSYCHOLOGICAL EFFECT. TAXATION ON LIQUOR WAS A GOOD EXAMPLE. HE WAS GLAD THAT JAPAN HAD ACCEPTED THE GATT REPORT AND HOPED THEY WOULD NOW MOVE QUICKLY. IT WAS IMPORTANT THAT JAPAN SHOULD CONSULT THE COMMISSION ABOUT MEASURES IT PROPOSED TO TAKE. MIYAZAWA ASKED HIS AIDE TO TAKE A NOTE OF THIS. THE SECRETARY OF STATE WENT ON TO COMMENT ON THE HUGE SCALE OF JAPANESE ACTIVITY IN THE LONDON FINANCIAL MARKETS. WE HOPED THAT THIS WOULD BE RECIPROCATED IN TOKYO: HE MENTIONED THE WISH OF BARCLAYS AND CAPEL TO

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PARTICIPATE IN THE TOKYO STOCK EXCHANGE. MIYAZAWA SAID THAT THE ONLY REASON FOR FAILURE TO LICENSE BARCLAYS HAD BEEN THE SHORT EXPERIENCE WHICH THEY HAD HAD IN OPERATIONS IN TOKYO. THE SECRETARY OF STATE SAID THAT THEY HAD HUNDREDS OF YEARS OF EXPERIENCE ELSEWHERE.

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TAKESHITA'S VISIT TO WASHINGTON: JOINT ECONOMIC STATEMENT

1. TAKESHITA HAD TALKS AND LUNCH AT THE WHITE HOUSE ON 13 JANUARY WITH PRESIDENT REAGAN. AT THE CONCLUSION OF THIS SESSION THEY RELEASED A JOINT STATEMENT ON ECONOMIC ISSUES. TEXT IN MIFT.
2. WE HAVE DISCUSSED THE FINAL SENTENCE WITH CONTACTS AT TREASURY AND THE FED. THE SENTENCE IS INTENDED TO REFER TO TWO THINGS. FIRST TO THE EXISTING DOLLARS 5 BILLION SWAP ARRANGEMENT BETWEEN THE FED AND THE BANK OF JAPAN. THE REFERENCE IS DESIGNED TO REMIND THE MARKETS THAT THIS EXISTING FACILITY IS AVAILABLE TO REINFORCE THE RESOURCES AVAILABLE TO THE US FOR INTERVENTION. IT IS NOT INTENDED AS A HINT THAT THE SWAP WILL SHORTLY BE ACTIVATED.
3. SECONDLY, THE STATEMENT IS A REFERENCE TO A CONTINGENCY PLAN WHEREBY THE US HOLDING OF SDRS (WHICH WE WERE TOLD ARE WORTH DOLLARS 10 BILLION) COULD, IF NECESSARY BE SWAPPED INTO YEN ALSO TO REINFORCE RESOURCES FOR INTERVENTION.
4. FCO PLEASE ADVANCE TO PS/CHANCELLOR AND LITTLER (TREASURY) AND LOEHNIS (BANK).
5. SEE MIFT.

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MIPT: TAKESHITA'S VISIT TO WASHINGTON: JOINT ECONOMIC STATEMENT
1. FOLLOWING IS THE TEXT OF THE JOINT STATEMENT ISSUED ON 13
JANUARY:

PRESIDENT REAGAN AND PRIME MINISTER TAKESHITA REAFFIRMED THEIR SUPPORT FOR THE ECONOMIC POLICY COORDINATION PROCESS ADOPTED AT THE TOKYO AND VENICE SUMMITS. THE PRESIDENT AND PRIME MINISTER ENDORSED THE ECONOMIC GOALS AND POLICIES SET FORTH IN THE DECEMBER 22 STATEMENT OF THE G-7. THEY AGREED THAT THE ACHIEVEMENT OF SUSTAINED NON-INFLATIONARY GROWTH AND REDUCED TRADE IMBALANCES REMAINS A TOP PRIORITY OF THEIR ECONOMIC POLICIES. THEY WELCOMED THE RECENT ACTIONS OF OTHER INDUSTRIAL COUNTRIES IN SUPPORT OF THESE OBJECTIVES, AND CALLED ON THE NEWLY INDUSTRIALISED ECONOMIES TO PLAY A MORE CONSTRUCTIVE ROLE IN FOSTERING A STRONG WORLD ECONOMY WITH REDUCED EXTERNAL IMBALANCES.

THE PRESIDENT STRESSED HIS DETERMINATION TO CONTINUE THE PROGRESS THAT HAS BEEN MADE IN REDUCING THE US BUDGET DEFICIT. HE INDICATED THAT THE FISCAL 1989 BUDGET TO BE TRANSMITTED TO THE CONGRESS WILL CONTINUE THE EFFORT TO REDUCE THE BUDGET DEFICIT AND WILL MEET THE DEFICIT REDUCTION OBJECTIVES ESTABLISHED IN THE GRAMM-RUDMAN-HOLLINGS BUDGET LEGISLATION. THE PRESIDENT ALSO REITERATED HIS PLEDGE TO VETO PROTECTIONIST TRADE LEGISLATION WHILE SEEKING AUTHORITY FOR THE URUGUAY ROUND OF TRADE NEGOTIATIONS.

PRIME MINISTER TAKESHITA INDICATED THAT JAPAN WILL PURSUE ECONOMIC POLICIES TO CONTINUE ITS STRONG GROWTH IN DOMESTIC DEMAND AND TO REDUCE ITS TRADE SURPLUS. THE PRIME MINISTER REAFFIRMED HIS COMMITMENT TO CARRYING FORWARD STRUCTURAL REFORM OF THE JAPANESE ECONOMY THROUGH IMPLEMENTATION OF THE RECOMMENDATIONS OF THE MAEKAWA REPORT AND BY ACCELERATING LIBERALISATION OF DOMESTIC FINANCIAL MARKETS, INCLUDING DEREGULATION OF DOMESTIC INTEREST RATES. TO ACHIEVE SUSTAINED GROWTH AS WELL AS TO FOSTER EXCHANGE RATE STABILITY, THE BANK OF JAPAN AGREES, UNDER THE PRESENT STABLE PRICE CONDITIONS, TO CONTINUE TO PURSUE THE CURRENT POLICY STANCE AND TO MAKE EFFORTS TO ACCOMMODATE DECLINING SHORT-TERM INTEREST RATES.

THE PRESIDENT AND THE PRIME MINISTER BELIEVE THAT THE CLOSE COORDINATION OF THEIR POLICIES WITHIN THE FRAMEWORK OF THE ARRANGEMENTS ADOPTED BY THE VENICE SUMMIT IS ESTABLISHING THE FUNDAMENTAL ECONOMIC CONDITIONS FOR GREATER STABILITY OF EXCHANGE RATES AND THAT A FURTHER DECLINE OF THE DOLLAR COULD BE COUNTER-PRODUCTIVE. IN ADDITION, THEY NOTED THAT THEIR AUTHORITIES ARE COOPERATING CLOSELY ON EXCHANGE MARKETS AND HAVE DEVELOPED ARRANGEMENTS TO ASSURE THE ADEQUACY OF RESOURCES FOR THEIR COOPERATIVE EFFORTS.

2. FCO PSE ADVANCE TO PS/CHANCELLOR AND LITTLER (TREASURY) AND LOEHNIS (BANK).

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2. FCO PSE ADVANCE TO PS/CHANCELLOR AND LITTLER (TREASURY) AND LOEHNIS (BANK).

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Ch/ I suppose it is possible that Tanaka may raise this this afternoon.

18/1

YOUR TELNO 9 TO TOKYO:

JAPANESE PROPOSAL FOR TRADE MINISTERS TO JOIN THE ECONOMIC SUMMIT

1. DAVID MALONE (DEPUTY DIRECTOR AND ECONOMIC SUMMIT COORDINATOR, INTERNATIONAL ECONOMIC RELATIONS DIVISION, DEPARTMENT OF EXTERNAL AFFAIRS) VOLUNTEERED TO US IN A DISCUSSION ON SUMMIT MATTERS THAT THE JAPANESE AMBASSADOR IN OTTAWA HAD MADE A LOW-KEY DEMARCHE IN FAVOUR OF TRADE MINISTERS TAKING PART IN THE TORONTO ECONOMIC SUMMIT. IT WAS CLEAR, ACCORDING TO MALONE, THAT THE AMBASSADOR'S HEART WAS NOT IN IT. THE CANADIAN REPLY IS LIKELY TO BE DISCOURAGING.

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H.M. TEASURY.

YOUR VISIT TO JAPAN

SUMMARY

1. THIS WAS AN IMPORTANT AND SUCCESSFUL VISIT. OBJECTIVELY THE TIME WAS RIGHT FOR A RADICALLY CHANGED PERSPECTIVE IN ANGLO-JAPANESE RELATIONS: THE DECLINE IN AMERICAN ECONOMIC DOMINANCE, A REVITALISED UNITED KINGDOM IN THE FOREFRONT OF A MORE CONFIDENT AND COHESIVE EUROPE, A JAPAN WHICH WAS PLAYING A LARGER AND MORE CONSTRUCTIVE ROLE IN THE MANAGEMENT OF THE WORLD ECONOMY AND IS MOVING TOWARDS GREATER INVOLVEMENT ON THE WORLD POLITICAL STAGE, COUPLED WITH THE RESOLUTION OR EASING OF MOST OF OUR PRINCIPAL BILATERAL TRADING PROBLEMS.

2. YOU CALLED FOR A DYNAMIC PLAIN-SPEAKING PARTNERSHIP BETWEEN THE UNITED KINGDOM AND JAPAN TO WHICH THE JAPANESE RESPONDED WITH ENTHUSIASM. BOTH SIDES RECOGNISED THAT THIS WOULD INVOLVE A TWIN TACK APPROACH: STRAIGHT SPEAKING ON BILATERAL PROBLEMS PLUS A MORE BROADLY-BASED, SERIOUS AND CONSTRUCTIVE DIALOGUE ON WIDER ECONOMIC AND POLITICAL ISSUES. IT WILL BE IMPORTANT TO BUILD ON THIS MAJOR INITIATIVE BY ENGENDERING A GREATER REFLEX OF CONSULTATION WITH THE JAPANESE AND LOOKING FOR ISSUES ON WHICH WE CAN COOPERATE IN A WIDE VARIETY OF FIELDS.

DETAIL

3. YOUR VISIT TO JAPAN FROM 9 - 13 JANUARY WAS IMPORTANT AND VERY SUCCESSFUL. FORMALLY, YOU CAME HERE FOR THE 17TH ROUND OF POST-WAR FOREIGN MINISTERIAL CONSULTATION. BUT THIS WAS A VISIT WITH A DIFFERENCE: CONTEXT, CONTENT AND BREADTH OF CONTACT ALL REPRESENTED A MAJOR AND SIGNIFICANT CHANGE FROM PREVIOUS OCCASIONS. AS YOU TOLD THE PRESS AT THE END OF YOUR VISIT, IT MARKED THE BEGINNING OF A NEW, DYNAMIC, PLAIN-SPEAKING PARTNERSHIP INTENDED TO TAKE BRITAIN AND JAPAN WELL INTO THE NEXT CENTURY.

4. THE NEW CONTEXT STEMS FROM CHANGES IN JAPAN AS WELL AS IN THE WORLD AT LARGE. IN PAST YEARS IN THE MACRO-ECONOMIC AND POLITICAL FIELDS

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JAPAN'S ACCEPTANCE OF HER INTERNATIONAL RESPONSIBILITIES AS A MAJOR ECONOMIC POWER, PRODUCING ROUGHLY ONE-EIGHTH OF ALL OF THE WORLD'S GOODS AND SERVICES, HAS BEEN PAINFULLY SLOW. IN THE MICRO-ECONOMIC AND TRADING FIELDS CHANGES IN RESTRICTIVE MARKET PRACTICES HAVE ONLY BEEN MADE IN RESPONSE TO EXTERNAL PRESSURE. MORE RECENTLY FORMER PRIME MINISTER NAKASONE CHARTED A MORE RESPONSIBLE AND CONSTRUCTIVE COURSE TO BE FOLLOWED. ENCOURAGINGLY PRIME MINISTER TAKESHITA SHOWED HIMSELF DETERMINED TO FOLLOW THROUGH EVEN AS HE TOLD YOU, AT DOMESTIC POLITICAL COST.

5. THE CHANGES IN THE WORLD AGAINST WHICH YOU VISIT TOOK PLACE CENTRE ON THE WEAKENING OF THE PREDOMINANCE OF THE TWO SUPER-POWERS OUTSIDE THE MILITARY SPHERE. THE JAPANESE ARE INCREASINGLY CONSCIOUS OF THEIR ENHANCED ECONOMIC STATUS. YOU FOUND A COMMON MEASURE OF CONCERN BETWEEN THE UK AND JAPAN ABOUT AMERICAN ECONOMIC POLICY AND STRIKING AGREEMENT, PARTICULARLY FROM FINANCE MINISTER MIYAZAWA, THAT JAPAN SHOULD PLAY HER PART IN STEERING THE WORLD ECONOMY THROUGH A DIFFICULT PERIOD AHEAD. LIKE TAKESHITA HIS CHIEF MESSAGE WAS THAT AGREEMENT AMONG THE LEADING ECONOMIES ON WHAT WAS NECESSARY HAD TO BE FOLLOWED BY ACTION, EVEN AT POLITICAL COST. FACED WITH POTENTIAL UNCERTAINTIES IN THE ECONOMIC POLITICAL AND EVEN DEFENCE FIELDS, THE JAPANESE ARE KEEN TO DEVELOP A CLOSER RELATIONSHIP WITH EUROPE. FOREIGN MINISTER UNO READILY ACKNOWLEDGED THAT THE UK WAS WELL PLACED TO PLAY A KEY PART IN THIS PROCESS.

6. THERE WERE ALSO SIGNIFICANT SHIFTS IN THE PERCEPTION BY BOTH SIDES OF OUR BILATERAL RELATIONS. THE JAPANESE RECOGNISED THE REVITALISED ECONOMY AND DYNAMIC POLICIES WHICH WERE BEING PURSUED CONSISTENTLY IN THE UNITED KINGDOM AND THE IMPORTANT ROLE THAT WE WERE THEREFORE PLAYING AS A LEADING MEMBER OF THE EUROPEAN COMMUNITY. YOU ACKNOWLEDGED THAT MANY OF THE PRINCIPAL IRRITANTS IN OUR BILATERAL RELATIONS IN 1987 HAD EITHER BEEN REMOVED (CABLE AND WIRELESS) OR WERE IN THE PROCESS OF RESOLUTION (REFORM OF THE LIQUOR TAX AND ACCESS TO THE TOKYO STOCK EXCHANGE). YOUR EXPLORATION WITH JAPANESE MINISTERS OF AREAS FOR BROADENED COOPERATION BETWEEN OUR TWO COUNTRIES WAS NOT THEREFORE OVERSHADOWED BY THE NEED TO SPEND A DISPROPORTIONATE AMOUNT OF TIME ON TACKLING IMMEDIATE TRADING ISSUES, ALTHOUGH YOU MADE IT CLEAR THAT WE WOULD BE NO LESS VIGOROUS IN PURSUING A RESOLUTION

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OF GENUINE GRIEVANCES AS AND WHEN THEY AROSE.

7. AT BREAKFAST MEETING WITH A GROUP OF BRITISH BUSINESSMEN YOU TOLD THAT THE JAPANESE MARKET WAS MUCH MORE OPEN THAN IT USED TO BE AND THAT MANY BRITISH COMPANIES WERE DOING VERY WELL HERE. THEY CONSIDERED HOWEVER THAT MANY BRITISH COMPANIES WERE STILL VERY IGNORANT ABOUT THE SIGNIFICANCE OF THIS MARKET AND MUCH STILL NEEDED TO BE DONE TO GET THE MESSAGE ACROSS TO BRITISH INDUSTRY. IN THEIR VIEW TRADE BARRIERS WERE LARGELY A THING OF THE PAST, EVEN IF A FEW IRRITANTS REMAINED. IN YOUR TALKS WITH THE JAPANESE YOU EXPRESSED MEASURED APPRECIATION FOR WHAT JAPAN HAD DONE SO FAR TO OPEN HER MARKETS. BUT YOU INSISTED THAT A SUSTAINED AND MORE RADICAL EFFORT WAS REQUIRED TO RAISE IMPORTS, AND AGRICULTURE COULD NOT BE LEFT ASIDE. YOU PUT OUR OUTSTANDING BILATERAL PROBLEMS FIRMLY IN THE CONTEXT OF THE NEED TO KEEP UP MOMENTUM AND PREVENT PROTECTIONISM. YOU LEFT THE CLEAR MESSAGE THAT WE REGARDED SCOTCH WHISKY AND THE TOKYO STOCK EXCHANGE AS UNFINISHED BUSINESS. UNO AND MITI MINISTER TAMURA BOTH EXPRESSED THEIR INTENTION TO MAKE THE JAPANESE MARKET AS OPEN AS POSSIBLE. HOWEVER, THE POLITICAL SENSITIVITY OF AGRICULTURE WAS STRESSED BY ALL.

8. IN YOUR POLITICAL CONSULTATIONS, FOREIGN MINISTER UNO AGREED BROADLY WITH YOUR ANALYSES, IN PARTICULAR OF EAST/WEST RELATIONS AND OF DEVELOPMENTS IN THE GULF. THE JAPANESE SHARE OUR BELIEF THAT THE WEST SHOULD BE OPEN-MINDED, BUT REALISTIC IN REACTING TO GORBACHEV'S INITIATIVES, ALTHOUGH THEY ARE IF ANYTHING MORE SCEPTICAL ABOUT THE EXTENT TO WHICH THEY WILL BRING BENEFITS TO JAPAN, WHOSE RELATIONS WITH THE SOVIET UNION ARE BURDENED BY THE LEGACY OF HISTORICAL ANTI-PATHY, THE WAR AND AN OUTSTANDING TERRITORIAL DISPUTE. MOST OF THOSE WHOM YOU QUESTIONED WERE CONFIDENT THAT A RUSSIAN CHARM OFFENSIVE DIRECTED AT JAPAN WOULD HAVE LITTLE EFFECT ON JAPANESE ATTITUDES AND POLICIES, PARTICULARLY IF THIS WAS UNACCOMPANIED BY A WILLINGNESS TO RETURN THE FOUR NORTHERN ISLANDS. ON THE GULF, DESPITE SOME HESITATION ON THE PART OF HIS OFFICIALS, UNO ACCEPTED THAT IRANIAN INTRANSIGENCE IN HOLDING OUT AGAINST ACCEPTANCE OF SCR 598 MADE CONSIDERATION OF ENFORCEMENT MEASURES INEVITABLE.

9. APART FROM YOUR OFFICIAL TALKS WITH FOREIGN MINISTER UNO AND YOUR CALL ON PRIME MINISTER TAKESHITA, YOU HAD TALKS WITH FINANCE MINISTER MIYAZAWA, MITI MINISTER TAMURA, FORMER PRIME MINISTER NAKASONE, LDP SECRETARY GENERAL ABE AND MICHIO

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WATANABE, CHAIRMAN OF THE PARTY'S POLICY RESEARCH COUNCIL. YOU ALSO MET OTHER RISING JAPANESE POLITICIANS, ECONOMIC OPINION LEADERS, ACADEMICS AND JOURNALISTS AT SOCIAL OCCASIONS AND WORKING MEALS. YOU WERE THEREFORE ABLE TO REGISTER OUR EXPECTATIONS FOR ANGLO/JAPANESE RELATIONS, AS WELL AS OUR CONTINUED CONCERN IN CERTAIN AREAS, TO A WIDE AUDIENCE OF INFLUENTIAL AND ARTICULATE JAPANESE, MANY OF WHOM WILL BE IN POSITIONS OF LEADERSHIP IN JAPAN DURING THE REMAINING YEARS OF THIS CENTURY.

10. IN YOUR SPEECH AT THE JAPAN PRESS CLUB YOU SET OUT AN AGENDA FOR ANGLO/JAPANESE PARTNERSHIP. POLITICALLY THIS CALLED FOR EFFORTS TO IMPROVE EAST/WEST RELATIONS, COOPERATION OVER THE GULF, AND A FIRM STAND AGAINST TERRORISM. ON ECONOMIC ISSUES WE SHOULD PROMOTE STABILITY IN THE WORLD ECONOMY AND IN CURRENCY MARKETS. MAINTAIN FREE TRADE AND OPEN OUR MARKETS MORE WIDELY, INCREASE INVESTMENT OVERSEAS AND FACILITATE CAPITAL FLOWS, OPEN UP STOCK EXCHANGES (NOTABLY THE JAPANESE, SO THAT ALL THOSE FIRMS WHICH WERE SUITABLY QUALIFIED SHOULD OBTAIN SEATS) AND CAPITAL MARKETS. YOU CALLED FOR AN ATTACK ON AGRICULTURAL PROTECTIONISM AND COOPERATION OVER AID PROGRAMMES. YOU AND FOREIGN MINISTER UNO AGREED THAT TO WORK TOWARDS THESE ENDS WOULD REQUIRE A SUBSTANTIAL INTENSIFICATION AND BROADENING OF CONTACTS AT ALL LEVELS: MINISTERIAL, OFFICIAL AND BETWEEN THE PEOPLES OF THE UK AND JAPAN.

11. YOUR VISIT TO OITA PREFECTURE ON THE ISLAND OF KYUSHU, 600 MILES SOUTH OF TOKYO, AT THE OUTSET OF YOUR STAY IN JAPAN WAS ALSO EXTREMELY VALUABLE. IT ENABLED YOU TO SEE AT FIRST HAND HOW AT THE LOCAL LEVEL THE JAPANESE ECONOMY IS CARRYING THROUGH THE STRUCTURAL REFORMS ADVOCATED IN THE MAEKAWA REPORT. IT PROVIDED NOT ONLY WHAT I HOPE WAS AN ENJOYABLE INTRODUCTION TO RURAL JAPAN BUT ALSO AN INSIGHT INTO PROVINCIAL ATTITUDES, WHICH STILL CARRY A DISPROPORTIONATE WEIGHT IN JAPANESE POLITICS. YOUR VISIT TO A FAMILY FARM AT YUFUIN SHOWED YOU THE REALITY OF JAPANESE AGRICULTURE BEHIND ALL THE ABSTRACT ARGUMENTS. YOUR JAPANESE HOSTS WERE CLEARLY APPRECIATIVE THAT YOU HAD SPENT THE TIME TO LEAVE THE TRACK USUALLY BEATEN BY FOREIGN VISITORS TO JAPAN. THE VISIT TO OITA RECEIVED EXTENSIVE FAVOURABLE COMMENT IN THE JAPANESE PRESS.

12. ALTHOUGH YOUR VISIT TO JAPAN WAS IMPORTANT IN ITSELF, ITS REAL SIGNIFICANCE LAY IN PRODUCING THE FIRST MAJOR MOVE IN A PROCESS WHICH SHOULD LEAD TO A RADICALLY CHANGED PERSPECTIVE IN ANGLO-JAPANESE RELATIONS. THE JAPANESE AT ALL LEVELS WELCOMED

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THIS INITIATIVE AND FOREIGN MINISTER UNE HAS LET IT BE KNOWN WIDELY THAT HE WAS EXTREMELY PLEASED WITH THE TONE AND CONTENT OF THE DISCUSSIONS WITH YOU. AS SEEN FROM HERE WE MUST NOW MAINTAIN THE MOMENTUM THAT HAS BEEN GENERATED AS WELL AS KEEP THE JAPANESE UP TO THE MARK. JAPAN IS POTENTIALLY A COUNTRY OF MAJOR WORLDWIDE IMPORTANCE, POLITICALLY AS WELL AS ECONOMICALLY. AN IMPROVED RELATIONSHIP SHOULD PROVE TO BE OF CONSIDERABLE VALUE TO US BILATERALLY AS WELL AS CONTRIBUTING TO THE COHESION AND STRENGTH OF A WESTERN COMMUNITY INCLUDING JAPAN. LORD YOUNG'S VISIT IN MARCH WILL PROVIDE A GOOD OPPORTUNITY TO CONSOLIDATE THE OPENINGS FOR BRITISH EXPORTERS IN A JAPANESE MARKET THAT HAS SEEN A 50% INCREASE IN OUR EXPORTS OVER THE PAST TWO YEARS. THE REINFORCEMENT OF POLITICAL RELATIONS REQUIRES MORE REGULAR CONTACT AT MINISTERIAL LEVEL AND THE DEVELOPMENT ON BOTH SIDES OF A NEW REFLEX OF CONSULTATION.

FCO PLEASE REPEAT AS NECESSARY.

WHITEHEAD

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PS/CHANCELLOR

H.M. TEASURY.

TOKYO TELNO 41 AND MY TELS NO 78, 79 AND 91: JAPANESE PRIME
MINISTER'S VISIT TO THE UNITED STATES.

SUMMARY

1. A GOOD VISIT FOR TAKESHITA. FEW SURPRISES ON THE SUBSTANCE.

DETAIL

2. TAKESHITA HAD A MEETING AND LUNCH WITH THE PRESIDENT ON 13
JANUARY, AND HE AND HIS WIFE HAD TEA WITH THE PRESIDENT AND MRS
REAGAN IN A FURTHER UNSCHEDULED CALL ON 14 JANUARY.

3. THE WHITE HOUSE HAVE TOLD US THAT THEY ARE VERY PLEASED
WITH THE TONE OF THE MEETING WITH THE PRESIDENT, WHO HAD BEEN
AT PAINS TO PUT TAKESHITA AT HIS EASE AND TO GET THEIR RELATION-
SHIP OFF ON THE RIGHT FOOTING. IN HIS PRESENTATION, THE
PRESIDENT HAD TOUCHED ONLY BRIEFLY ON THE CONTROVERSIAL ISSUES,
AND HAD CONCENTRATED ON UNDERLINING THE STRENGTH OF THE
RELATIONSHIP BASED ON THE MUTUAL SECURITY TREATY. TAKESHITA HAD
MADE CLEAR HIS SUPPORT FOR THE PRESIDENT'S HANDLING OF EAST/
WEST RELATIONS AND FOR THE INF TREATY. ON THE GULF, THE
AMERICANS HAD PUT NO PARTICULAR PRESSURE ON THE JAPANESE (THEY
ARE CONFIDENT THAT JAPAN WILL NOT WANT TO BE LEFT BEHIND IN
MOVEMENT TOWARDS A SECOND SECURITY COUNCIL RESOLUTION.) THE
PRESIDENT HAD URGED TAKESHITA TO MAINTAIN OR INCREASE JAPANESE
AID AND INVESTMENT IN THE PHILIPPINES. THERE WERE NO CONTENTIOUS
ISSUES TO RAISE IN THE DEFENCE AREA (WHERE THE AMERICANS PROFESS
THEMSELVES VERY SATISFIED WITH THE CURRENT JAPANESE DEFENCE EFFORT)
AND THE PRESIDENT CONFINED HIMSELF TO WARMLY WELCOMING JAPAN'S
DECISION TO INCREASE ITS CONTRIBUTION TO THE COST OF US FACILITIES
IN JAPAN BY A FURTHER DOLLARS 100 MILLION IN 1988. THE TWO LEADERS
AGREED THAT THE DETAILS WOULD BE PURSUED WHEN DEFENCE MINISTER
KAWARA IS IN WASHINGTON LATER IN THE MONTH.

4. TAKESHITA ALSO MET THE HOUSE AND SENATE MAJORITY LEADERS,
AND GAVE A SPEECH AT THE NATIONAL PRESS CLUB (AT THE LATTER
EVENT HE WAS GIVEN A RELATIVELY EASY TIME BY THE PRESS: THE
EMPHASIS IN HIS SPEECH WAS ON JAPAN'S CONTRIBUTION TO WORLD ECONOMIC
STABILITY THROUGH THE EXPANSION OF INTERNAL DEMAND, STRUCTURAL
ADJUSTMENT AND OVERSEAS AID, AND ON THE STRENGTH AND UNIQUE

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CHARACTER OF THE US-JAPAN RELATIONSHIP: HE MADE ONLY THE BRIEFEST REFERENCES TO TRADE TENSIONS).

5. WE HAVE ALREADY REPORTED ON ECONOMIC AND TRADE ASPECTS OF THE VISIT (MY TELS UNDER REFERENCE). THE DEVELOPMENT WHICH HAS CAUGHT MOST PRESS ATTENTION IS THE CONTINGENCY PLAN WHEREBY THE US WOULD BE ENABLED TO SWAP SDRS FOR YEN. ON THE TRADE SIDE, THE MAIN ISSUE WAS ACCESS TO PUBLIC SECTOR CONSTRUCTION, ON WHICH THE PRESENTATION OF A NEW JAPANESE OFFER IMMEDIATELY BEFORE THE VISIT HELPED TO LOWER THE TEMPERATURE (MY TELNO 91). HOWEVER USTR YEUTTER STRUCK A SOUR NOTE IN A RADIO INTERVIEW AFTER THE VISIT WHEN HE SAID THAT THE JAPANESE OFFER DID NOT MEET US NEEDS, AND THAT THE US WOULD HAVE TO MAKE ITS OWN JUDGEMENT AS TO WHETHER FURTHER RETALIATORY ACTIONS WOULD ULTIMATELY BE NEEDED. THE ONLY OTHER TRADE ISSUES WHICH APPEAR TO HAVE BEEN DISCUSSED IN ANY SUBSTANCE DURING THE VISIT WERE SEMICONDUCTORS AND THE US' GATT COMPLAINT AGAINST JAPAN ON 12 PROCESSED AGRICULTURAL PRODUCTS. ON THE FORMER, TAKESHITA ASKED WHETHER IT WAS YET POSSIBLE FOR THE US TO RAISE THE REMAINING RETALIATORY SANCTIONS, BUT GOT NOWHERE. ON THE LATTER, THE JAPANESE CONFIRMED THEIR INTENTION TO ACCEPT THE GATT REPORT BUT SAID THAT THEY STILL HAD PROBLEMS OVER ITS IMPLEMENTATION IN RESPECT OF STARCH AND MILK PRODUCTS (THE IMPLICATION IN USTR'S ACCOUNT OF THIS EXCHANGE WAS THAT THE US MIGHT BE PREPARED TO ACCEPT COMPENSATION IN LIEU OF IMPLEMENTATION OF THE REPORT FOR THESE TWO PRODUCTS). THE AMERICANS DID NOT RAISE THE ALCOHOLIC BEVERAGES ISSUE.

COMMENT

6. BOTH THE JAPANESE AND THE ADMINISTRATION WERE KEEN TO MAKE AN ATMOSPHERIC SUCCESS OF THIS VISIT (CF TOKYO TELNO 41). THEY APPEAR TO HAVE SUCCEEDED, PARTLY BY AVOIDING TOO MUCH EMPHASIS ON DIVISIVE TRADE ISSUES. TAKESHITA LAID EMPHASIS ON US-JAPANESE UNANIMITY ON POLITICAL AND MACROECONOMIC ISSUES, AND ADMINISTRATION CONTACTS HAVE TOLD US THAT HE CAME ACROSS WELL.

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JAPAN POLITICAL AND ECONOMIC

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Ch.

Sir JG Litter cannot
come to this: Tamura is
not attending the Anglo-Japanese
lunch, + Geoff thinks he
will himself not be able to get
away in time.

JF

15/11

* I will have to finish
by 30 mins. What start
2.15 pm.
* for 15 mins



2.1 will discuss (a) Amplify
no Maclean
Report
(b) X
N.

Mr Tamura the MITI
Minister from Japan is now
coming to see you at 2.30pm
on Monday next 18 Jan here
in the Treasury. He will be
accompanied by

Mr Kuroda - Vice Minister
of MITI.

Mr Yoshida - Deputy Director
General of Trade
Policy Board.

Mr Yamazaki - Ambassador

Mrs Omoni - Interpreter.

They have suggested the following
topics for discussion but will
be guided by what you would
like to discuss:

- Japanese Economic Policy
- International Policy Coordination
- Stimulation of Domestic Demand
- Stabilisation of Exchange Rate over X

- ~~Financial Problems in less developed countries.~~

This is obviously too much for 15 minutes.

Have you any subjects you would like to discuss?

It would be helpful to know first thing tomorrow so we can arrange briefing.

Would you like the EST, -
Haw Evans + Mr Savage (from IF) -
to be present, as well as Jun & Ken.

SGC has another engagement?

Mr Tamura is bringing ^{an additional} 8 officials who will wait in another room!

Julie
14/11.

Briefing Utt
Int Economic
Aspects.



Matthews.

Mother.

~~£~~

9 Visit of Mr Tamura

Minister in charge of MITI.

Sir G. Little suggests
that we tell the Japanese
that you are not prepared
to hold a full meeting with
the MITI team but that
you would see Mr Tamura
himself for a 15-20 min
chat.

If you are content with this
shall I go ahead & arrange
the chat for the half hour
slot before Budget Overview
on Monday 18 Jan?

Julie
11/1

Ym P.S. ✓

full meeting
willing to



see man
himself
for chat.

[Faint, mostly illegible handwritten text]

Mr Tamura Monday
18 Jan.

It now seems he wants
to bring a team of 13
people with him!

This is clearly impractical
before a Budget Overview
meeting.

Regrets?

V. White
regrets.

Julie
8/1

[Red handwritten notes and signatures]
The
5/12
1/1



C/mr Tamura is seeing
Lord Young at 10.30-11.30
am on Mon 18 Jan. He is
however free in the afternoon

I suggested you might see
Mr Tamura at 2.30pm
for 1/2 hr after your lunch
with Christopher Aides
r before the Budget Overview

However the meeting would
have to be in HMT because
the Caterers ^{etc} will be
preparing for the Patrons
Club Dinner at 12.01.

Content?

Julie
2/1.

OK

Slot when in @ 11 am
on 18th, & market



Prayers 10.15a

Also, on 19th,
post slot to

Friday 12.30 to 6.15
afternoon, & keep

the money free.

1. Jonathan

2. You suggested seeing

Mr Tamura at 9.30^{am} on

Monday 18 Jan. You have
agreed to be interviewed
by Channel 4 (Int. Debt)
then.

We could try the afternoon
of Tues 19 Jan - You are
speaking at CPS in the
evening - while the speech
is being typed?

If not we could try to
rearrange something already
in the diary?

Julie
6/11.

01 493 6030.

Mr Kitamura.

Richard Carter

215 4288.

DTI.

10.30 - 11.30 Lord
Young.



This is different.
But I will
offer it on 18th 9.30 am
Mr.

Ch.

(note by AA below)

Visit by Mr Tamura

Mr Hajime Tamura, the Minister in charge of MITI in Japan is in London on 16-19^{*} January. He is seeing the PM, and Lord Young is hosting a dinner for him.

2. He would like to call on you during his visit. Are you interested?

JH
5/1

* 16 & 17 is a weekend 18 & 19 are immediately before your philosophical speech - but diary could probably accommodate.

John

D Jones - 215 5104
#2588.



Note

Robert Tulshaw (PS/SO (Home))

rang to warn me that one of
Tamura's lines was that
Trade minutes should go to
Economic Summits. FCO
are briefing No 10 to take
a firm line.



FROM: MRS JULIE THORPE

DATE: 15 January 1988

PS/ECONOMIC SECRETARY

cc Sir P Middleton
Sir G Littler
Mr H P Evans
Mr S W Matthews
Mr D Savage**VISIT OF MR TAMURA**

As you know the Chancellor has agreed to see Mr Tamura, the Japanese Minister of MITI, at 2.30pm on Monday 18 January here in the Treasury.

2. Also attending the meeting will be Mr Kuroda, Vice-Minister of MITI; Mr Yoshida, Deputy Director General of the International Trade Policy Board; Mr Yamazaki, Japanese Ambassador; and Mrs Omori, Interpreter. The Chancellor would like the Economic Secretary, Mr Evans and Mr Savage to attend the meeting as well.

3. Subjects for discussion will be:

Japanese Economic Policy including the Maekawa report.

International Policy Coordination including stabilisation of exchange rates.

Mr Savage is providing briefing. The meeting will last for half an hour.

A handwritten signature in cursive script that reads 'Julie Thorpe'.

MRS JULIE THORPE

FROM: D SAVAGE
DATE: 15 January 1988

1. ~~MR EVANS~~

2. CHANCELLOR

The adjustment by Japanese industry to the high yen has been surprising and impressive, especially through higher productivity. HPE 15/1

cc: PS/Economic Secretary
Sir P Middleton
Sir G Littler
Sir T Burns
Mr H P Evans
Mr Odling-Smee
Mr Sedgwick
Mr Matthews
Mr Carter - DTI

VISIT OF MR TAMURA, MONDAY 18 JANUARY AT 2.30PM

You are seeing Mr Tamura, the Japanese Minister of MITI, for half an hour. He will be accompanied by Mr Kuroda (Vice-Minister of MITI), Mr Yoshida (Deputy Director General of the International Trade Policy Board), Mr Yamazaki (Japanese Ambassador), and Mrs Omori (interpreter). The Economic Secretary, Mr Evans and I will be present as well.

2. Subjects for discussion are:

(a) Japanese Economic Policy including the Maekawa Report.

(b) International Policy Co-ordination including stabilisation of exchange rates.

3. You might, by way of introduction, refer to the Foreign Minister's talks in Japan. The recent improvement in relations between the two countries was noted on both sides. There was agreement on the need to work together in tackling world economic problems.

4. I attach:

(a) A personality note on Mr Tamura.

(b) A short note on the Japanese economy. Given the high yen, the current strength of industrial production in Japan is remarkable. To some extent this strength reflects domestic demand growth - but there is also a suspicion that exports are picking up again.

- (c) A note on the Maekawa Report - comparing recommendations and actions. The conclusion is that there has been some shift in the stance of fiscal policy, but progress towards structural reforms - in industry, financial markets and particularly in agriculture - has tended to be slow.
- (d) A note assessing the Japanese Budget announced on 28 December. It was virtually a 'no change' Budget, following last year's fiscal stimulus.
- (e) The text of the Joint Economic Statement made by President Reagan and Prime Minister Takeshita on 13 January.

d.s.

D SAVAGE

HAJIME TAMURA

Minister for Trade and Industry (since July 1986)

Member of House of Representatives (Takeshita faction). Elected twelve times.

Born 1924. Graduated Keio University in Law in 1950. Taught as a middle school teacher until 1955, when he was first elected to the House of Representatives.

Parliamentary Vice Minister for Construction in 1960, and for Labour in 1962. Minister for Labour in 1973. Minister for Transport in 1976. Between 1979 and 1981 was Chairman of the House Budget Committee, LDP National Organisation Committee, and LDP Diet Policy Committee. First appointed MITI Minister by Mr Nakasone in 1986. Reconfirmed as MITI Minister following Mr Takeshita's appointment as Prime Minister.

Tamura has no particular economic expertise, but is reputed to be forceful and influential within the LDP.

He is married with two sons and three daughters. His hobbies include sumo wrestling and reading. Open, extrovert personality. Quite popular with his officials.

JAPANESE ECONOMY

1. A two year phase of slow growth ended in the Spring - partly because domestic demand accelerated but partly also because exports stopped falling. Despite the high yen, industrial production was 8 per cent higher in the three months to November than a year before.

2. The acceleration in domestic demand is fairly narrowly based on a re-expansion in public investment (following cuts in 1984-85) and a boom in private housebuilding. Fears have been expressed that the construction industry is overheating. But the real bottleneck is the supply of development land, which is restricted by excessive regulations.

3. General inflationary pressures remain very weak. Since average earnings in manufacturing increased only 2 per cent, and output per employee in manufacturing rose about 5 per cent, labour costs per unit of output actually declined substantially during last year. In yen terms, commodity prices were little changed last year despite their appreciable rise in dollars.

4. The current balance of payments surplus changed very little between 1986 and 1987 when measured in terms of the depreciating dollar, but declined from 4½ to 3½ per cent of Japanese GNP. This reduction was due chiefly to a reduction in the volume of imports; there was little change in the volume of exports and, with the yen appreciating, some further improvement in Japan's terms of trade.

5. Of the world's major stock exchanges, Tokyo enjoyed the biggest gain prior to the crash and has suffered the smallest loss since. In January, share prices in Tokyo were 17 per cent lower than on 15 October but still 35 per cent higher than on average in 1986.

6. In late October, the Bank of Japan publicly announced that it was easing monetary policy in the interests of stock market stability. In the event however 3-month interest rates have remained almost unchanged at just under 4 per cent - their approximate level for almost a year. The broad money supply is

growing at an annual rate of over 10 per cent; but this partly reflects rapid growth in wholesale bank deposits following their deregulation and is not good evidence that monetary conditions are loose.

7. Table 1 gives summary figures for 1985 and 1986 and OECD estimates and forecasts for 1987 and 1988.

Table 1: Japanese Economy: Key Figures*

	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>
GNP: Nominal	6.3	4.3	3½	4½
Real	4.7	2.4	3½	3½
Real Domestic Demand	3.8	4.0	4½	4
Consumer prices	2.1	0.6	½	1¾
Current balance (\$ bn)	49	86	86½	81
General government deficit (% of GNP)	0.8	0.9	1.2	1.1

* Percentage changes.

THE MAEKAWA REPORTS: RECOMMENDATIONS AND ACTIONS**The Reports**

1. The Commission was set up by Nakasone in October 1985, shortly after the Plaza Agreement. Its first report appeared in April 1986 and called for a more open economy and greater reliance on domestic demand growth. **The recommendations fall under six principal heads:**

- i. **Expansion of domestic demand**, e.g. by public works, tax reforms (including abolition of the tax break on small savings), and reduction in working hours.
- ii. **More flexibility in fiscal policy** (but the medium-term objective of balancing the budget on current account should be retained).
- iii. **Transformation in industrial structure**, including cuts in production in declining industries (e.g. coal) in which Japan has a low comparative advantage, more direct investment abroad (especially in LDC's) and reform of agriculture.
- iv. **Stabilisation of the yen**, at "a high level".
- v. **Liberalisation and internationalisation of capital markets**.
- vi. **More aid**, to LDC's in general and low-income debtors in particular.

2. There was nothing here that was very new to the discussion of Japan's economy policy, and very little in the way of concrete proposals. In May 1986 (in an 'Outline of Procedures for the Promotion of Economic Structural Adjustment') the Government formally adopted most of the ideas in the Maekawa report.

3. Maekawa's second and final report was published last April. Maekawa was reported as being unhappy with the pace of reform and **his second report contained some more specific recommendations.** These included:

- i. More public investment, e.g. in town planning and communications.
- ii. Financial incentives for housebuilding.
- iii. Removal of tax advantages enjoyed by small farmers (to increase the supply of land for urban development).
- iv. A five-day week.
- v. Making Japanese markets more accessible by relaxing quality standards etc.
- vi. A reduction in the difference between the administered prices of food on the home market and prices on the world market.
- vii. An increase in expenditure on overseas aid as a percentage of GNP.

Actions

4. These may be considered under the six heads in the original report:

- i. Expansion of domestic demand. Several of the recommendations have been acted upon to some extent. Increases in public works expenditure were included in packages announced in September 1986 and May 1987. Proposals for a comprehensive tax reform were announced in December 1986. Some of these proposals, including cuts in income tax and the removal of the exemption for small savings, have been implemented, but a proposed shift from direct to indirect taxation has been frustrated by opposition to a general sales tax. Proposed tax reforms in 1988-89 principally involve capital gains tax. By reducing tax rates on capital gains, it is hoped to encourage the release of land to the market and thus to alleviate the steep increase in land prices in the main metropolitan areas. Steps have been taken towards establishing a five-day week in the public financial sectors, and for manufacturing a target has been set of reducing annual hours of work from 2,100 currently to 2,000 by 1990.

Measures to stimulate housebuilding (including a relaxation of regulations limiting where building is allowed and subsidised loans to builders) have helped stimulate an 18 per cent increase in private investment in housing over the year to 1987Q3. Total real domestic demand grew almost 5 per cent over the same period.

- ii. More flexibility in fiscal policy. In 1987-88 there was some modest relaxation in fiscal stance - though last May's 'Y6 trillion' package did not prove as large or stimulative as it had been presented (see note on Japan's Budget for 1988-89).
- iii. Transformation in industrial structure. One of Japan's eleven remaining coal mines has been closed, and a plan was approved in November 1986 that would half the industry's capacity by 1990. However mining is a very small industry, accounting for only about $\frac{1}{2}$ per cent of Japan's total industrial production. Support for other, larger traditional industries, steel and shipbuilding, remains considerable. The price at which rice is sold to the domestic market has been lowered somewhat, but remains many times the level on world markets; there has been very little in the way of agricultural reform. The railways and airlines have or are about to be privatised.
- iv. Stabilisation of the yen. Ever since the exchange rate with the dollar passed \$1=200 yen, the Japanese have been pressing for yen stabilisation. Arguably, though, the fall in the dollar to around 125 yen has done more to bring about a restructuring of the Japanese economy than all the other measures put together; even so, such exchange rates appear less harmful to Japanese exports than was expected.
- v. Liberalisation of financial markets. There has been further limited progress. The deregulation of large-denomination deposit rates is being implemented in steps. However the structure of short-term interest rates remains largely administered.

vi. More overseas aid. Japan has promised to double its aid between 1985 and 1990. But this is less generous than it sounds. The target is expressed in nominal dollars. Taking into account the appreciation in the yen since 1985 and inflation and economic growth in Japan, it might well imply an actual decline in Japan's aid as a proportion of its GNP. Suppose, for illustration, that the yen - dollar exchange rate stays unchanged at its current level and that Japanese nominal GNP grows by 5 per cent a year between now and 1990. Then a doubling in the dollar value of Japan's aid between 1985 and 1990 would imply a reduction from 0.28 per cent of GNP in 1986 (rather below the OECD average) to 0.24 per cent of GNP in 1990.

5. In short: there has been some shift in the stance of fiscal policy; progress towards structural reforms - in industry, financial markets and particularly in agriculture - has tended to be slow; a limited effort has been made to improve Japan's poor record on overseas aid.

JAPAN
BUDGET
1988-89**JAPAN'S BUDGET FOR 1988-89**Assessment

Although presented as expansionary in the press, the draft Budget announced on 28 December implies a slight reduction in the central government borrowing requirement in 1988-89 and probably little change in the general government financial deficit. This follows some easing in fiscal stance in 1987-88 - though an easing that was much more modest than the size of last year's Emergency Package (presented as worth Y6 trillion or 1.7 per cent of GNP).

The context: Policy since 1980

2. A policy of fiscal expansion over the second half of the 1970s was reversed in 1980 because of mounting concern over the size of public sector deficits and the rapid increases in government debt and debt interest payments. A target was set in 1980 for the elimination of the central government deficit on current account by 1984-85. Though this target was not achieved, the central government financial deficit was reduced from 5.4 per cent of GNP in 1979/80 to 4.4 per cent in 1984/85. The deficit of general government as a whole, which comprises local authorities and the social security funds as well as central government, declined more sharply - from 4.4 per cent to 1.8 per cent (table 1).

Table 1: Japanese Budget Deficits

	<u>Percentage of GNP</u>					
	1979- 80	1984- 85	1985- 86	1986- 87	1987- 88	1988- 89
Central government*	5.4	4.4	3.8	3.2	3.0**	2.5**
General government	4.4	1.8	0.8	0.9	1.2**	1.2***

* General Account

** Estimated

*** Forecast on basis of draft Budget.

3. Since 1985, when economic growth weakened, fiscal policy has sought a compromise between maintaining progress towards fiscal consolidation whilst at the same time providing support to activity. In line with a revised medium-term objective of eliminating the central government current deficit by 1990/91, initial budgets in the last three years provided for reductions in the deficit. However, in each of the three years a package of expansionary measures was subsequently announced.

4. In spite of the packages, the central government deficit turned out to be little or no higher in 1985-86, 1986-87 and 1987-88 than had been provided for in the initial budgets (table 2). This reflected partly the fact that the packages included a high proportion of expenditure - chiefly on the Fiscal Investment and Loan Program and by local authorities - that is outside the central government budget, and partly errors in estimation and forecasting which caused deficits to be over-predicted in the initial budgets.

Table 2: Central Government Budget Deficits and Expansionary Packages*

	1985- 86	1986- 88	1987- 88	1988- 89
<u>Initial Budgets:</u>				
Jan. 1985	3.7			
Jan. 1986		3.2		
Jan. 1987			3.1	
Jan. 1988				2.5
<u>Expansionary packages:</u>				
Oct. 1985	0.6			
Sep. 1986		1.1**		
May 1987			1.7	
Final Budgets (Autumn)	4.0	3.7	3.4	
Outturns	3.8	3.2	3.0***	

* Percentage of GNP

** An earlier package for 1986-87 was announced in December 1985, but most of the measures it contained had already been incorporated in the initial budget.

*** Draft Budget forecast.

1988-89 Draft Budget

5. Table 3 compares in more detail the draft 1988-89 Budget with the initial and final 1987-88 Budgets.

Table 3: Comparison of 1987-88 and 1988-89 Budgets

	<u>Yen trillion</u>		
	<u>1987-88</u>		<u>1988-89</u>
	<u>Initial Budget</u>	<u>Final Budget</u>	<u>Initial Budget</u>
Debt interest	11.3	12.2	11.5
Public works	6.1	7.8	7.3
Other expenditure	<u>36.7</u>	<u>38.2</u>	<u>37.9</u>
Total expenditure	<u>54.1</u>	<u>58.2</u>	<u>56.7</u>
Tax revenues	41.2	44.9	46.6
Carryover of previous year's surplus	2.4	2.3	0
Proceeds from sale of NTT	<u>0</u>	<u>0.5</u>	<u>1.3</u>
Total revenues	<u>43.6</u>	<u>47.7</u>	<u>47.9</u>
Borrowing requirement	<u>10.5</u>	<u>10.5</u>	<u>8.8</u>
% of GNP	3.1	3.0	2.5

6. It is expected that central government borrowing for 1987-88 will be held at the original estimate of Y10.5 trillion, despite an increase in expenditure of Y4 trillion. This is because of greater buoyancy than expected in tax revenues and proceeds of Y½ trillion from the sale of NTT.

7. It is planned that expenditure will be reduced slightly in 1988-89, partly because of lower debt interest. The pledge to the G7 countries that 'expenditure for general public works will not

be less than for the FY1987 Budget including the July supplemental' has not strictly been kept. Direct public works expenditure is to be reduced slightly from Y7.8 trillion to Y7.3 trillion. However the Fiscal Investment and Loan Programme (a non-budgetary item) is to be increased from Y27.1 trillion to Y29.6 trillion. This Programme finances 'public works' projects undertaken by private companies.

8. Given the reduction in spending, continued buoyancy of tax revenues and a further Y1.3 trillion of revenue from the NTT sale, the borrowing requirement is projected to decline to Y8.8 trillion - despite the fact there is no surplus to carry over from the previous year, as in 1987-88.

9. The publication of the draft Budget is only the first step in the determination of fiscal policy for 1988-89. The proposals have to be debated by the Diet in March. There will as usual be a supplementary Budget in the Autumn. Before then, as in each of the last three years, an expansionary package could be announced - but in the present mood of satisfaction with the state of the economy, this does not seem very likely.

Line to take

10. It is almost a 'no change' Budget. This is not inappropriate in view of the fact that domestic demand in Japan is now rising at a satisfactory rate of some 5 per cent a year. However the current rate of expansion will have to be sustained for several years if Japan's trade surplus is to be substantially reduced. Policy in Japan should respond flexibly to see that it is sustained.

BF 29/1.



purp

Ch

I have been enquiring
whether there is likely to be
any chance of your
seeing Piers Jacobs in
the near future. But he
has no plans to come to
London in next 4-6 weeks.
There was a chance Geoff might
have been going to Japan in
mid-Feb & could have stopped
in Hong Kong; but that is now
off. Probably too sensitive
to ring Jacobs. I have asked
Geoff to check further on Jacobs
movements & date of his Budget.

IN CONFIDENCE



MP

FROM: J M G TAYLOR

DATE: 19 JANUARY 1988

PS/SIR PETER MIDDLETON

GIFT FROM MR TAMURA

Mr Tamura, the Japanese Minister of International Trade, called on the Chancellor yesterday. I have recorded the meeting separately.

2. At the conclusion of the meeting, Mr Tamura presented the Chancellor with what the interpreter described as an "antique Japanese badminton racket". This turned out to be an ornamental wooden object with a doll-like effigy attached.

3. I would estimate the cost of this at around £15-20. I should be grateful if you could confirm that Sir Peter is content for the Chancellor to keep this gift.

A handwritten signature in dark ink, appearing to be 'J M G Taylor'.

J M G TAYLOR

Mr Nicolas Wolfers

Dr Stanley Ridgwell

Dr William Wallace

Mr Graham McCallum

Sir Geoffrey Littler

Professor Alan Budd

Sir Edwin Nixon

Sir Francis Tombs

Mr Tadahiro Sekimoto

Mr Masahide Shibusawa

The Rt Hon Bruce Millan

Sir Peter Parker

Mr Takashi Hosomi

Mr Isamu Miyazaki

The Rt Hon Robin Leigh-Pemberton

The Rt Hon Lord Jenkin of Roding

Mr Motoo Shiina

His Excellency the Ambassador of Japan

THE RT HON THE PRIME MINISTER

The Lord Glenarthur

Ambassador Tadao Kato

Mr Naohiro Amaya

The Rt Hon Norman Lamont

Mr Richard Needham

Mr Nobutoshi Hagihara

Mr Takashi Mukaibo

The Lord Chilver

The Rt Hon Sir Michael Palliser

Mr Keizo Saji

Mr Tadashi Yamamoto

Sir Hugh Cortazzi

Sir Trevor Holdsworth

Mr Atsushi Shimokobe

Mr Mitsuya Goto

Professor Ronald Dore

Mr Keith McDowall

Mr Nicholas Colchester

Mr Charles Powell

ENTRANCE



LUNCHEON

To mark
the Fourth Conference of the
UK-Japan 2000 Group

10 DOWNING STREET
MONDAY, 18TH JANUARY 1988

Sir Geoffrey Lither



10 DOWNING STREET
LONDON SW1A 2AA

mp

CH/EXCHEQUER	
REC.	19 JAN 1988
ACTION	Mr H.P. EVANS
COPIES TO	PS/CST, PS/EST, PS/PAG, PS/EST, SIR G. LITTON, Mr ANSON, SIR T. BURNS, Mr MANICK, Mr BYATT, Mr BURGNER, Mr MOUNTFIELD, Mr SH MATTHEWS, Mr SAVAGE.

19 January 1988

From the Private Secretary

**PRIME MINISTER'S MEETING WITH THE JAPANESE MINISTER
FOR TRADE AND INDUSTRY**

The Prime Minister had a meeting this morning with the Japanese Minister for Trade and Industry. Mr. Tamura was accompanied by one of his deputies, by the Japanese Ambassador and an interpreter.

The Prime Minister began by expressing her sympathetic concerns about the illness of Mr. Tamura's mother. She stressed her hope that Mr. Takeshita would find time to visit the United Kingdom before the Economic Summit in June. She referred to the recent and successful meeting of the United Kingdom/Japan 2000 Group.

Mr. Tamura was clearly moved by the Prime Minister's expressions of sympathy for his mother. When he had composed himself, he handed over a message to the Prime Minister from Mr. Takeshita (copy enclosed) and said that Mr. Takeshita looked forward to meeting the Prime Minister soon. He himself was a close colleague of Mr. Takeshita's and could say that he would follow most of the policies of his predecessor. But he was a different personality, so there would be some differences of style. He tended to ponder problems carefully. But once he had made up his mind he would not falter.

The Prime Minister read Mr. Takeshita's message and expressed appreciation for it, particularly the commitment to make changes in the liquor tax in conformity with the GATT recommendation. She continued that 1987 had been a very significant year in economic terms. She recognised the substantial structural change which had taken place in Japan's economy and acknowledged the difficulties which the increase in the value of the yen caused for Japanese industry. Mr. Nakasone had done an enormous amount to bring Japan into a more responsible role in the international economic community. Even so, it had to be acknowledged that the change in the value of the yen had not had the striking effect on Japan's trade surplus that a similar rise in the dollar or the pound would have had for the United States or Britain. Japanese companies cut export prices to the bone and there was still resistance to imports. As a result Japanese surplus remained very large, even though the trend was in the right direction. She hoped that the period of disruption in financial markets

was coming to an end and that we could all look forward to conditions of monetary stability. But this would only occur if each nation puts its financial house in order and if countries with permanent trade surpluses were willing to see these reduced. It would also be very important to deal with problems of agricultural subsidies and protectionism.

Turning to bilateral matters, the Prime Minister said that she was grateful that progress had been made on some of the problems that she had raised during her last meeting with Mr. Tamura, for instance Cable and Wireless and the question of seats on the Tokyo Stock Exchange for British firms. But we continue to come across obstacles to trade and would pursue these vigorously in the spirit of trying to solve them. The commitment in Mr. Takeshita's letter to deal at last with the discriminatory tax on imported alcoholic drinks was welcome although she had to say it was overdue. We were concerned by the apparent preference for American companies in bidding for major contracts which had been announced during Mr. Takeshita's visit to Washington. There had also been allegations of discrimination against foreign cars in municipal car parks in Japan, although she understood this was being dealt with. But overall she detected a willingness on Japan's part to see particular problems resolved satisfactorily. She could assure Mr. Tamura that we wanted to strengthen bilateral ties with Japan. We also very much welcomed Japanese investment.

Mr. Tamura said that he was glad the Prime Minister had noted the progress on a number of bilateral issues since their last talk. He could assure her that the Japanese Government would make the utmost efforts to push through the tax reform including reform of the liquor tax. Since time was short, he would hand over a paper summarising progress with Japan's economic structural adjustment (copy enclosed). The general picture was one of declining exports and increasing imports. Some myths about Japan's trading practices remained. The Prime Minister interjected that there was no myth about Japan's trade surplus. It was still very large and it was taking a long time to come down. There were also still barriers to trade. None of this was myth. It was fact. Mr. Tamura continued that it was not the case that Japan was offering the US preferential access to tendering for major contracts. It had simply been agreed that both sides' procedures should be respected. This was an issue which should be pursued on a multilateral basis.

!!
||| The discussion had to end at this point. I should record that the Japanese Ambassador passed me a note which reads: "In Japan parking lot underground is sometimes narrow and in those circumstances there are cases where 'big limousine type of car' can be rejected".

I am copying this letter and enclosures to Alex Allan (HM Treasury) and Robert Culshaw (Foreign and Commonwealth Office).

(CHARLES POWELL)

Miss Alison Brimelow,
Department of Trade and Industry.

OFFICE OF THE PRIME MINISTER
TOKYO

(Translation)

Dear Prime Minister,

It gives me very great pleasure to write to you on the occasion of the visit to the United Kingdom of Mr. Hajime Tamura, Minister of International Trade and Industry.

I very much regret that my existing official commitments and our heavy parliamentary calendar should have made it impossible for me to accept your very kind invitation to visit the United Kingdom this month. I am now seeking to ensure that it would be possible for me to make such a visit at some time before the Summit meeting in Canada.

I am happy and gratified to see how the friendly and cooperative relationship between Japan and your country has in recent years been continuously strengthened in every field, most notably those of political affairs, the economy and culture.

The Secretary of State for Foreign and Commonwealth Affairs, Sir Geoffrey Howe, had very meaningful consultations with our Minister for Foreign Affairs, Mr. Uno, when he visited Japan recently. I confidently hope that our two countries will be able to deepen our relationship yet further, and together make an increasingly effective joint contribution.

Mr. Tamura is one of my most able and trusted colleagues, and I hope that frank exchanges of views between the members of your Cabinet and Mr. Tamura will significantly promote our mutual understanding and cooperation.

Her Excellency
Mrs. Margaret Thatcher
Prime Minister of the U.K.
London

Regarding the liquor tax, which is one of the major pending issues we have to address, the basic policy direction for tax reform in this area has, in fact, already been decided upon and announced, a direction which is in line with the GATT RECOMMENDATION. An overall tax reform is now one of the most urgent tasks in the area of domestic policy in Japan, and my Government is making every effort for its prompt realization. It is intended to make the necessary changes in the liquor tax in the context of that overall reform of Japan's tax system.

Yours sincerely,

Noboru Takeshita
Prime Minister of Japan

Progress of Japan's Economic Structural Adjustment

January 1988

Progress made	Notes																
<p>1. Expansion of Domestic Demand</p> <p>(1) Emergency Economic Measures</p> <p>-- Measures to expand domestic demand totalling more than ¥6 trillion.</p> <p>1) Additional public investment and spending amounting to ¥5 trillion.</p> <p>2) Utilization of revenues accruing from the sale of Nippon Telegraph and Telephone Corp. stocks to consolidate the basis for private-sector projects in the implementation of public works projects.</p>	<p>o The scale of the measures to expand domestic demand included in the May 1987 Emergency Economic Measures was equivalent to 1.8% of GNP.</p> <p>o Economic growth led by domestic demand.</p> <table border="1" data-bbox="1484 911 2187 1246"> <thead> <tr> <th></th> <th>real GNP growth</th> <th>domestic demand</th> <th>net export</th> </tr> </thead> <tbody> <tr> <td>FY 1986</td> <td>2.6%</td> <td>4.1%</td> <td>-1.5%</td> </tr> <tr> <td>FY 1987</td> <td>3.7%*</td> <td>5.0%*</td> <td>-1.3%*</td> </tr> <tr> <td>FY 1988</td> <td>3.8%*</td> <td>4.7%*</td> <td>-1.0%*</td> </tr> </tbody> </table> <p>(* according to the Government Economic Outlook)</p>		real GNP growth	domestic demand	net export	FY 1986	2.6%	4.1%	-1.5%	FY 1987	3.7%*	5.0%*	-1.3%*	FY 1988	3.8%*	4.7%*	-1.0%*
	real GNP growth	domestic demand	net export														
FY 1986	2.6%	4.1%	-1.5%														
FY 1987	3.7%*	5.0%*	-1.3%*														
FY 1988	3.8%*	4.7%*	-1.0%*														

Note : Japanese fiscal year begins on April 1 and ends on March 31.

Progress made	Notes						
<p>(2) FY 1988 Budget</p> <p>-- An extraordinarily large 20% increase was ensured in the FY 1988 budget over the FY 1987 initial budget for general public works, making an effective use of revenues accruing from the sale of stocks of the Nippon Telegraph and Telephone Corp.</p> <p>2. Tax Reforms</p> <p>-- Income tax reductions amounting to ¥1.54 trillion in FY 1987.</p> <p>Revision of taxation on interests and dividends including the abolition in principle of the non-taxable savings system (effective as from April 1, 1988).</p> <p>3. Shorter Working Hours</p> <p>-- The Labor Standard Law has been amended to reduce the statutory weekly working hours in stages from 48 hours to 40 hours.</p>	<p>o Housing construction is steadily increasing.</p> <p>Increase of the numbers of new housing construction starts over the corresponding period of the previous year:</p> <table data-bbox="1485 730 2083 826"><tr><td>FY 1986</td><td>11.9%</td></tr><tr><td>April to June, 1987</td><td>24.0%</td></tr><tr><td>July to September, 1987</td><td>28.2%</td></tr></table> <p>o Local inhabitants tax reductions scheduled for FY 1988 and FY 1989 amount to ¥660 billion.</p>	FY 1986	11.9%	April to June, 1987	24.0%	July to September, 1987	28.2%
FY 1986	11.9%						
April to June, 1987	24.0%						
July to September, 1987	28.2%						

Progress made	Notes
<p data-bbox="152 427 976 456">4. Transformation of Industrial Structure</p> <p data-bbox="230 491 1346 587">Various major industries have been taking structural adjustment measures including reduction in production capacity.</p> <ul data-bbox="271 624 1368 1294" style="list-style-type: none"><li data-bbox="271 624 1368 810">-- Coal: Under the 8th Coal Policy Plan the domestic coal supply is to be reduced to about 10 million tons in FY 1991, or only 50% of 20 million tons stipulated in the 7th Coal Policy Plan. The number of operating major coal mines went from 11 in April 1986 to 8 in October 1987.<li data-bbox="271 847 1368 970">-- Steel: The number of operating blast furnaces is scheduled to be reduced from 34 to 27; the work force in the steel sector is to be reduced from 140,000 to 100,000.<li data-bbox="271 1007 1173 1066">-- Shipbuilding: Measures include large-scale reductions in facilities.<li data-bbox="271 1102 1350 1161">-- Nonferrous mining: The number of mines in operation went from 52 in April 1986 to 32 in October 1987.<li data-bbox="271 1198 1368 1294">-- Aluminum: The number of companies in the aluminum smelting industry decreased from 4 in April 1986 to 1 in April 1987.	

Progress made	Notes
<p>5. Increased Direct Overseas Investment</p> <p>-- Direct overseas investment by all industries is rapidly expanding.</p> <p>FY 1986 \$22.3 billion (up 82.7% over FY 1985)</p> <p>April to September, 1987 \$15.8 billion (up 69.1% over the corresponding period in 1986)</p>	
<p>6. Agricultural Policy</p> <p>-- The rice production adjustment program is further reinforced, reducing the rice production acreage by 30% in FY 1987.</p> <p>-- The government-set prices for such products as rice, wheat and livestock have been lowered.</p> <p>-- Imports of agricultural, forest, and fishery products increased to about \$29.9 billion in 1986, up 13.9% over 1985, and those from January to October 1987 reached about \$30.1 billion, up 22% over the corresponding period in 1986.</p>	<p>o Price changes for 1987 from 1986: rice, -5.95%; wheat, -5.0%; pork, -15.4%; beef, -6.4%</p> <p>o Rise in imports in 1986 from 1985: beef, 19.4%; tobacco, 18.5%; grapefruit, 63.9%</p>
<p>7. Improvement of Market Access and Promotion of Manufactured Imports</p> <p>-- The complete implementation of the July 1985 Action Program for Improved Market Access is being accelerated:</p>	

Progress made	Notes						
<p>1) The average tariff rate on the 1,053 items chosen for tariff elimination or reduction has been reduced from 5.0% to 3.9%.</p> <p>2) Approximately 90% of the planned improvements in standards, certification systems, and import procedures have already been implemented.</p> <p>-- Additional imports of manufactured goods through government procurement totalling about \$1 billion in FY 1987.</p> <p>-- Requests for expansion of imports have been addressed to 302 major corporations in April 1987; the expected rise in their purchases of imports in FY 1987 is about \$8.3 billion.</p>	<p>o Average tariff rate on mining and industrial products: 2.1% (April 1986)</p>						
<p>8. Liberalization and Internationalization of Financial and Capital Markets</p> <p>-- An offshore market for financial transactions was inaugurated in Tokyo in December 1986.</p> <p>-- The following improvements have been achieved:</p> <p>1) further liberalization of interest rates on deposits,</p>	<p>o The share of manufactured goods in total imports:</p> <table data-bbox="1456 893 2105 1005"> <tr> <td>1985</td> <td>31.0%</td> </tr> <tr> <td>1986</td> <td>41.8%</td> </tr> <tr> <td>January to November, 1987</td> <td>44.1%</td> </tr> </table> <p>o As of October 1987, the total asset of the Tokyo offshore market comprised \$223.4 billion.</p>	1985	31.0%	1986	41.8%	January to November, 1987	44.1%
1985	31.0%						
1986	41.8%						
January to November, 1987	44.1%						

Progress made	Notes
<p>2) development of short-term financial markets (including establishment of a Commercial Paper market),</p> <p>3) increase of the number of the Tokyo Stock Exchange membership (from 93 companies to 114 companies),</p> <p>4) improvement of the access by foreign financial institutions to the Japanese government bond issues.</p> <p>9. Official Development Assistance (ODA) and Recycling of Funds to Developing Countries</p> <p>-- Implementation of the current medium-term ODA expansion program is being accelerated. The target of doubling ODA in the 7 year period from 1986 to 1992 will now have to be achieved by 1990, 2 years earlier than originally scheduled.</p> <p>-- In addition to the decisions to provide funds amounting to \$10 billion to developing countries, Japan will recycle more than \$20 billion in new and completely untied funds over the next 3 years to developing countries by way of the following; 1) making contributions to multilateral development banks and expansion of special funds within such banks (\$8 billion), 2) expanding co-financing with</p>	<p>o The allocation of about ¥701 billion for ODA in FY 1988 general account budget represents a 6.5% increase over the FY 1987 level.</p> <p>o About 87% of the \$10 billion recycling program and about 28% of that of \$20 billion have been committed in specific terms.</p>

Progress made	Notes						
<p>multilateral development banks and extending loans to support economic policies of developing countries (more than \$9 billion), 3) activating the untied loans of the Export-Import Bank of Japan (\$3 billion).</p> <p>10. Balance of International Payments</p> <p>-- While the volume of exports decreased (by 1.3% in FY 1986 from FY 1985, and by 4.0% in the period from July to September 1987 over the corresponding period in 1986), the volume of imports increased (by 14.1% in FY 1986 from FY 1985 and by 6.9% in the period from July to September 1987 over the corresponding period in 1986). The current account surplus is also diminishing. The surplus in FY 1986 was equivalent to 4.5% of GNP and that in July to September in 1987 was 3.4% of GNP.</p>	<p>o The current account surplus compared to GNP</p> <table><tbody><tr><td>FY 1985</td><td>4.5%</td></tr><tr><td>FY 1987</td><td>3.3%*</td></tr><tr><td>FY 1988</td><td>2.6%*</td></tr></tbody></table> <p>(* according to the Government Economic Outlook)</p>	FY 1985	4.5%	FY 1987	3.3%*	FY 1988	2.6%*
FY 1985	4.5%						
FY 1987	3.3%*						
FY 1988	2.6%*						

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FROM: J M G TAYLOR
DATE: 19 January 1988

NOTE FOR THE RECORD**VISIT OF MR TAMURA (JAPANESE MINISTER FOR INTERNATIONAL TRADE AND INVESTMENT)**

Mr Tamura paid a courtesy call on the Chancellor yesterday. He was accompanied by Mr Kuroda, the Vice-minister for International Trade and Investment, Mr Yoshida, the Deputy Director of the Trade Policy Board, the Japanese Ambassador H E Mr Yamasaki, and an interpreter. The Chancellor was supported by the Economic Secretary, Mr H P Evans and Mr D Savage.

2. Following an exchange of courtesies, Mr Tamura said he wished to give a brief account of the current state of the Japanese economy, and of Japan's current policy towards exchange rates. He distributed some notes (attached).

3. Mr Tamura said that the Japanese Government had introduced a package of emergency economic measures last May, in order to expand domestic demand. Real GNP in fiscal year 1988 was expected to expand by 3.8 per cent, with an expected growth rate in the medium term of around 4 per cent. Mr Tamura said that, in line with the Maekawa reports, Japan was planning for considerable structural adjustment. A declining trade surplus was expected. The extent of Japan's structural adjustment was exemplified by the running down of traditional industries, such as steel and non-ferrous metals.

4. Mr Tamura said that the Japanese were concerned about the fall in the dollar. They thought this could lead to a "shrinkage" in the use of the dollar in international trade, which would impact adversely on the free flow of goods. There should be stability in exchange rates, through international co-ordination. He expected

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that the US would continue to work to reduce its budget and trade deficits. He hoped that we would continue our efforts to encourage Germany to pursue more expansionary policies.

5. The Chancellor said there was little difference between the UK and Japan on the need for stability in exchange rates. It would be difficult to secure any stability in the dollar unless the US authorities were committed to this. The recent agreement between President Reagan and Mr Takeshita was a welcome sign that the US authorities were now so committed. His own view was that the dollar was probably undervalued. But it could go lower unless Governments and central banks pursued appropriate policies. The Chancellor said that the performance of the Japanese economy had been most impressive in recent years, especially given the adjustments which had been necessary to deal with the appreciation of the yen. This contrasted with the failure of the German economy to respond adequately to the appreciation of the Deutschmark. The Chancellor hoped that we would see further substantial moves, as soon as possible, to open up the Japanese market to a wide range of consumer goods. The Japanese economy was now so strong that it had no need of protection, nor of subsidies to its industries. In particular, subsidies to agriculture should be reduced. We were trying very hard ourselves to reduce the levels of agricultural support in the EC; we hoped that the Japanese would be able to make a determined move in this area as well. The Chancellor noted that there was a lot of Japanese investment in the UK: this was most welcome.

6. Mr Tamura said that there was plenty of room for more UK investment in Japan. The doors were wide open. There were no real barriers to the Japanese markets. He hoped that the Chancellor would further encourage British businessmen to invest in Japan.

7. The Chancellor pointed out that the recent GATT judgement about Scotch Whisky demonstrated that Japan's trade barriers were

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not entirely psychological. Mr Tamura said he had been taking the UK's side in this matter. The Japanese Government were seeking to change the structure of taxes so as to avoid this discrimination. A Bill was now before the Diet. He was determined that this should pass. The Chancellor said he was grateful for these assurances.

J M G TAYLOR

Copies to:

Those present
Sir P Middleton
Sir G Littler
PS/Prime Minister
PS/Secretary of State for Foreign and Commonwealth Affairs
PS/Secretary of State for Industry

Progress of Japan's Economic Structural Adjustment

January 1988

Progress made	Notes																
<p>1. Expansion of Domestic Demand</p> <p>(1) Emergency Economic Measures</p> <p>-- Measures to expand domestic demand totalling more than ¥6 trillion.</p> <p>1) Additional public investment and spending amounting to ¥5 trillion.</p> <p>2) Utilization of revenues accruing from the sale of Nippon Telegraph and Telephone Corp. stocks to consolidate the basis for private-sector projects in the implementation of public works projects.</p>	<p>o The scale of the measures to expand domestic demand included in the May 1987 Emergency Economic Measures was equivalent to 1.8% of GNP.</p> <p>o Economic growth led by domestic demand.</p> <table border="1" data-bbox="1447 892 2148 1224"> <thead> <tr> <th></th> <th>real GNP growth</th> <th>domestic demand</th> <th>net export</th> </tr> </thead> <tbody> <tr> <td>FY 1986</td> <td>2.6%</td> <td>4.1%</td> <td>-1.5%</td> </tr> <tr> <td>FY 1987</td> <td>3.7%*</td> <td>5.0%*</td> <td>-1.3%*</td> </tr> <tr> <td>FY 1988</td> <td>3.8%*</td> <td>4.7%*</td> <td>-1.0%*</td> </tr> </tbody> </table> <p>(* according to the Government Economic Outlook)</p>		real GNP growth	domestic demand	net export	FY 1986	2.6%	4.1%	-1.5%	FY 1987	3.7%*	5.0%*	-1.3%*	FY 1988	3.8%*	4.7%*	-1.0%*
	real GNP growth	domestic demand	net export														
FY 1986	2.6%	4.1%	-1.5%														
FY 1987	3.7%*	5.0%*	-1.3%*														
FY 1988	3.8%*	4.7%*	-1.0%*														

Note : Japanese fiscal year begins on April 1 and ends on March 31.

Progress made	Notes						
<p>(2) FY 1988 Budget</p> <p>-- An extraordinarily large 20% increase was ensured in the FY 1988 budget over the FY 1987 initial budget for general public works, making an effective use of revenues accruing from the sale of stocks of the Nippon Telegraph and Telephone Corp.</p> <p>2. Tax Reforms</p> <p>-- Income tax reductions amounting to ¥1.54 trillion in FY 1987.</p> <p>Revision of taxation on interests and dividends including the abolition in principle of the non-taxable savings system (effective as from April 1, 1988).</p> <p>3. Shorter Working Hours</p> <p>-- The Labor Standard Law has been amended to reduce the statutory weekly working hours in stages from 48 hours to 40 hours.</p>	<p>o Housing construction is steadily increasing.</p> <p>Increase of the numbers of new housing construction starts over the corresponding period of the previous year:</p> <table data-bbox="1433 702 2060 813"><tr><td>FY 1986</td><td>11.9%</td></tr><tr><td>April to June, 1987</td><td>24.0%</td></tr><tr><td>July to September, 1987</td><td>28.2%</td></tr></table> <p>o Local inhabitants tax reductions scheduled for FY 1988 and FY 1989 amount to ¥660 billion.</p>	FY 1986	11.9%	April to June, 1987	24.0%	July to September, 1987	28.2%
FY 1986	11.9%						
April to June, 1987	24.0%						
July to September, 1987	28.2%						

Progress made	Notes
<p data-bbox="147 400 958 427">4. Transformation of Industrial Structure</p> <p data-bbox="226 464 1323 563">Various major industries have been taking structural adjustment measures including reduction in production capacity.</p> <ul data-bbox="266 595 1346 1278" style="list-style-type: none"><li data-bbox="266 595 1346 786">-- Coal: Under the 8th Coal Policy Plan the domestic coal supply is to be reduced to about 10 million tons in FY 1991, or only 50% of 20 million tons stipulated in the 7th Coal Policy Plan. The number of operating major coal mines went from 11 in April 1986 to 8 in October 1987.<li data-bbox="266 823 1346 951">-- Steel: The number of operating blast furnaces is scheduled to be reduced from 34 to 27; the work force in the steel sector is to be reduced from 140,000 to 100,000.<li data-bbox="266 987 1155 1046">-- Shipbuilding: Measures include large-scale reductions in facilities.<li data-bbox="266 1083 1323 1142">-- Nonferrous mining: The number of mines in operation went from 52 in April 1986 to 32 in October 1987.<li data-bbox="266 1179 1346 1278">-- Aluminum: The number of companies in the aluminum smelting industry decreased from 4 in April 1986 to 1 in April 1987.	

Progress made	Notes
<p>5. Increased Direct Overseas Investment</p> <p>-- Direct overseas investment by all industries is rapidly expanding.</p> <p>FY 1986 \$22.3 billion (up 82.7% over FY 1985)</p> <p>April to September, 1987 \$15.8 billion (up 69.1% over the corresponding period in 1986)</p>	
<p>6. Agricultural Policy</p> <p>-- The rice production adjustment program is further reinforced, reducing the rice production acreage by 30% in FY 1987.</p> <p>-- The government-set prices for such products as rice, wheat and livestock have been lowered.</p> <p>-- Imports of agricultural, forest, and fishery products increased to about \$29.9 billion in 1986, up 13.9% over 1985, and those from January to October 1987 reached about \$30.1 billion, up 22% over the corresponding period in 1986.</p>	<p>o Price changes for 1987 from 1986: rice, -5.95%; wheat, -5.0%; pork, -15.4%; beef, -6.4%</p> <p>o Rise in imports in 1986 from 1985: beef, 19.4%; tobacco, 18.5%; grapefruit, 63.9%</p>
<p>7. Improvement of Market Access and Promotion of Manufactured Imports</p> <p>-- The complete implementation of the July 1985 Action Program for Improved Market Access is being accelerated:</p>	

Progress made	Notes						
<p>1) The average tariff rate on the 1,853 items chosen for tariff elimination or reduction has been reduced from 5.0% to 3.9%.</p> <p>2) Approximately 90% of the planned improvements in standards, certification systems, and import procedures have already been implemented.</p> <p>-- Additional imports of manufactured goods through government procurement totalling about \$1 billion in FY 1987.</p> <p>-- Requests for expansion of imports have been addressed to 302 major corporations in April 1987; the expected rise in their purchases of imports in FY 1987 is about \$8.3 billion.</p> <p>8. Liberalization and Internationalization of Financial and Capital Markets</p> <p>-- An offshore market for financial transactions was inaugurated in Tokyo in December 1986.</p> <p>-- The following improvements have been achieved:</p> <p>1) further liberalization of interest rates on deposits,</p>	<p>o Average tariff rate on mining and industrial products: 2.1% (April 1986)</p> <p>o The share of manufactured goods in total imports:</p> <table data-bbox="1442 874 2063 975"><tr><td>1985</td><td>31.0%</td></tr><tr><td>1986</td><td>41.8%</td></tr><tr><td>January to November, 1987</td><td>44.1%</td></tr></table> <p>o As of October 1987, the total asset of the Tokyo offshore market comprised \$223.4 billion.</p>	1985	31.0%	1986	41.8%	January to November, 1987	44.1%
1985	31.0%						
1986	41.8%						
January to November, 1987	44.1%						

Progress made	Notes
<p>2) development of short-term financial markets (including establishment of a Commercial Paper market),</p> <p>3) increase of the number of the Tokyo Stock Exchange membership (from 93 companies to 114 companies),</p> <p>4) improvement of the access by foreign financial institutions to the Japanese government bond issues.</p> <p>9. Official Development Assistance (ODA) and Recycling of Funds to Developing Countries</p> <p>-- Implementation of the current medium-term ODA expansion program is being accelerated. The target of doubling ODA in the 7 year period from 1986 to 1992 will now have to be achieved by 1990, 2 years earlier than originally scheduled.</p> <p>-- In addition to the decisions to provide funds amounting to \$10 billion to developing countries, Japan will recycle more than \$20 billion in new and completely untied funds over the next 3 years to developing countries by way of the following; 1) making contributions to multilateral development banks and expansion of special funds within such banks (\$8 billion), 2) expanding co-financing with</p>	<p>o The allocation of about ¥701 billion for ODA in FY 1988 general account budget represents a 6.5% increase over the FY 1987 level.</p> <p>o About 87% of the \$10 billion recycling program and about 28% of that of \$20 billion have been committed in specific terms.</p>

Progress made	Notes						
<p>multilateral development banks and extending loans to support economic policies of developing countries (more than \$9 billion), 3) activating the untied loans of the Export-Import Bank of Japan (\$3 billion).</p> <p>10. Balance of International Payments</p> <p>-- While the volume of exports decreased (by 1.3% in FY 1986 from FY 1985, and by 4.0% in the period from July to September 1987 over the corresponding period in 1986), the volume of imports increased (by 14.1% in FY 1986 from FY 1985 and by 6.9% in the period from July to September 1987 over the corresponding period in 1986). The current account surplus is also diminishing. The surplus in FY 1986 was equivalent to 4.5% of GNP and that in July to September in 1987 was 3.4% of GNP.</p>	<p>o The current account surplus compared to GNP</p> <table><tbody><tr><td>FY 1985</td><td>4.5%</td></tr><tr><td>FY 1987</td><td>3.3%*</td></tr><tr><td>FY 1988</td><td>2.6%*</td></tr></tbody></table> <p>(* according to the Government Economic Outlook)</p>	FY 1985	4.5%	FY 1987	3.3%*	FY 1988	2.6%*
FY 1985	4.5%						
FY 1987	3.3%*						
FY 1988	2.6%*						



Minister of International Trade
and Industry

CF

cc PC

DTI
HMT
FCO

CH/EXCHEQUER	
REC.	08 FEB 1988
ACTION	Mr H.P. EVANS
COPIES TO	PS/EST, PS/FST, PS/PMG, PS/EST, SIR G. LITTLE, MR ANSON, SIR BURNS, MR MONCK, MR BHATT, MR BURGNER, MR MOUNTFIELD, MR S.H. MATTHEWS, MR SAVAGE

✓
8/2

January 29, 1988

Her Excellency
Margaret Thatcher
Prime Minister
No. 10 Downing Street
London SW1
United Kingdom

Dear Prime Minister:

I write to tell you how very happy I was with the warm reception given me during my recent visit to your country. I deeply appreciate your having found an opportunity to talk with me despite the many calls upon your time. In particular, I wish to thank you again for the kind words you offered upon learning of my mother's illness. It was a satisfaction to be able, shortly before her death, to show my mother the picture you had taken with me and convey to her your sympathetic message.

I found it especially valuable to hear your views on the progress of my country's efforts to adjust its economic structure, including our latest moves to improve market access, and also to confirm with you the necessity for a further strengthening of Japanese-British economic ties.

On my part, I shall redouble my efforts to see that Japan more fully meets its obligations to the international community.

I informed Prime Minister Takeshita of the results of our discussion as soon as I returned to Tokyo, in particular your desire to arrange a meeting with him at an early date. I added that I, too, thought an early visit to United Kingdom most advisable. Mr. Takeshita was pleased that our talk had pointed to a further tightening of relations between Japan and United Kingdom, and indicated that he would like to meet with you as soon as possible.

Our meeting in London produced good results which I shall try my best to translate into closer ties between our two nations.

With my best wishes for your health and continued success.

Very truly yours,

田中 元

Hajime Tamura
Minister

P.S.

Two matters which you raised at our meeting -- Japanese trade trends, and the question of parking for imported cars at municipal car parks -- are now being looked into. Our ministry will inform the Department of Trade and Industry of our findings.



*Minister of International Trade
and Industry*

prof

✓
January 29, 1988

His Excellency
Rt Hon Nigel Lawson, MP
Chancellor of the Exchequer
HM Treasury
London SW1P 3AG
United Kingdom

Dear Chancellor :

I am very happy that my recent visit to United Kingdom gave me my first opportunity for a genuine conversation with you. I greatly appreciate your sparing me the time.

Particularly significant in our discussion was our agreement on the need for stable exchange rates and the policy coordination necessary to achieve them. On my part, I shall do my best to see that Japan fulfils its international obligations.

I informed Prime Minister Takeshita about our discussion directly upon my return. He was very pleased at the indications of a further tightening of Japanese-British relations that were apparent from our talk.

Our meeting in London produced good results which I shall try my best to translate into closer ties between our two nations.

With my best wishes for your health and continued success.

Very truly yours,

田村 九

Hajime Tamura
Minister



mp
✓

CH/EXCHEQUER	
REC.	08 FEB 1988
ACTION	Mr H. P. EVANS
COPIES TO	CST, FST, PMG, EST, SIR P. MIDDLETON, SIR G. LITTLE, SIR T. BURNS, MR MONCK, MR SCHOLAR, MR LANKESTER, MR BURGNER, MR S. J. MATTHEWS, MR P. G. DAVIS, MR MOLAN.

9/2 ✓

FCS/88/024

5/2/88

SECRETARY OF STATE FOR TRADE & INDUSTRY

"Imperialist Japan"

1. I had a chance of looking at "Imperialist Japan", a newly published book by Michael Montgomery, just before I went to Japan. The book's epilogue is a catalogue of unfair trading practices by Japan in the post-war period. I read this with some interest since it called to mind some of my own experiences with Japan since I first went there as Trade Minister in 1973. Both as Minister for Trade and Foreign Secretary our dealings with Japan have sometimes reminded me of Hercules' battle against the hydra: as soon as one barrier to trade is removed, another seems to spring up in its place.

2. Mr Montgomery's epilogue struck a second chord, in the picture it suggested of Japan as a society struggling towards openness. There is no liberal tradition in Japan: instead there is an instinctive nationalism which in the post-war period has often expressed itself in the economic field. Even among the internationally-minded, Japanese instincts are still towards a strong industrial policy; and protectionism goes naturally with this. None of this is, perhaps, very surprising after 300 years of isolation followed by a century of more or less tight State control. Caution and scepticism will be required for some time to come.



3. Where I part company with Mr Montgomery is that I do not think he takes adequate account of the changes that have taken place in the last 10-15 years. What is most remarkable is not that Japan was a closed market in the 1950s and 1960s but that it has since then moved as far as it has in the right direction - though the psychology of many Japanese still lags behind. Michael Montgomery's list alarmed me sufficiently that I had officials look into the specific examples he quoted with the limited resources available (your department no doubt has fuller data). My conclusion was that, almost without exception, the barriers listed by Montgomery had disappeared. In most cases foreign pressure had been needed but the Japanese government had at least responded. Here is a selection of examples:

Page 501: Foreign Exchange and Foreign Trade Control Law was gradually liberalised over the period 1967-72, with approval in May 1973 for 100% foreign ownership of subsidiaries in most industries.

Page 505: Tax exemption on up to 80% of export profits. This system operated from 1955-1964. Thereafter the system of export related accelerated depreciation applied. This was abolished in 1972 and was not replaced.

Page 505: IBM forced to license Patents locally. Late 1950s. According to the Boston Consulting Group, quantitative restrictions on computers were among the last to be lifted in the 1970s and until the late 1970s MITI actively discouraged Japanese companies from buying



foreign. By the early 1980s, however, the private sector of the computer market was essentially open - imports accounted for over 40%. (The public sector was, however, protected by purchasing policies). By 1983 Nippon IBM was Japan's 22nd most profitable company (profits at \$373m).

Page 507: Japanese numerically-controlled machine tools captured 60% of the US market by means of cut prices, subsidised "by the \$1 billion annual levy culled by MITI from licensed gambling on bicycle racing". Exaggerated. It is true that the Japan Machinery Exporters Association benefits from the revenue of the bicycle racing fund, but (a) this is worth about yen 4 billion pa; (b) it is used to finance research and development as well as export promotion; (c) the fund is divided among a large number of industries covered by the Exporters Association, including plant and equipment, for example. The impact on numerically-controlled machine tools has almost certainly been tiny.

Page 511: Every imported car has to be individually tested: no longer true.

Page 511: All foreign drugs have to be tested in Japanese laboratories or on Japanese. True. This requirement is not necessarily unreasonable since Japanese have a different diet, a different physiology (eg an extra metre of intestine) and are prone to different diseases. We should like to see certain improvements (the Commission



has sectoral talks in this area) but drug testing is a difficult area in all countries. In the UK it takes seven years to test a new drug.

Page 511: "New non-international standards imposed on skis" - not as simple as that. A new standard would have meant that skis not meeting that standard could not have been sold in Japan. What actually happened was that local manufacturers devised their own standard and persuaded insurance companies in Japan to offer insurance only where this standard was met. Foreign skis could still be sold but were placed at a disadvantage. The Japanese government was not involved until foreign governments started complaining: it then persuaded those concerned to drop the scheme.

4. It is possible to think of other examples as well - and again your department will know more about this than mine - but in the cases of which I am aware, such as seat belts for rally cars, or the cockpit configuration of the HS146, the Japanese government has acted to remove the problems.

5. As I recorded in my minute to the Prime Minister, I was agreeably surprised to hear British businessmen in Japan tell me that in their view most of the major barriers to imports had now been lowered (leaving aside whisky and the financial services sector where there is still work to be done). A glance at the MITI budget suggests that there have been major changes in MITI's role as well. Apart from energy and assistance for small and medium sized enterprises, a strikingly large



proportion of their funds seem now to be used for import finance and for assistance for overseas investment. And proportionately, Government subsidies for research and development are less than in most Western countries.

6. My conclusion is that Japan is indeed inching towards a more internationalist position, in politics as well as trade. It is important that they should succeed. It is also important for us not to let memories of past unfair practices blind us to the very real opportunities which Japan offers today. Hence the "plain speaking partnership" of which I spoke in Tokyo.

7. I am copying this minute to the Prime Minister and the Chancellor of the Exchequer.

(GEOFFREY HOWE)



CH/EXCHEQUER	
REC.	16 FEB 1988
ACTION	Mr H.P. EVANS
COPIES TO	CST, FST, PMG, EST, SIR P. MIDDLETON, SIR G. LITTLER SIR T. BURNS, Mr MONCK, Mr SCHOLAR, Mr LANKESTER, Mr S.W. MATTHEWS, Mr P.G. DAUS, Mr MOLAN.

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16/2

M

Foreign and Commonwealth Office

London SW1A 2AH

15 February 1988

Dear Charles

Visit by the Japanese Prime Minister

The Japanese Embassy have proposed that the Japanese Prime Minister, Mr Takeshita, should visit the UK from 3-5 May. He also hopes to visit the FRG and Italy (but not France, because of the Presidential elections). The Embassy have sought our confirmation that these dates are convenient.

The Prime Minister invited Mr Takeshita to visit the UK on the way back from his visit to the United States in January. He was unable to take this up but said that he hoped mutually convenient dates might be found before the Toronto Summit.

We hope that the Prime Minister will be able to receive Mr Takeshita and offer him some entertainment. In view of the need for interpretation, it would be wise to allow 1½ hours for talks, if possible.

The Japanese would see a dinner as a great honour (formal lunches are comparatively rare in Japan). If the Prime Minister's schedule makes a lunch more convenient, it would be presentationally better to make it a working lunch.

We are looking into the options for the remainder of Mr Takeshita's programme. We have not yet heard from the Japanese of any special wishes on the part of Mr Takeshita. It may be appropriate to arrange a Guard of Honour before talks with the Prime Minister, and the Lord Mayor has agreed in principle to host a lunch for Mr Takeshita - this would be an opportunity to meet business leaders. The Government Hospitality Fund have agreed to accept Mr Takeshita as a guest of government.

Does the Prime Minister agree that we may now confirm to the Japanese that a visit on the dates proposed is convenient?

I am copying this letter to Alex Allan, Alison Brimelow and Trevor Woolley.

Yours ever
Alison Brimelow
(P. N. Culshaw)



10 DOWNING STREET
LONDON SW1A 2AA

✓
18/2

CH/EXCHEQUER	
REC.	18 FEB 1988
ACTION	Mr H.P. EVANS
COPIES TO	CST, PST, PMG, EST, Sir P. MIDDLETON, Sir G. LITTLE, Sir T. BURNS, Mr MONCK Mr SCHOLAR Mr LANKESTER, Mr S.W. MATTHEWS Mr P.G. DAVIS, Mr MOLAN

17 February 1988

From the Private Secretary

VISIT BY THE JAPANESE PRIME MINISTER

Thank you for your letter of 15 February about the visit of the Japanese Prime Minister. The Prime Minister will see Mr Takeshita on Tuesday 3 May from 1000-1130 and give a dinner for him that evening.

I am copying this letter to Alex Allan (HM Treasury), Alison Brimelow (Department of Trade and Industry) and Trevor Woolley (Cabinet Office).

Charles Powell

R.N. Culshaw, Esq., MVO.,
Foreign and Commonwealth Office.

dti

the department for Enterprise

Ch. / Another trip to Japan for Lt. Young!

The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

Rt Hon Sir Geoffrey Howe QC MP
Secretary of State for Foreign
and Commonwealth Affairs
Foreign and Commonwealth Office
Downing Street
LONDON SW1A 2AL

Unfair. He is after a chance!

2/22/2

Department of
Trade and Industry

1-19 Victoria Street
London SW1H 0ET

Switchboard
01-215 7877

Telex 8811074/5 DTHQ G
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CH/EXCHEQUER	
REC.	22 FEB 1988
ACTION	Mr H.P. EVANS
COPIES TO	EST, PFI, PMG, EST Sir P. MIDDLETON, S. G. CITLER, Sir T. BURNS, Mr MONCK, Mr SCHOLAR, Mr LANKESTER, Mr BURGNER, Mr S.W. MATTHEWS, Mr P.G. DAVIS, Mr MOLAN

Direct line 215 5422
Our ref DC6ABH
Your ref
Date 18 February 1988

Geoffrey

Thank you for your minute of 5 February on Michael Montgomery's recent work "Imperialist Japan".

I have not yet had the opportunity to read Mr Montgomery's book. Although I welcome what you say about Mr Montgomery's recognition of the dangers of protectionism, like you I regret undue emphasis on past barriers to trade, rather than present and future opportunities. Japan's trade practices are not perfect: for instance alcoholic beverages form one sector where we and the Community must continue to press Japan. But we should not let particular difficulties distract the attention for our exports to what is the third largest economy in the world, and one which has a lower average tariff than either the US or the EC. It is for these reasons, amongst others, that I will be announcing later this month an "Opportunity Japan" campaign, and I have asked the businessmen accompanying me to Japan in March to help me spread the message to their colleagues on return. Provided we avoid complacency, the prospects for UK plc in Japan are good.

I am sending copies of this letter to the Prime Minister and the Chancellor of the Exchequer.

John G. ...

the Enterprise Initiative

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PS/CHANCELLOR
H.M. TEASURY.

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FM TOKYO

TO PRIORITY DOE

TELNO DOEMS 03

OF 230827Z FEBRUARY 88

AND TO PRIORITY DTI, WASHINGTON, UKREP BRUSSELS, UKDEL OECD

AND TO PRIORITY UKMIS GENEVA

DOE FOR CONSTRUCTION DIRECTORATE

DTI FOR OT2

OUR TELNOS 101 AND 117 US/JAPAN TALKS ON JAPANESE CONSTRUCTION MARKET

SUMMARY

1. TALKS BREAK DOWN WITH U S SIDE UNHAPPY WITH THE ACCESS TO SIX PROJECTS OFFERED BY JAPAN. NEXT ROUND TO TALKS IN WASHINGTON IN THE SPRING.
2. PARTIAL EVOLUTION OF JAPANESE THINKING ON ACCESS FOR THIRD COUNTRIES, AWAY FROM RECIPROCITY AND TOWARDS QUOTE MUTUAL BENEFIT UNQUOTE AS CRITERION.

DETAIL

3. TALKS HELD IN TOKYO 17-19 FEBRUARY BETWEEN THE AMERICANS AND JAPANESE DESIGNED TO HELP ACCESS FOR US FIRMS TO JAPANESE PUBLIC WORKS ENDED WITHOUT AGREEMENT. FAREN, DEPT UNDER-SECRETARY OF COMMERCE AND LEADER OF THE US DELEGATION, REMAINED UNHAPPY WITH BOTH THE SCOPE AND PERMANENCE OF MEASURES PROPOSED BY THE JAPANESE DELEGATION (LED BY SATO, DIRECTOR GENERAL OF THE ECONOMIC AFFAIRS BUREAU, MFA). THESE MEASURES WOULD:
A) ENSURE THAT THE EXPERIENCE OF FOREIGN FIRMS OUTSIDE JAPAN WOULD BE TAKEN INTO ACCOUNT WHILE COMPILING THE LIST OF DESIGNATED BIDDERS FOR SIX - AND ONLY SIX - PUBLIC WORKS PROJECTS (THE EXPANSION OF HANEDA AIRPORT, THE NEW HIROSHIMA AIRPORT, THE AKASHI STRAIT BRIDGE, THE ISE BAY HIGHWAY, THE TOKYO BAY COASTAL DEVELOPMENT, AND THE YOKOHAMA URBAN PROJECT MINATO MIRAI) COMMENT: THE JAPANESE INTENTION IS THAT EXPERIENCE GAINED IN JAPAN ON THESE CONTRACTS WOULD THEN BE THE BASIS ON WHICH US FIRMS WOULD CLAIM THE RIGHT TO BID FOR OTHER PROJECTS FOR WHICH THE DOMESTIC EXPERIANCE RULE WOULD REMAIN IN FORCE, AND
B) SIMPLIFY PROCEDURES AND INCREASE TRANSPARANY.
4. DISCUSSION APPEARS TO HAVE SNAGGED ON THE SCOPE OF THE SIX

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PROJECTS, WITH THE QUESTION OF TRANSPARENCY AND SIMPLIFICATION OF PROCEDURES DEALT WITH ONLY IN PASSING. THE AMERICANS ACCEPTED THE NEED TO WORK WITHIN THE JAPANESE DESIGNATED BIDDING SYSTEM, BUT HAD THREE DIFFICULTIES WITH THE JAPANESE PROPOSAL. FIRST, THERE WERE STILL TOO FEW PROJECTS OPENED TO ALLOW US FIRMS A CHANCE OF BUILDING UP DOMESTIC JAPANESE EXPERIENCE. ULTIMATELY THE US WANTS ALL PUBLIC PROJECTS TO TAKE FOREIGN EXPERIENCE INTO ACCOUNT, AND HAS PASSED A LIST OF FOURTEEN PROJECTS, (INCLUDING THE KANSAI AIRPORT, THE TOKYO BAY BRIDGE AND THE OFFERED SIX PROJECTS) TO THE JAPANESE TO INDICATE IMMEDIATE PRIORITIES. SECOND, AND THE NUB OF THE TALKS' COLLAPSE, MUCH OF THE TECHNOLOGY-INTENSIVE WORK CONNECTED WITH THE SIX PROJECTS IS EXCLUDED FROM THE PUBLIC PORTION OF THE PROJECT AND THUS, ACCORDING TO THE JAPANESE, CANNOT BE INCLUDED IN ANY GOVERNMENTAL PACKAGE TO ALLOW SPECIAL ACCESS FOR US FIRMS. THE GOVERNMENT IS SUPERVISING ONLY THE CIVIL WORK OF THE HANEDA EXTENSION FOR EXAMPLE, AND MORE SOPHISTICATED TASKS SUCH AS THE TERMINALS, CONSULTANCY AND DESIGN ARE LEFT TO A PRIVATE FIRM SIMILAR TO THE KANSAI INTERNATIONAL AIRPORT COMPANY. FARREN ARGUED THAT THIS UNACCEPTABLY DENIED US FIRMS ACCESS IN THOSE SECTORS WHERE THEY WERE STRONGEST. THE JAPANESE REPLIED THAT FOREIGN FIRMS COULD ALREADY ENTER THE PRIVATE SECTOR FREELY. FINALLY, THE AMERICANS REMAINED UNHAPPY THAT THE JAPANESE PROPOSALS WOULD BE TEMPORARY MEASURES ALLOWING A LIMITED NUMBER OF FOREIGN FIRMS INTO THE MARKET WITHOUT MAKING ANY PERMANENT CHANGE TO THE SYSTEM. THIS WOULD LEAVE THE MARKET AS IMPENETRABLE FOR A NEWCOMER IN TEN YEARS AS IT WAS NOW.

5. IN DEBRIEFING, BOTH THE AMERICANS AND JAPANESE EXPRESSED FRUSTRATION THAT TOO MUCH TIME HAD BEEN SPENT RESTATING POSITIONS AND TOO LITTLE IN NEGOTIATING. THE NEXT ROUND OF TALKS WOULD TAKE PLACE IN WASHINGTON IN PERHAPS LATE MARCH OR EARLY APRIL.

COMMENT

6. BOTH SIDES ARE PLAYING HARD-BALL AND, DESPITE THIS RUPTURE, SOME KIND OF AGREEMENT SEEMS LIKELY LATER IN THE YEAR. REPORTING AND BRIEFING BY BOTH SIDES HAS MADE LITTLE ATTEMPT TO GLOSS OVER THE ESSENTIALLY BILATERAL EMPHASIS OF THE TALKS. THE JAPANESE ARE NOW TALKING OF USING MUTUAL BENEFIT RATHER THAN RECIPROCITY AS THE CRITERION FOR EXTENDING TO THIRD COUNTRIES THE PRINCIPLES OF ANY ACCORD WITH THE AMERICANS. THE MFA DECLINED TO DEFINE THIS TERM CLEARLY, BUT IT WOULD APPEAR TO SUGGEST

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THAT THE JAPANESE WILL JUDGE THE VALUE OF EXTENDING CONCESSIONS TO, SAY, THE UK LESS ON THE OPPORTUNITIES IN PRINCIPLE FOR JAPANESE FIRMS IN UK PUBLIC PROJECTS AND MORE ON THE ACTUAL COMMERCIAL INTEREST AND PERHAPS EVEN RECORD OF CONTRACTS WON BY JAPANESE FIRMS IN THE UK. EVEN IF THE JAPANESE CONTINUE TO TALK OF RECIPROCITY THEY MAY NOW INTERPRET THIS AS A MORE RESTRICTIVE SENSE, WITH THE SAME EFFECT. EITHER WAY, THE AIM IS PROBABLY TO LIMIT THOSE COUNTRIES WHO FIRMS CAN GAIN ACCESS TO PUBLIC PROJECTS IN JAPAN, ESPECIALLY CHINA AND ROK. BUT IT COULD ALSO CATCH OUR FIRMS.

7. WE NEED THEREFORE TO KEEP UP THE ~~QUITE~~ PRESSURE ON BOTH JAPAN AND THE US SO THAT THE UK IS IN A POSITION OF PRINCIPLE AT LEAST TO TAKE ADVANTAGE OF WHATEVER CONCESSIONS THE JAPANESE MAKE TO THE US. THE JAPANESE WILL RESIST ALLOWING CONCESSIONS TO EUROPE AS A WHOLE WHILE IT REGARDS BOTH THE PRACTICES OF MEMBER STATES AND THEIR INTEREST FOR JAPANESE FIRMS AS SO DIVERSE. AT THE SAME TIME, WE NEED TO SUPPORT THE AMERICAN DEMAND THAT ANY CHANGES ARE NOT TEMPORARY SO THAT CONCESSIONS GIVEN NOW WILL STILL APPLY TO THOSE CONSTRUCTION FIRMS OF OURS WHICH MAY HAVE AN INTEREST IN FIVE YEARS TIME.

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