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PART 2

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Internal Situation

JAPAN

PT 1: November 1979

PT 2: March 1987

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
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PART 2 ends:-

JSW to FCO 28 10 91

PART 3 begins:-

PM to PM Miyazawa 5 11 91

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10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

28 October 1991

NEW JAPANESE PRIME MINISTER

Thank you for your letter of 25 October enclosing a draft message from the Prime Minister to Mr. Miyazawa. The Prime Minister agrees with the draft with the minor amendments shown in manuscript on the enclosed copy.

I should be grateful if you could arrange for the message to issue once Mr. Miyazawa is elected Prime Minister.

(J. S. WALL)

S. L. Gass, Esq.,
Foreign and Commonwealth Office.

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SCANNED

DRAFT MESSAGE FROM PRIME MINISTER TO JAPANESE PRIME MINISTER

Congratulations on ~~I was delighted to learn of~~ your election as Prime Minister of Japan.

The last few years have seen the relationship between Japan and the United Kingdom strengthen in virtually every area. We have welcomed the dynamic contribution that Japanese investment has made to the British economy. Our two countries have cooperated closely on trade matters during the "Opportunity Japan" export campaign and are now seeking to expand British investment in Japan, technology transfer, tourism and British exports in important sectors such as aerospace. Increasing our cooperation in the scientific field is also an important objective for us.

Our cultural links are also very close. Last year saw the largest ever British cultural festival in Japan and this year the Japan Festival has produced a dramatic growth of interest in all aspects of Japanese art, culture and society throughout Britain.

Above all, ~~though,~~ I welcome the closeness of our political contacts. Japan and the United Kingdom have a common approach to many of the global problems that now face us. I have particularly valued the contribution that Japan has made within the G7 and in helping to reach a consensus on ~~a common approach to~~ the many problems of the Soviet Union.

I am sure that with your help we shall be able to make further progress in all these areas. I have heard much of your experience and understanding of the great international problems which

confront us and much look forward to meeting you. I hope that this may be in January when I am hoping to make my first ever visit to Japan.

Once again, my warmest congratulations.

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MDHIAN 9350

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FM TOKYO
TO IMMEDIATE FCO
TELNO 883
OF 280824Z OCTOBER 91
INFO ROUTINE SEOUL, PEKING, WASHINGTON

LDP PRESIDENTIAL ELECTION

SUMMARY

1. MIYAZAWA WINS LDP PRESIDENTIAL ELECTION, BUT WITH SIGNIFICANT DEFECTIONS BY TAKESHITA FACTION MEMBERS. WATANABE DOES BETTER THAN PREDICTED.

DETAIL

2. ON 27 OCTOBER IN THE LDP PRESIDENTIAL ELECTION MIYAZAWA CAME FIRST WITH 285 VOTES, WATANABE SECOND WITH 120 VOTES AND MITSUZUKA THIRD WITH 87. MIYAZAWA THUS OBTAINED A CLEAR MAJORITY AT THE FIRST ROUND. (THE 395 LDP DIET MEMBERS HAD ONE VOTE EACH, AND 101 VOTES WERE ALLOCATED TO THE 1.75 MILLION RANK AND FILE PARTY MEMBERS).

3. MIYAZAWA HAD HOWEVER BEEN EXPECTED TO WIN 300 OR MORE OF THE VOTES INCLUDING 217 DIET MEMBERS' VOTES RATHER THAN THE 207 HE ACTUALLY RECEIVED. AT LEAST 10, MORE PROBABLE 25, MEMBERS OF THE TAKESHITA AND KOMOTO FACTIONS MUST HAVE DISOBEYED FACTIONAL ORDERS AND VOTED FOR WATANABE OR MITSUZUKA RATHER THAN MIYAZAWA. SOME PUNDITS SUGGEST THAT THIS WAS A PLOT BY THE TAKESHITA FACTION TO KEEP MIYAZAWA ON HIS TOES. MORE PROBABLY IS THAT THE VOTE REPRESENTS DISCONTENT WITHIN THE FACTION AT THE LEADERSHIP'S CHOICE OF MIYAZAWA - A RARE SHOW OF DISUNITY IN A NORMALLY WELL-DISCIPLINED FACTION AND A POSSIBLE SIGN OF TROUBLE TO COME. MIYAZAWA WILL NEED TAKESHITA FACTION SUPPORT TO OBTAIN PARTY CONSENSUS ON A NUMBER OF ISSUES, AND THAT SUPPORT MAY NOT BE AS WHOLE-HEARTED OR EFFECTIVE AS HE WOULD LIKE.

4. WATANABE'S INFLUENCE WILL HAVE BEEN BOLSTERED BY HIS STRONG SHOWING IN SECOND PLACE, AND HIS FUTURE PROSPECTS FOR TAKING OVER AS PRIME MINISTER HAVE BRIGHTENED. MIYAZAWA WILL PROBABLY HAVE TO APPOINT HIM AS DEPUTY PRIME MINISTER AS WELL AS GIVING HIM A SENIOR POST IN THE NEW CABINET. WATANABE HAS MADE IT CLEAR THAT

HE WOULD LIKE THE POST OF FOREIGN MINISTER ALTHOUGH MIYAZAWA MAY RESIST THIS.

5. ATTENTION IS NOW FOCUSSED ON THE APPOINTMENTS TO CABINET AND TOP LDP POSTS. WE SHALL COMMENT FURTHER WHEN THESE ARE KNOWN. SEE MIPT FOR COMMENT ON MIYAZAWA.

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Foreign &
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London SW1A 2AH

25 October 1991

Dear Stephen,

New Japanese Prime Minister

Mr Kiichi Miyazawa is due to be elected President of the Japanese Liberal Democratic Party on 27 October, and confirmed by the Diet as Prime Minister on 5 November.

I enclose a biographical note on Mr Miyazawa, whom the Prime Minister has not, we think, met. He will be the first Prime Minister for nearly 40 years to speak English fluently. His election could make it easier for Japan to project herself as a country whose basic policies and objectives are in line with those of the West. Mr Miyazawa is the product of Japanese machine politics of a classical kind. His dependence upon the support of the LDP faction led by former Prime Minister Takeshita will be as strong as that of his predecessor, and is likely to make him cautious in his policy. So far, his pronouncements on policy have not broken new ground.

Mr Miyazawa is unlikely to be Prime Minister for more than two years or so, since the Takeshita faction, on whose patronage he depends, are likely to want a younger candidate by then.

I enclose the text of a message that the Prime Minister may wish to send Mr Miyazawa on his election as Prime Minister on 5 November.

Yours ever,

(S L Gass)
Private Secretary

TEMPORARILY RETAINED J. Gray 25/3/2017
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J S Wall Esq
10 Downing Street

Premiership again. Like most Japanese politicians he has tried to maintain a position on the international stage. Among his recent foreign visits, he went to the US in December 1989, when he met both Bush and Baker, and China in July 1990.

Miyazawa is seen as a political heavyweight: he heads his own faction, has considerable Cabinet experience and, rather unusual for a Japanese politician, is fluent in English and speaks some French. He is urbane and articulate and has a reputation for great intelligence. But he is also seen as an elitist who lacks the common touch; aloof and snobbishly attached to his Tokyo University/Ministry of Finance background. He is not as adept as his rivals in the Takeshita faction at back-room politicking and will, therefore, be dependent not only on this faction's votes but also on its expertise in this field.

He is married with two children, one of whom married a diplomat in the US Embassy in Tokyo; now serving in Washington.

As well as being at home reading English books and magazines, he is also a devoted reader of Chinese classics and is an expert on "kouta" a type of short, traditional Japanese ballad. He is also partiuclarly fond of Noh plays.

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TELNO 824
OF 070808Z OCTOBER 91
INFO ROUTINE WASHINGTON, PEKING, SEOUL

MIPT: THE KAIFU PREMIERSHIP

SUMMARY

1. THE LAST TWO YEARS HAVE EXPOSED THE GAP BETWEEN JAPAN'S ASPIRATIONS TO BECOME A MAJOR ACTOR ON THE WORLD POLITICAL SCENE AND THE QUALITY OF ITS POLITICAL LEADERSHIP. KAIFU HIMSELF WON HIGH POPULARITY RATINGS FOR HIS SINCERITY IN COPING WITH THE PROBLEMS, BUT HE WAS ALWAYS A PRISONER OF THE FACTION SYSTEM AND FAILED IN HIS ATTEMPT TO CHANGE IT. NEVERTHELESS, JAPAN HAS CHANGED IN THE LAST TWO YEARS AND WILL CONTINUE TO INCH FORWARD.

DETAIL

2. KAIFU SHOULD NEVER HAVE BECOME PRIME MINISTER. HE WAS PROPELLED INTO THE JOB FROM THE SMALLEST LDP FACTION ONLY BECAUSE ALL THE LEADERS OF THE FOUR BIG FACTIONS WERE INVOLVED IN SCANDAL. HIS MISSION WAS TO HOLD THE FORT UNTIL THE POLITICAL SITUATION CALMED AGAIN. IN PRACTICE HE WAS ALMOST AT ONCE ENGULFED IN INTERNATIONAL CRISES WHICH HAVE POSED AND POSE AN ENORMOUS CHALLENGE TO JAPAN'S ASPIRATIONS TO BECOME A WORLD POLITICAL POWER.

3. AGAINST THAT BACKGROUND, KAIFU POINTS TO A RECORD OF GENUINE ACHIEVEMENT:-

- THE LDP SUFFERED ELECTORAL DEFEAT IN JULY 1989 AND LOST CONTROL OF THE UPPER HOUSE. UNDER KAIFU, IT RECOVERED TO WIN A CLEAR MAJORITY IN FEBRUARY 1990 IN THE ELECTION FOR THE MORE POWERFUL LOWER HOUSE. ALL POLLS NOW GIVE IT AN EXTREMELY HIGH LEVEL OF POPULAR SUPPORT (WELL OVER 50 PER CENT, IN ONE POLL 65 PER CENT). MISS DOI HAS HAD TO RESIGN FROM LEADERSHIP OF THE MAIN OPPOSITION PARTY TO TAKE RESPONSIBILITY FOR A STRING OF LOCAL ELECTION DEFEATS, AND HER PARTY REMAINS IN DISARRAY.

- THE JAPANESE ECONOMY IS ONLY NOW SLOWING DOWN AFTER THE LONGEST PERIOD OF CONSISTENT GROWTH IN POST-WAR HISTORY.

- DURING THE GULF WAR, IN SPITE OF PACIFIST SENTIMENT AMONG THE

PEOPLE, THE JAPANESE GOVERNMENT CONSISTENTLY SUPPORTED THE ALLIED CAUSE AND CONTRIBUTED USD 13 BILLION TO ALLIED COSTS AND REGIONAL COUNTRIES. AFTER THE WAR, AN IMPORTANT PRECEDENT WAS SET BY THE DESPATCH OF MINESWEEPERS TO THE GULF.

- KAIFU WAS ACTIVE IN PROMOTING JAPANESE INTEREST IN EASTERN EUROPE AND PROVIDING AID. JAPAN HAS KEPT IN STEP WITH G7 PARTNERS ON THE SOVIET UNION WHILE PURSUING ITS OWN BILATERAL AGENDA. IT HAS LED WESTERN MOVES TO RE-ESTABLISH CONTACTS WITH THE CHINESE, AND TAKEN INITIATIVES ON CAMBODIA. GREATER POLITICAL CONDITIONALITY HAS BEEN INTRODUCED TO THE LARGE JAPANESE AID PROGRAMME.

- AFTER A MAJOR NATIONAL DEBATE, KAIFU CAME VERY CLOSE TO SECURING PARLIAMENTARY APPROVAL FOR A BILL TO SEND SELF-DEFENCE FORCE UNITS TO PARTICIPATE IN UN PEACE-KEEPING FORCES AND PROSPECTS FOR SECURING THAT APPROVAL EARLY IN THE NEXT DIET SESSION ARE VERY

GOOD.

4. KAIFU'S CRITICS RESPOND THAT KAIFU'S PERSONAL CONTRIBUTION TO ALL THIS WAS MODEST. HE DEPENDED ON THE BUREAUCRACY TO PRODUCE POLICY PROPOSALS AND THEN ON POWERFUL LDP BOSSES TO PUSH THEM THROUGH - A SITUATION IN WHICH DECISIONS WERE DELAYED AND KAIFU HIMSELF GAVE EVERY IMPRESSION OF INDECISIVENESS, WITH FATAL CONSEQUENCES FOR JAPAN'S OVERSEAS IMAGE. USD 13 BILLION, SAY THE CRITICS, MEANT RAISING TAXES IN JAPAN BUT EARNED NO THANKS AROUND THE WORLD.

5. TO SOME EXTENT THESE CHARGES HAVE BEEN EXAGGERATED FOR RIVALS' POLITICAL GAIN, BUT THEY HAVE A BEDROCK OF TRUTH. KAIFU COULD NOT CONTROL HIS OWN PARTY WITHOUT BACKING FROM TAKESHITA AND HIS FACTION - A FACT DRAMATICALLY EXPOSED LAST WEEK WHEN THAT BACKING WAS SUDDENLY WITHDRAWN. ALTHOUGH CHARGES THAT HE WAS A PUPPET ARE UNFAIR, THERE WAS A FUNDAMENTAL WEAKNESS IN KAIFU'S POSITION, WHICH UNDERMINED HIS PRESTIGE AND PERHAPS EVEN HIS SELF-CONFIDENCE.

6. KAIFU'S BIGGEST SINGLE FAILURE WAS HIS FAILURE TO REFORM THE POLITICAL SYSTEM. THE IMPETUS OF THE RECRUIT SCANDAL AND A FEELING AMONG SOME LDP POLITICIANS THAT POLITICS COULD NOT GO ON AS THEY ARE, PRODUCED AMBITIOUS PROPOSALS FOR REFORM OF THE ELECTORAL SYSTEM AND OF POLITICAL FINANCING. THE AIM WAS TO REDUCE THE POWER OF THE FACTIONS, TO REDUCE THE IMPORTANCE OF FINANCIAL

CONTRIBUTIONS AND TO ENCOURAGE POLITICIANS TO FOCUS ON NATIONAL ISSUES RATHER THAN LOCAL PORK-BARRELLING. KAIFU IS PERSONALLY COMMITTED TO THIS CAUSE AND WITH THE TAKESHITA FACTION HELP RAMMED THE PROPOSALS THROUGH THE LDP. BUT IN THE END, THE VESTED INTERESTS OF LDP AND OPPOSITION POLITICIANS PROVED TOO STRONG FOR HIM. THIS ISSUE HAS BEEN LEFT FOR HIS SUCCESSOR. IT WILL NOT GO AWAY.

7. IT IS ONE OF THE KEY ISSUES NOW ON THE AGENDA OF THOSE WHO WANT TO SEE JAPAN PLAY A LEADING POLITICAL ROLE IN WORLD AFFAIRS. THE LAST TWO YEARS HAVE EXPOSED HOW FAR THE DOMESTIC BASIS FOR THAT IS STILL INADEQUATE, BUT HAVE ALSO PROMPTED SOME GENUINE MOVEMENT FORWARD ON SUCH FACTORS AS:-

- BUREAUCRATIC INFRASTRUCTURE. THE MFA AND OTHER MINISTRIES HAVE DEVELOPED SYSTEMS AND MIND-SETS WHICH ARE GEARED TO REACTING TO EVENTS AND PRESSURES. THEY ARE NOW REALISING THAT A PRO-ACTIVE FOREIGN POLICY MUST BE UNDER-PINNED BY IMPROVED SYSTEMS FOR COLLECTING AND ANALYSING INFORMATION RAPIDLY, BY MUCH IMPROVED PR, AND BY A CAPACITY TO TAKE THE INITIATIVE.

- POLITICAL LEADERSHIP. THIS IN TURN REQUIRES POLITICAL JUDGEMENTS TAKEN UNDER PRESSURE AND OFTEN WITHOUT A FULL PICTURE OF EVENTS. THE JAPANESE POLITICAL SYSTEM IS NOT GEARED UP TO PRODUCE PEOPLE WITH THE NECESSARY SKILLS, ALTHOUGH THE COMING GENERATION ARE MORE FLEXIBLE AND OUTWARD-LOOKING THAN THEIR PREDECESSORS (MIYAZAWA PERHAPS BEING A RARE EXCEPTION AMONG THE OLDER LEADERS). NOR IS THE JAPANESE SYSTEM OF WIDE CONSULTATION LEADING TO CONSENSUS DECISIONS WELL-ADAPTED TO CRISIS MANAGEMENT. ALL THIS IS THE SUBJECT OF MUCH INFORMED DEBATE HERE, PARTLY BECAUSE OF WHAT ARE SEEN AS FAILURES DURING THE GULF CRISIS. A FAMILIARITY WITH FOREIGN POLICY ISSUES AND LEADERS IS NOW SEEN AS ONE REQUIREMENT FOR JAPAN'S PRIME MINISTERS AND IS LIKELY TO FEATURE INCREASINGLY IN THE CAREER-PLANS OF BUDDING SUCCESSORS.

- PUBLIC ATTITUDES. AS THE MFA VICE-MINISTER RECENTLY COMMENTED, POLITICAL DECISIONS NEED TO BE BASED ON AN INFORMED DEBATE AMONG BUSINESSMEN, ACADEMICS, JOURNALISTS ETC AND ON A READING OF PUBLIC EXPECTATIONS. THE LACK OF THIS TOO WAS EXPOSED BY THE HEAD-IN-THE-SAND REACTIONS OF MANY PEOPLE TO THE OPENING STAGES OF THE GULF CONFLICT, BUT THAT AFFAIR ITSELF HAD A POWERFUL EDUCATIVE EFFECT ON PUBLIC OPINION. FOREIGN POLICY AND DEFENCE ARE THE ONE AREA WHERE NO POLITICAL CONSENSUS HAS BEEN ACHIEVED IN POST-WAR

JAPAN, BUT EVENTS ARE STARTING TO IMPOSE MORE REALISTIC ATTITUDES. NEVERTHELESS THIS REMAINS AN INWARD-LOOKING SOCIETY, AND THAT SEEMS DESTINED ONLY TO CHANGE RELATIVELY SLOWLY AS THE JAPANESE TRAVEL IN GREATER NUMBERS AND BECOME MORE FAMILIAR WITH THE WORLD OUTSIDE.

8. THE TASK FOR KAIFU'S SUCCESSOR WILL NOT THEREFORE BE EASY. HE WILL PROBABLY HAVE TO COPE WITH FURTHER DRAMATIC INTERNATIONAL DEVELOPMENTS, AND HE SHOULD ALSO TACKLE AN IMPORTANT LONG-TERM SOCIAL AGENDA OF GROWING INEQUALITIES OF WEALTH, CONTINUING ENVIRONMENTAL PROBLEMS IN THE CITIES, AND SLOW DECLINE OF THE TRADITIONAL SOCIAL COHESION. BUT HE WILL BE GOVERNING THROUGH A POLITICAL SYSTEM AND WITH PUBLIC ATTITUDES WHICH ARE ONLY STARTING TO COME TO TERMS WITH THE DEMANDS FLOWING FROM JAPAN'S NEW-FOUND POWER.

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TOKYO STOCK BROKING SCANDAL (OUR TELNO 574)

SUMMARY

1. THE SCANDAL REFUSES TO DIE DOWN. NOMURA CHAIRMAN SETSUYA TABUCHI HAS RESIGNED, DEPRIVING THE SECURITIES INDUSTRY OF A MAJOR FIGURE. SMALLER SECURITIES FIRMS HAVE ALSO BEEN INVOLVED IN COMPENSATING CLIENT'S LOSSES. THE EXTRAORDINARY DIET SESSION WHICH OPENS ON 5 AUGUST HAS HELPED GIVE THE AFFAIR A SECOND WIND. THE MINISTRY OF FINANCE WILL HAVE TO IMPLEMENT SOME REFORM OF THEIR REGULATORY ACTIVITIES, BUT ARE LIKELY TO SEEK TO AVOID ANY MAJOR STRUCTURAL CHANGE.

DETAIL

2. THE SECURITIES SCANDAL IS REFUSING TO DIE DOWN. THE BIG FOUR FIRMS HAVE NOW ADMITTED TO PAYING OUT YEN 128 BILLION IN LOSS COMPENSATION TO 231 CLIENTS (REPORTEDLY INCLUDING PRIVATE INDIVIDUALS) BETWEEN OCTOBER 1987 AND MARCH 1990. SO FAR THEY HAVE BEEN FINED YEN 30 MILLION BY THE JAPAN SECURITIES DEALERS ASSOCIATION, YEN 16 MILLION BY THE TSE AND RECEIVED PENAL TAX DEMANDS OF YEN 9 BILLION. 74 EMPLOYEES HAVE BEEN DISCIPLINED. ON 18 JULY MINISTRY OF FINANCE TEAMS ENTERED THE FOUR COMPANIES TO BEGIN INVESTIGATING WHETHER IN FACT THERE HAVE BEEN VIOLATIONS OF ARTICLE 50, SECURITIES AND EXCHANGE LAW WHICH PROHIBITS SOLICITING BUSINESS BY PERFORMANCE GUARANTEE OR PROMISES OF LOSS COMPENSATION.

3. IN RECOGNITION THAT THE EARLIER RESIGNATION OF NOMURA'S VICE-CHAIRMAN YOSHIHISA TABUCHI, WAS INSUFFICIENT ATONEMENT, ON 22 JULY THE CHAIRMAN, SETSUYA TABUCHI, THE MOST POWERFUL

FIGURE IN JAPAN'S SECURITIES INDUSTRY, ANNOUNCED HIS RESIGNATION. NOMURA'S MANAGEMENT IS NOW ENTRUSTED TO SAKIMAKI (PRESIDENT) AND AIDA (HON. CHAIRMAN), THE LATTER WELL KNOWN IN INTERNATIONAL SECURITIES CIRCLES, WHO WILL PRESENT A KINDER, GENTLER FACE. THERE ARE SIGNS THAT, FOR THE PRESENT AT LEAST, NOMURA IS TAKING A LESS AGGRESSIVE ROLE IN DRIVING THE STOCK MARKET BY LEAVING INVESTMENT ADVICE MORE IN THE DISCRETION OF BRANCH MANAGERS.

4. ON 23 JULY IT BECAME CLEAR THAT THE SECOND STRING SECURITIES FIRMS ALSO HAD BEEN COMPENSATING CLIENTS' LOSSES. 30 SUCH FIRMS HAVE ADMITTED PAYING OUT A TOTAL OF YEN 20 BILLION, IN PARTICULAR, NEW JAPAN SECURITIES (YEN 14 BN), WAKO, KANKAKU AND KOKUSAI. THESE FIRMS FACE TAX DEMANDS AND WILL BE EXPECTED TO DISCIPLINE STAFF MEMBERS.

5. THE MOF HAS ATTEMPTED TO DEFLECT CRITICISM BY 'VOLUNTARY' SALARY CUTS OF 10PERCENT ON THE PART OF HASHIMOTO, VICE-MINISTER YASUDA AND SECURITIES BUREAU DG, MATSUNO. IT IS ALSO DRAFTING AMENDMENTS TO THE SECURITIES AND EXCHANGE LAW WITH A VIEW TO SUBMITTING THEM TO THE EXTRAORDINARY DIET SESSION WHICH BEGINS ON 5 AUGUST. THE AMENDMENTS WILL BE AIMED AT PROHIBITING DISCRETIONARY FUND MANAGEMENT ACCOUNTS AND THE PRACTICE OF AFTER THE EVENT LOSS COMPENSATION. THE EXTRAORDINARY SESSION WAS ORIGINALLY CALLED TO DEAL WITH ADMINISTRATIVE REFORM.

6. IT IS PERHAPS UNFORTUNATE FOR THE MOF THAT THE EXTRAORDINARY SESSION SHOULD CONVENE. IT HAS PROVIDED A READY FORUM FOR OPPOSITION PARTIES TO MAKE THE MOST OF THE GOVERNMENT'S AND HASHIMOTO'S DIFFICULTIES. THE OPPOSITION IS CALLING FOR A FULL INQUIRY AND THE ESTABLISHMENT OF A SPECIAL DIET COMMITTEE TO INVESTIGATE. THE GOVERNMENT ARGUE THAT THE STANDING FINANCE COMMITTEE OF THE LOWER HOUSE, WHICH IS EXPECTED TO DEBATE THE ISSUE WHEN IT SITS ON 25 JULY, IS ADEQUATE. THERE ARE ALSO CALLS FOR REPRESENTATIVES OF THE BIG FOUR TO TESTIFY BEFORE THE DIET. DIET PRIVILEGE WOULD PROVIDE AN OPPORTUNITY FOR THE 231 CLIENTS TO BE NAMED. THEY ARE NOW CLAIMING PROTECTION UNDER THE INDUSTRY PRINCIPLE OF CONFIDENTIALITY AND A GUARANTEE OF CONFIDENTIALITY APPARENTLY GIVEN BY THE MOF WHEN THE BIG FOUR FIRST 'CONFESSED'. THE GOVERNMENT WILL RESIST THIS, BUT THE OPPOSITION MAY NOT PRESS HARD AS DISCLOSURE OF THE IDENTITIES OF THE CLIENTS WHO HAVE RECEIVED COMPENSATION MAY DAMAGE THEM AS MUCH AS THE LDP.

7. THERE CONTINUE TO BE CALLS FOR THE ESTABLISHMENT OF A REGULATORY BODY, INDEPENDENT OF THE MOF. HAYAMI (KEIZAI DOYUKAI) HAS SPOKEN OF AN INDEPENDENT PRACTITIONER BASED SELF-REGULATORY BODY AND HIRAIWA (KEIDANREN) HAS COME OUT IN FAVOUR OF AN (ILL-DEFINED) NEW BODY, THOUGH NOT ALONG THE LINES OF SEC OR SIB. THE PRESS CALL FOR A SEC OR SIB TYPE ORGANISATION BUT THERE IS A FEELING THAT THE JAPANESE SYSTEM IS NOT YET READY FOR SUCH A REFORM, AND POINT TO THE WEAKNESS OF THE FTC AND THE LIKELIHOOD OF THE MOF RETAINING INFLUENCE OVER ANY NEW INSTITUTION. THE MOF ARE CONSIDERING RESTRUCTURING THEIR BUREAUX TO CREATE A SINGLE FINANCIAL SYSTEM INSPECTORATE (TAKING ON THE INSPECTION ROLES NOW FULFILLED BY THE SECURITIES, BANKING AND INTERNATIONAL FINANCE BUREAUX). THIS WOULD REQUIRE LEGISLATION.

8. THE STOCK MARKET REMAINS WEAK, WITH THE NIKKEI 225 INDEX HOVERING BELOW THE 23,000 LEVEL. BUT THERE ARE NO SIGNS YET OF A MORE SIGNIFICANT DOWNTURN IN RESPONSE TO THESE SCANDALS. THERE IS SOME SPECULATION THAT DISRUPTION IN THE CAPITAL MARKETS MAY BRING ABOUT A REDUCTION IN BUSINESS INVESTMENT.

COMMENT

9. PUBLIC PERCEPTIONS THAT THE INITIAL RESPONSE OF THE MOF AND THE SECURITIES COMPANIES WAS INADEQUATE HAVE BEEN SEIZED ON BY OPPOSITION POLITICIANS TO DISCOMFIT THE GOVERNMENT AND APPEAR TO HAVE LED TO A MORE THOROUGH INVESTIGATION THAN THE MOF MAY HAVE WANTED. THERE IS AN EXPECTATION THAT MORE WRONG DOING WILL EMERGE AND IN PARTICULAR THE MOF MAY BE PRESSED TO LOOK INTO THE EXTENT OF LOSS COMPENSATION IN THE TRUST BANKING BUSINESS. IT IS WIDELY RECOGNISED THAT THE ROOTS OF THE AFFAIR ARE DEEP IN THE JAPANESE WAY OF BUSINESS AND OF BUREAUCRATIC ADMINISTRATION, AND ALTHOUGH HASHIMOTO WILL BE THREATENED BY ANY ESCALATION OF THE SCANDAL, THE GOVERNMENT SHOULD SUCCEED IN SHIFTING RESPONSIBILITY TO THE INDUSTRY. ALTHOUGH THE EPISODE HAS POINTED UP THE FAILINGS OF THE SYSTEM OF ADMINISTRATIVE GUIDANCE, THIS IS NOT LIKELY TO LEAD SOON TO A CHANGE OF ATTITUDE ON THE PART OF THE BUREAUCRACY.

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MY TELNO 244: JAPANESE FINANCIAL MARKETS

SUMMARY

1. LAST WEEK'S 1% RISE IN THE OFFICIAL DISCOUNT RATE HAS FAILED TO DISPEL THE MOOD OF PESSIMISM IN JAPANESE FINANCIAL MARKETS. THE YEN CONTINUES TO WEAKEN. THE ODDS ARE PROBABLY AGAINST A FURTHER MAJOR COLLAPSE IN STOCK PRICES, BUT MARKETS ARE LIKELY TO REMAIN WEAK FOR SOME TIME. HIGH INTEREST RATES, COUPLED WITH WEAK FINANCIAL MARKETS, WILL HAVE SOME GRADUAL BUT QUITE FAR REACHING EFFECTS ON THE JAPANESE ECONOMY.

DETAIL

2. THE 1% INCREASE IN THE BANK OF JAPAN'S OFFICIAL DISCOUNT RATE, ANNOUNCED ON 20 MARCH, FAILED TO REVERSE THE DOWNWARD TREND IN EITHER THE FOREIGN EXCHANGE OR THE DOMESTIC FINANCIAL MARKETS. MARKETS WERE CLOSED ON THE 21ST (A PUBLIC HOLIDAY) BUT ON THE FOLLOWING DAY THE NIKKEI INDEX FELL BELOW THE 30,000 LEVEL FOR THE FIRST TIME SINCE DECEMBER 1988: THE YEN FELL BELOW YEN 155 TO THE US DOLLAR, THE LOWEST LEVEL FOR 3 YEARS: AND THE YIELD ON THE GOVERNMENT BENCHMARK BOND ROSE TO 7.5%, ITS HIGHEST LEVEL SINCE 1984.

3. SINCE THEN THE STOCK AND BOND MARKETS HAVE RECOVERED A LITTLE, ALTHOUGH TRADING REMAINS NERVOUS AND VOLATILE. ON THE FOREIGN EXCHANGE MARKETS, HOWEVER, THE YEN HAS CONTINUED TO FALL REACHING YEN 158 TO THE DOLLAR ON 28 MARCH (BEFORE RECOVERING A LITTLE ON THE 29TH). THE CONTINUING WEAKNESS OF THE YEN IS LIKELY TO GIVE WEIGHT TO THOSE WHO ARGUE THAT A FURTHER OFFICIAL DISCOUNT RATE INCREASE WILL BE REQUIRED BEFORE LONG. THIS IN TURN WILL TEND TO KEEP THE EQUITY AND BOND MARKETS DEPRESSED. AS WE SUGGESTED IN OUR TUR, ANY RECOVERY IN THE EQUITY MARKET SEEMS UNLIKELY WHILST THE YIELD DIFFERENTIAL BETWEEN EQUITY AND BOND MARKETS REMAIN SO WIDE. THE DOMESTIC STOCK MARKET WILL ONLY BEGIN A SUSTAINED RECOVERY WHEN THE MARKETS BELIEVE

THAT INTEREST RATES HAVE PEAKED, AND THAT THE NEXT MOVE WILL BE IN A DOWNWARD DIRECTION.

4. MANY MARKET PARTICIPANTS BELIEVE THAT THE LONG-AWAITED ADJUSTMENT TO BRING JAPANESE STOCKS (AND PERHAPS LAND PRICES) MORE INTO LINE WITH THOSE IN OTHER LEADING CAPITALS HAS NOW STARTED. THE TRIGGER FOR THE ADJUSTMENT WAS THE PROSPECT OF RISING INTEREST RATES, IN JAPAN AND WORLDWIDE, AND THE OUTLOOK FOR THE STOCK MARKET WILL STILL BE MAINLY DETERMINED BY THESE FACTORS. BUT AN IMPORTANT ADDITIONAL ELEMENT WILL BE THE EXTENT TO WHICH INVESTORS CARRY THROUGH THE ADJUSTMENT, EG BY LETTING STOCK PRICES FALL TO A LEVEL AT WHICH PRICE EARNINGS RATIONS IN JAPAN ARE MORE IN LINE WITH THOSE ABROAD. FEW COMMENTATORS EXPECT SUCH A DRAMATIC ADJUSTMENT AS THPBK IT SEEMS LIKELY THAT THE ''JAPAN PREMIUM'', WHICH REFLECTS THE STRENGTH AND VITALITY OF THE JAPANESE CORPORATE SECTOR, WILL CONTINUE TO BE SUBSTANTIAL.

5. IF, AS NOW SEEMS INCREASINGLY LIKELY, JAPAN IS FACED WITH A PERIOD OF HIGH INTEREST RATES AND FINANCIAL MARKET WEAKNESS FOR AN EXTENDED PERIOD IT WILL NOT BE LONG BEFORE THE IMPACT IS FELT ON THE REAL ECONOMY. INDEED, SOME COMMENTATORS ARGUE THAT THESE FACTORS MAY NOW REINFORCE WHAT IS ALREADY A CYCLICAL TREND: AS DESCRIBED IN OUR RECENT MONTHLY ECONOMIC REPORTS, INDUSTRIAL PRODUCTION HAS BEEN FLAT FOR SEVERAL MONTHS, INVENTORIES ARE RISING, AND BUSINESS CONFIDENCE ALTHOUGH STILL AT A HIGH LEVEL, IT APPRECIABLY LOWER THAN IT WAS LAST SUMMER. ON THIS LINE OF ARGUMENT, THE CURRENT EXPANSIONARY PHASE, WHICH STARTED IN DECEMBER 1986 AND WHICH IS ALREADY ONE OF THE LONGEST SINCE THE WAR, MAY HAVE ALREADY COME TO AN END. IT WILL, HOWEVER, BE ANOTHER 2 OR 3 MONTHS BEFORE THERE IS SUFFICIENT ECONOMIC DATA TO SUBSTANTIATE THIS.

6. THE RECENT EVENTS IN THE FINANCIAL MARKETS HAVE, HOWEVER, HAD A MORE FAR REACHING PSYCHOLOGICAL IMPACT. THE MOOD OF PESSIMISM HAS BEEN SPREAD BEYOND THE RANKS OF A FEW ECONOMISTS. FOR BORROWERS, OR FO
THOSE WISHING TO RAISE EQUITY ON THE
STOCK MARKET, THE IMPACT IS PARTICULARLY DIRECT. WITH THE SHORT-TERM PRICE RATE NOW STANDING AT 7.1%, AND THE LONG-TERM PRIME RATE AT 7.9%, REAL INTEREST RATES FOR MOST BORROWERS ARE NOW MORE THAN 5%: SOME REAPPRAISAL OF CORPORATE INVESTMENT PLANS, AND ALSO OF PERSONAL BORROWING, SEEMS

INEVITABLE. ON THE EQUITY MARKET, IT IS REPORTED THAT 13 COMPANIES HAVE SO FAR CANCELLED OR POSTPONED PLANNED EQUITY ISSUES. ALTHOUGH CORPORATE LIQUIDITY REMAINS VERY HIGH, ESPECIALLY FOLLOWING AN UNPRECEDENTED LEVEL OF CORPORATE EQUITY-LINKED BORROWING ON THE INTERNATIONAL CAPITAL MARKET LAST YEAR, DIFFICULTY IN RAISING FRESH EQUITY CAPITAL MAY ALSO REDUCE INVESTMENT BEFORE LONG. SOME COMMENTATORS HAVE POINTED OUT THAT THE JAPANESE BANKS WILL NO LONGER FIND IT SO EASY TO COMPLY WITH BIS CAPITAL ADEQUACY STANDARDS: AND SINCE THE YEN'S DECLINE HAS INFLATED THE VALUE OF THEIR FOREIGN CURRENCY ASSETS RELATIVE TO THEIR YEN CAPITAL BASE, A MORE CAUTIOUS APPROACH TO INTERNATIONAL LENDING MAY BE EXPECTED.

7. THE DECLINE IN STOCK PRICES, AND THE PROSPECTIVE DECLINE IN PROPERTY PRICES, MAY ALSO HAVE AN IMPORTANT PSYCHOLOGICAL IMPACT ON THOSE INDIVIDUALS OR COMPANIES WHICH ARE NOT NET BORROWERS. JUST AS RISING ASSET PRICES PROBABLY FUELLED THE CONSUMER BOOM THROUGH THE ''WEALTH EFFECT'' BETWEEN 1987 AND 1989, SO THE REVERSE EFFECT MAY NOW LEAD TO A MORE CAUTIOUS APPROACH TO SPENDING BY CONSUMERS, AND TO THE SCALING BACK OF INVESTMENT PLANS BY COMPANIES.

8. THE INCREASED COST OF BORROWING WILL HAVE A MAJOR IMPACT ON THE PROPERTY MARKET (AS THE AUTHORITIES CLEARLY INTEND). RUMOURS ARE CIRCULATING THAT SEVERAL PROPERTY COMPANIES, FACED WITH A WIDENING DIFFERENTIAL BETWEEN THE COST OF BORROWING AND THE YIELD FROM PROPERTY, MAY BE IN DIFFICULTY. OVERALL, THE ATTRACTIONS OF PROPERTY AS AN INVESTMENT ASSET ARE LIKELY TO BE REDUCED, AND SOME DECLINE IN PRICES SEEMS INEVITABLE. SINCE ONE OF THE JUSTIFICATIONS FOR THE HIGH VALUE OF STOCK PRICES HAS BEEN THE HIGH VALUATION PUT UPON COMPANIES' LAND ASSETS, SOME COMMENTATORS HAVE SPECULATED THAT FALLING LAND PRICES MIGHT PROMPT A FURTHER REASSESSMENT OF STOCK PRICES (WHICH, IN TURN, COULD REBOUND ON LAND PRICES). ALTHOUGH A FALL IN LAND PRICES WILL UNDOUBTEDLY ACT AS A FURTHER DEPRESSANT ON STOCK PRICES, FEARS THAT THIS MAY DEVELOP INTO A VICIOUS CIRCLE ARE PROBABLY EXAGGERATED AT PRESENT.

CONCLUSION

9. IT IS STILL TOO EARLY TO TRY TO QUANTIFY THE EFFECT OF RECENT DEVELOPMENTS IN THE FINANCIAL MARKETS, AND THE

RISE IN INTEREST RATES, ON THE REAL ECONOMY. ALTHOUGH THE FINANCIAL MARKETS HAVE BEEN WEAK FOR NEARLY 3 MONTHS, AND THE RISING TREND OF INTEREST RATES HAS BEEN APPARENT FOR LONGER STILL, A MORE FUNDAMENTAL CHANGE IN SENTIMENT HAS ONLY TAKEN PLACE IN THE LAST MONTH. IT IS UNCLEAR AT THIS STAGE WHETHER THIS CHANGE IN SENTIMENT IS LIKELY TO REINFORCE A CYCLICAL DOWNTURN WHICH HAS ALREADY BEGUN, OR WHETHER THE ECONOMY IS STILL ON AN UPTURN AND THE PEAK IN THE CYCLE IS STILL AHEAD OF US. SEVERAL FORECASTERS HAVE TALKED IN GENERAL TERMS OF THE NEED TO SHADE DOWN THEIR FORECASTS FOR REAL GNP GROWTH FOR FY 1990, BUT NO ONE HAS YET ISSUED ANY FORMAL REVISIONS TO EARLIER FORECASTS. THE ECONOMY IS CLEARLY AT SOMETHING OF A TURNING POINT, AND ECONOMIC INDICATORS FOR THE NEXT 2 OR 3 MONTHS WILL NEED TO BE WATCHED PARTICULARLY CLOSELY.

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JAPANESE FINANCIAL MARKETS

SUMMARY

1. THE TOKYO STOCK EXCHANGE HAS FALLEN BY AROUND 15% SINCE THE BEGINNING OF THE YEAR, AND BY OVER 10% IN THE LAST EIGHT DAYS. THE BOND MARKET, AND THE YEN, ARE ALSO VERY WEAK. COMPLEX SET OF REASONS FOR THE FALL, BUT WORRIES ABOUT RISING INTEREST RATES IN JAPAN AND WORLDWIDE PROBABLY THE MOST IMPORTANT. AMERICAN SECURITIES COMPANIES BEING BLAMED FOR PROGRAMME SELLING. SOME EVIDENCE OF SUPPORT FOR MARKET BY JAPANESE BROKERS, BUT NO MAJOR CONCERTED ACTION YET.

DETAIL

2. THE NIKKEI 225 STOCK INDEX FELL BY 7% LAST WEEK, AND BY A FURTHER 4.5% YESTERDAY, TO CLOSE AT 33,321, AGAINST A RECORD HIGH OF 38,916 AT THE END OF LAST YEAR. MONDAY'S FALL WAS THE SECOND LARGEST DECLINE IN A DAY, AFTER THE QUOTE CRASH UNQUOTE OF OCTOBER 1987. THE MARKET ROSE BY 571 TODAY BUT THE MOOD REMAINS VERY NERVOUS AND THE GAIN COULD BE EASILY REVERSED. GOVERNMENT BOND YEILDS HAVE RISEN 5.7% AT THE END OF LAST YEAR TO AROUND 7.0% NOW, AND THE YEN HAS WEAKENED FROM Y143.4 TO Y148.7 TO THE DOLLAR, OVER THE SAME PERIOD. THE YEN'S WEAKNESS IS NOW INCREASINGLY THE RESULT OF CAPITAL OUTFLOWS, AS BOTH FOREIGN INVESTORS AND THE JAPANESE INSTITUTIONS REACT TO THE WEAKNESS OF DOMESTIC FINANCIAL MARKETS BY SWITCHING FROM YEN INTO DOLLARS AND OTHER CURRENCIES.

3. THE REASONS FOR THE WEAKNESS OF JAPANESE FINANCIAL MARKETS ARE COMPLEX. THE ECONOMIC FUNDAMENTALS REMAIN STRONG, ALTHOUGH THE OUTLOOK IS PERHAPS A SHADE LESS BUOYANT THAN IT APPEARED IN THE SECOND HALF OF LAST YEAR. RISING INTEREST RATES MAY NOW REDUCE BUSINESS INVESTMENT TO SOME EXTENT. REAL GROWTH IN FY 1990 SHOULD STILL MEET OR EXCEED THE GOVERNMENT'S OFFICIAL FORECAST OF 5%. RATHER, THE FINANCIAL MARKETS HAVE BEEN RESPONDING TO A MIX OF THE FOLLOWING FACTORS:

(I) WORRIES ABOUT THE PROSPECT OF RISING INTEREST RATES, BOTH IN JAPAN AND WORLDWIDE. AN OFFICIAL DISCOUNT RATE INCREASE ON DECEMBER 25 (THE THIRD IN 1989), AND FEARS THAT THE BANK OF JAPAN MIGHT BE LOOKING FOR FURTHER INCREASES, PROMPTED MARKET WEAKNESS IN JANUARY AND EARLY FEBRUARY. CURIOUSLY ENOUGH, THE VICTORY OF THE RULING LIBERAL DEMOCRATIC PARTY IN THE GENERAL ELECTIONS ON FEBRUARY 18 WAS ALMOST CERTAINLY A TRIGGER FOR THE MOST RECENT SLIDE: IT WAS SEEN BY THE MARKETS AS CLEARING THE WAY FOR FURTHER INTEREST RATE RISES. INTERNATIONALLY, THE JAPANESE MARKETS ARE CONCERNED AT THE PROSPECT THAT GERMAN UNIFICATION AND INFLATIONARY WORRIES IN THE US MAY LEAD TO A WORLDWIDE INTEREST RATE SPIRAL. DOMESTICALLY, ALTHOUGH THERE IS STILL LITTLE EVIDENCE OF AN ACTUAL INCREASE IN INFLATION IN JAPAN, MIENO, THE NEW GOVERNOR OF THE BANK OF JAPAN, HAS CLEARLY SIGNALLED HIS INTENTION TO TIGHTEN MONETARY POLICY (AFTER 3-4 YEARS OF RELATIVE LAXITY), AND TO STAMP OUT EVEN INCIPIENT INFLATIONARY EXPECTATIONS.

(II) THE MARKETS HAVE BEEN UNSETTLED BY THE RELUCTANCE OF THE MINISTRY OF FINANCE TO GO ALONG WITH THE NEW BOJ STANCE. IN THE LATTER PART OF LAST WEEK THE MOF CAME OUT INTO THE OPEN WITH THINLY-VEILED CRITICISM OF THE BANK OF JAPAN BY VICE-MINISTER UTSUMI.

(III) FEARS THAT BANKS MAY NOW START TO PULL BACK LINES OF CREDIT TO SECURITIES COMPANIES, AND TO OTHER INVESTORS IN THE WAKE OF THE COLLAPSE OF DREXEL BURNHAM LAMBERT, AND ALSO IN RESPONSE TO THE WEAKNESS OF THE STOCK MARKET.

(IV) PROGRAMME SELLING TO TAKE ADVANTAGE OF ARBITRAGE OPPORTUNITIES BETWEEN THE CASH AND FUTURES MARKETS. AS IN OCTOBER 1987, THIS IS BELIEVED TO BE INCREASING MARKET VOLITILITY.

3. ONE ASPECT OF THE LAST FEW DAYS IS THAT, AS IN

OCTOBER 1987, FOREIGNERS ARE BEING BLAMED FOR AT LEAST PART OF THE MARKET'S BEHAVIOUR. IN 1987, THE FALL IN THE TOKYO MARKET WAS ASCRIBED MAINLY TO SELLING BY FOREIGNERS: AT PRESENT, THE PROGRAMME SELLING BETWEEN THE CASH AND FUTURES MARKETS REFERRED TO ABOVE IS BEING BLAMED MAINLY ON THE AMERICAN SECURITIES COMPANIES, AND NOTABLY UPON MORGAN STANLEY AND SALOMON BROS.

4. RUMOURS ARE CIRCULATING THAT, AGAIN AS IN OCTOBER 1987, THE BIG FOUR JAPANESE SECURITIES COMPANIES MAY SHORTLY STEP IN TO SUPPORT THE MARKET, WITH THE CONNIVANCE OF THE MINISTRY OF FINANCE. THERE WAS SOME LIMITED EVIDENCE OF THIS YESTERDAY AFTERNOON, WHEN THREE OF THE BIG FOUR MOVED IN TO BUY SOME OF THE STOCKS WHICH FIGURE MOST PROMINANTLY IN THE NIKKEI 225 INDEX, THUS PUSHING THE INDEX UP ALMOST 1,000 POINTS TO CLOSE WITH A DECLINE OF ONLY 1,500 ON THE DAY. THIS SUGGESTS THAT THE BROKERS AND THE AUTHORITIES WILL BE CONCERNED TO PREVENT QUOTE EXCESSIVE UNQUOTE FALLS IN ANY ONE DAY: IT REMAINS TO BE SEEN AT WHAT LEVEL (IF ANY) THEY MIGHT INTERVENE TO TRY TO ESTABLISH A FLOOR FOR THE MARKET AS A WHOLE.

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MR KAIFU'S EUROPEAN TOUR: THE JAPANESE SCENE

SUMMARY
1. IN EUROPE, KAIFU'S EYES WILL BE FIRMLY ON THE RATINGS BACK HOME. HIS FUTURE DEPENDS ON THE 18 FEBRUARY ELECTION, WHICH HE AND THE LDP SEEM AT PRESENT LIKELY TO SCRAPE THROUGH. BUT THE TOUR ALSO CORRESPONDS TO A DEEPER FOREIGN POLICY AIM OF BUILDING UP LINKS WITH EUROPE.

DETAIL
2. TO ALL INTENTS AND PURPOSES THE CAMPAIGN IS WELL UNDERWAY HERE FOR THE GENERAL ELECTION ON 18 FEBRUARY. ALMOST ALL OBSERVERS NOW PREDICT THAT THE LDP WILL KEEP THEIR OVERALL MAJORITY, BUT BY A NARROW MARGIN. TWO TRENDS ARE EVIDENT:-

(A) THE CONTINUING DISUNITY OF THE OPPOSITION PARTIES AND THEIR FAILURE TO PRODUCE AN ADEQUATE RANGE OF CANDIDATES, AND

(B) THE GRADUAL COOLING OF THE PUBLIC MOOD OF RESENTMENT AGAINST THE L.D.P. SINCE THE PARTY'S DEFEAT IN THE JULY UPPER HOUSE ELECTION. ALTHOUGH THE LDP BUNGLED THE PRESENTATION IN DECEMBER OF NEW PROPOSALS TO REFORM THE CONSUMPTION TAX AND HAVE DONE LITTLE TO ACHIEVE POLITICAL REFORM, THE COMBINATION OF A NEW, YOUNGER LEADER, A LESS AGGRESSIVE PRESS AND THE PASSAGE OF TIME HAS SOMEWHAT BLUNTED PUBLIC IRRITATION. THIS MOOD, HOWEVER, REMAINS FRAGILE.

3. KAIFU HAS HELPED THE PARTY TO RECOVER GROUND, BUT HE HAS FAILED TO ESTABLISH A LEADERSHIP ROLE. HE IS SEEN AS A PRESENTER, RATHER THAN A DECIDER, OF POLICY. HIS LACK OF CLOUT HAS BECOME INCREASINGLY CLEAR IN THE LAST MONTH OR SO IN A SERIES OF MAJOR DECISIONS INCLUDING EVEN THE ELECTION DATE, AND HE IS SENSITIVE ABOUT IT. THE STRINGS ARE BEING PULLED BY THE FACTION BOSSES PARTICULARLY

TAKESHITA AND KANEMARU. THEY WILL HAVE LITTLE HESITATION IN DUMPING HIM IF THE LDP LOSES THE ELECTION. HOWEVER IF THE CURRENT PREDICTIONS ARE RIGHT, KAIFU WILL PROBABLY STAY ON PARTLY BECAUSE IT WILL BE DIFFICULT TO DROP A WINNER AND PARTLY BECAUSE THE OTHER CONTENDERS MAY CANCEL EACH OTHER OUT OR PREFER TO WAIT A WHILE. MORE GENERALLY THERE IS INCREASING TALK OF A MORE FLUID POLITICAL SITUATION POST-ELECTION AND OF SOME RE-ALIGNMENT PARTICULARLY AMONG THE OPPOSITION PARTIES. THE LIKELIEST OUTCOME IS SOME SORT OF A DEAL BETWEEN THE LDP AND KOMEITO SO AS TO GET LEGISLATION THROUGH THE UPPER HOUSE WHERE THE LDP IS LIKELY TO BE IN THE MINORITY FOR THE NEXT SIX YEARS.

4. KAIFU THEREFORE COMES TO EUROPE IN HOPES OF:-

- LOOKING GOOD ON JAPANESE TV AS HE MEETS WORLD LEADERS
- UNDERLINING THE FAILURE OF SOCIALISM AS AN ECONOMIC AND POLITICAL CREED,
- DRAWING ATTENTION TO JAPAN'S NEW INTERNATIONAL STATUS, EG AS A CONTRIBUTOR TO WESTERN AID EFFORTS FOR EASTERN EUROPE, AND
- DISTRACTING ATTENTION BACK HOME FROM AWKWARD ISSUES LIKE THE CONSUMPTION TAX AND RECRUIT.

5. NEVERTHELESS IT WOULD BE WRONG TO SEE THE VISIT SOLELY IN TERMS OF DOMESTIC POLITICS. JAPANESE FOREIGN POLICY IS GOING THROUGH A PERIOD OF DOUBT AND DEBATE, PROVOKED BY THE EXPECTATIONS AROUSED ABROAD AND AT HOME BY MANIFEST ECONOMIC SUCCESS, BY SERIOUS STRAINS IN THE KEY RELATIONSHIP WITH THE US, AND BY THE RAPID CHANGES IN EAST-WEST RELATIONS. THOUGHTFUL JAPANESE IN THE MFA AND ELSEWHERE ARE CONSCIOUS THAT THEY NEED TO WORK OUT A GLOBAL POLITICAL ROLE REFLECTING THEIR ECONOMIC POWER AND INTERESTS AND REDUCING THEIR CLOSE DEPENDENCE ON THE US. KAIFU IN HIS SPEECH IN BERLIN IS LIKELY TO STRESS:

- THE NEED TO DEVELOP THE RELATIONSHIP BETWEEN JAPAN AND WESTERN EUROPE, THE WEAK LINK HITHERTO IN WESTERN COORDINATION, THROUGH THE G7 AND OTHER MECHANISMS,
- THE NEED FOR THE WEST TO TAKE THE ASIA-PACIFIC DIMENSION FULLY INTO ACCOUNT WHEN ASSESSING EAST-WEST RELATIONS, AND
- THE DEGREE TO WHICH AID TO EASTERN EUROPE REPRESENTS A NEW DEPARTURE FOR JAPAN AND A SHOULDERING OF GLOBAL RESPONSIBILITIES, TAKING IT WELL BEYOND ITS TRADITIONAL

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FOCUS ON ASIA AND ON DEVELOPMENTAL AID TO LDC'S.

THESE ARE IMPORTANT POLICY ORIENTATIONS FOR JAPAN, WHATEVER THE IMMEDIATE POLITICAL PROSPECTS FOR THE MAN WHO DELIVERS THEM.

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JAPAN : ECONOMIC OUTLOOK AND DRAFT BUDGET FOR FY 1990

SUMMARY

1. THE MOST RECENT OFFICIAL FORECAST AND THE DRAFT FY 1990 BUDGET CONFIRM THE GOVERNMENT'S CONFIDENCE THAT THE ECONOMY WILL CONTINUE TO PERFORM WELL. THIS VIEW IS GENERALLY SHARED BY PRIVATE SECTOR COMMENTATORS. AN OFFICIAL FORECAST OF 4% REAL GNP GROWTH IN FY 1990 LIKELY (AS LAST YEAR) TO ERR ON THE SIDE OF CAUTION. INFLATION LIKELY TO FALL: THE TRADE SURPLUS (PERHAPS OPTIMISTICALLY) EXPECTED TO STAY ROUGHLY THE SAME. IN THE BUDGET, CONTINUED STRONG REVENUE GROWTH ALLOWS SIZEABLE INCREASES IN ODA AND DEFENCE, WITH CUTS IN BORROWING. OVERALL, BUDGET IS JUDGED TO BE NEUTRAL IN ITS IMPACT. BUDGET UNLIKELY TO BE PASSED UNTIL LATE SPRING BECAUSE OF GENERAL ELECTION IN FEBRUARY. ? 18 February.

DETAIL

2. THE JAPANESE GOVERNMENT ISSUED ITS OFFICIAL ECONOMIC FORECAST AND DRAFT BUDGET FOR FY 1990 AT THE END OF LAST YEAR. NEITHER CONTAIN ANY REAL SURPRISES, AND THE ECONOMIC OUTLOOK IS BROADLY CONSISTENT WITH THAT DESCRIBED IN OUR TELNO 1132 LAST MONTH. A SURPRISE 0.5% INCREASE IN THE OFFICIAL DISCOUNT RATE, TO 4.25% , ON 25 DECEMBER REFLECTS THE BANK OF JAPAN'S WISH TO PRE-EMPT ANY INFLATIONARY PRESSURE, RATHER THAN BE OBLIGED TO REACT TO IT. THIS INCREASE IS UNLIKELY TO HAVE ANY SIGNIFICANT IMPACT ON THE ECONOMIC FORECAST.

ECONOMIC OUTLOOK

3. THE GOVERNMENT IS OFFICIALLY FORECASTING REAL GNP GROWTH OF 4.0% IN FY 1990 (5.2% GROWTH IN NOMINAL TERMS). THIS IS THE SAME AS THE ORIGINAL FORECAST FOR FY 1989, WHICH HAS NOW BEEN REVISED UP TO 4.6% AND MAY COME OUT AT NEARER 5%. THE FY 1990 FORECAST MAY FOLLOW A SIMILAR PATTERN, SINCE THE GOVERNMENT IS ALMOST CERTAINLY ERRING ON THE SIDE OF CAUTION. 17 MAJOR PRIVATE SECTOR INSTITUTIONS THAT PUBLISHED FORECASTS

IN DECEMBER GIVE AN AVERAGE GNP GROWTH ESTIMATE OF 4.4% FOR NEXT FISCAL YEAR.

4. BOTH GOVERNMENT AND PRIVATE FORECASTERS ARE AGREED THAT THE MAIN CONTRIBUTION TO GNP GROWTH WILL CONTINUE TO COME FROM CONSUMER SPENDING, WHICH IS EXPECTED TO ACCELERATE (TO 4.6% GROWTH ON GOVERNMENT FIGURES) AS A RESULT OF RISING DISPOSABLE INCOMES AND LOWER INFLATION. SIMILARLY, THERE IS AGREEMENT THAT FIXED BUSINESS INVESTMENT WILL STILL PROVIDE A SIGNIFICANT IMPETUS TO GROWTH (UP 7.3% ON THE GOVERNMENT'S FORECAST), ALTHOUGH THE RATE OF GROWTH MAY BE ONLY ABOUT HALF OF THAT SEEN IN THE CURRENT YEAR.

5. WITH THE IMPACT OF THE 3% CONSUMPTION TAX INTRODUCED IN APRIL 1989 FINALLY DROPPING OUT OF THE FIGURES, INFLATION IS EXPECTED TO FALL QUITE SHARPLY IN FY 1990. WHOLESALE PRICES ARE EXPECTED TO RISE BY ONLY 0.6% NEXT YEAR (DOWN 3.5%) WHILST CONSUMER PRICES ARE EXPECTED TO RISE BY 1.6% (2.7% IN FY 1989).

6. ON THE EXTERNAL SIDE, THE GOVERNMENT IS EXPECTING AN INCREASE IN THE RATE OF GROWTH OF EXPORTS IN DOLLAR TERMS, AND A SLOWING IN THE GROWTH OF IMPORTS. THE OVERALL RESULT IS A MARGINAL DECLINE IN THE TRADE BALANCE, TO DOLLARS 78 BN, FROM DOLLARS 81 BN IN FY 89. ALTHOUGH THE TRADE FIGURES IN 1989 HAVE SHOWN A STEADY DECLINE, IN THE SURPLUS GOVERNMENT ECONOMISTS ARE PRIVATELY WORRIED THAT THE RELATIVE WEAKNESS OF THE YEN LAST YEAR MAY LEAD TO A WIDENING SOMETIME IN 1990. THIS VIEW IS SHARED BY 9 OF THE 17 PRIVATE SECTOR FORECASTERS MENTIONED ABOVE.

BUDGET

7. THE GOVERNMENT HAS AGREED TO A YEN 66.3 TRILLION (#287BN) DRAFT BUDGET FOR FY 1990, 9.7% UP ON LAST YEAR'S DRAFT. IT IS HOWEVER LITTLE DIFFERENT IN SIZE FROM THE MOST RECENT ESTIMATES FOR THE FY 89 OUTTURN, WHICH HAS BEEN BOOSTED BY HIGHER TAX REVENUES AND SUPPLEMENTARY EXPENDITURE. ALTHOUGH THE BUDGET WILL BE FORMALLY PRESENTED TO THE DIET IN LATE JANUARY, THE PROBABILITY OF A GENERAL ELECTION IN FEBRUARY MEANS THAT IT WILL NEED TO BE RE-SUBMITTED IN MARCH, ALONG WITH A BILL FOR THE FY 89 SUPPLEMENTARY BUDGET AND A BILL TO AMEND THE CONSUMPTION TAX. THEREAFTER, ITS FUTURE WILL DEPEND UPON THE OUTCOME OF THE ELECTION: MOST COMMENTATORS EXPECT THE LDP TO SCRAPE HOME. BUT THE NARROWER THE MARGIN OF VICTORY,

THE MORE DIFFICULT THE BUDGET DEBATE WILL BE. IT IS IN ANY EVENT UNLIKELY TO BE PASSED BEFORE MAY. THE FATE OF ANY BILL TO AMEND THE CONSUMPTION TAX, WHICH IS LIKELY TO PROVE MUCH MORE CONTROVERSIAL AND WHICH CAN BE BLOCKED BY THE UPPER HOUSE (WHERE THE OPPOSITION HAS A MAJORITY), WILL BE MUCH LESS CERTAIN.

EXPENDITURE

8. GENERAL EXPENDITURE (WHICH EXCLUDES DEBT SERVICING AND TRANSFERS TO LOCAL AUTHORITIES) IS DUE TO RISE BY 3.9% TO YEN 35.4 TRILLION. ODA WILL ONCE AGAIN BE THE FASTEST GROWING COMPONENT OF THE BUDGET, WITH AN 8.2% INCREASE. DEFENCE SPENDING IS DUE TO RISE BY 6.1% (IT WILL EXCEED Y4 TRILLION FOR THE FIRST TIME BUT WILL FALL BELOW 1% OF GNP), AND SOCIAL SECURITY BY 6.6%. SOCIAL SECURITY COSTS WILL BE BOOSTED BY A SERIES OF MEASURES TO IMPROVE PENSIONS AND OTHER WELFARE PAYMENTS AGREED BY THE DIET LATE LAST YEAR.

PUBLIC WORKS/FILP

9. PUBLIC WORKS SPENDING IN THE GENERAL BUDGET WILL RISE BY ONLY 0.3%, THUS REMAINING FLAT FOR THE SECOND YEAR RUNNING. THE FISCAL INVESTMENT AND LOAN PROGRAMME IS DUE TO RISE BY 7.1% (TO YEN 34.6 TRILLION), AND INCLUDES A 9.8% INCREASE FOR PUBLIC SECTOR HOUSING. OTHER MEASURES WHICH MAY CONTRIBUTE IN SOME WAY TO STRUCTURAL CHANGE INCLUDE A 19% INCREASE IN FUNDS TO THE EXIM BANK, MAINLY FOR IMPORT PROMOTION AND UNTIED AID: AND, WITHIN THE GENERAL ACCOUNT BUDGET, PROVISION HAS BEEN MADE FOR THE MEASURES TO EXPAND IMPORTS THROUGH TAX RELIEF AND IMPORT PROMOTION SCHEMES, AS DESCRIBED IN MY TELNO 1183.

REVENUES AND BORROWING

10. TAX REVENUES ARE FORECAST TO RISE BY Y58 TRILLION UP 13.7% FROM THE ORIGINAL FY 89 BUDGET AND UP 7.0% FROM THE LATEST ESTIMATE FOR THIS YEAR'S OUTTURN. ONCE AGAIN, IT IS LIKELY THAT THE MINISTRY OF FINANCE HAS UNDERSTATED LIKELY REVENUE GROWTH AND THE FY 1990 OUTTURN WILL BE HIGHER STILL. NON-TAX REVENUES ARE ALSO EXPECTED TO GROW RAPIDLY, AND INCLUDE PROCEEDS FROM THE SALE OF A NEW COMMEMORATIVE COIN TO BE ISSUED IN THE AUTUMN TO MARK THE CORONATION OF THE EMPEROR. THE GOVERNMENT'S BORROWING REQUIREMENT IS DOWN BY JUST OVER 20%, TO Y5.6 TRILLION, ALL OF WHICH WILL BE FINANCED BY 'CONSTRUCTION' BONDS. THE GOVERNMENT IS SET THEREFORE TO REACH ITS TARGET OF ELIMINATING 'DEFICIT FINANCING' BONDS, WHICH COVER CURRENT SPENDING, IN 1990, ALTHOUGH IT IS POSSIBLE

THAT THEY MAY YET MANAGE TO AVOID ISSUING ANY SUCH BONDS DURING FY 89 AS WELL. DEBT SERVICING COSTS ARE DUE TO RISE SHARPLY IN FY 1990, TO YEN 14.3 TRILLION, BUT THIS IS ENTIRELY THE RESULT OF A DECISION BY THE GOVERNMENT TO TAKE ADVANTAGE OF THE BUOYANCY OF REVENUES AND TO RESUME TRANSFERS TO A NATIONAL DEBT SINKING FUND.

CONCLUSION

11. WITH THE ECONOMY CONTINUING TO PERFORM SO WELL, THE FORMULATION OF THE BUDGET HAS AGAIN BEEN A RELATIVELY EASY TASK FOR THE MOF. WITH A GENERAL ELECTION LOOMING, MONEY HAS BEEN FOUND TO INCREASE PENSIONS, AND TO ALLOW A NUMBER OF OTHER PET LDP PROJECTS TO GO AHEAD: ODA AND DEFENCE HAVE ONCE AGAIN BEEN INCREASED SUBSTANTIALLY, TO MEET INTERNATIONAL EXPECTATIONS: AND AT THE SAME TIME THE MOF HAS MANAGED TO CUT BORROWING, AND TO MEET ITS TARGET FOR THE ELIMINATION OF DEFICIT COVERING BONDS.

12. OVERALL, THE BUDGET IS HELPFUL IN THAT IT IS INTENDED TO CONTINUE THE PRESENT DOMESTIC DEMAND-LED RATE OF ECONOMIC GROWTH. HOWEVER , THE SPECIFIC MEASURES IN THE BUDGET TO PROMOTE STRUCTURAL REFORM ARE EXTREMELY MODEST AND THE GOVERNMENT HAS MADE IT CLEAR THAT IT HAS NO INTENTION AT PRESENT OF EMBARKING OF ANY FURTHER MAJOR CAPITAL EXPENDITURE PROGRAMMES TO IMPROVE THE COUNTRY'S INFRASTRUCTURE ON PROPENSITY TO IMPORT. WITH THE ECONOMY CONTINUING TO OPERATE SO CLOSE TO FULL CAPACITY, AND WITH INFLATIONARY WORRIES NOT FAR BELOW THE SURFACE, IT WOULD BE UNREALISTIC TO EXPECT ANY SIGNIFICANTLY DIFFERENT STRATEGY AT PRESENT. FROM OUR POINT OF VIEW THE STRENGTH OF CONSUMER DEMAND SHOULD HELP BRITISH EXPORTS. WE SHOULD HOWEVER PERHAPS URGE THE GOVERNMENT TO ACKNOWLEDGE THE POSSIBILITY THAT A FURTHER STIMULUS WOULD BE BOTH DESIRABLE AND TECHNICALLY FEASIBLE IF DOMESTIC DEMAND WERE TO SLOW, PERHAPS SOMETIME DURING THE LATTER PART OF THE 1990 FISCAL YEAR.

13. FURTHER DETAILS WILL FOLLOW BY BAG.

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ADDITIONAL 42

JAPAN POLITICAL AND ECONOMIC

NNNN

EMBASSY OF JAPAN

LONDON

24th August 1989

C.S. FCO

C&P

24/8.

Dear Prime Minister,

I am asked by Prime Minister Toshiki Kaifu to to forward a message to you.

... I have much pleasure in enclosing this message herewith.

Yours sincerely,

Kazuo Chiba

Kazuo Chiba
Ambassador

The Rt.Hon. Margaret Thatcher, MP,
Prime Minister and First Lord of the Treasury,
10, Downing Street,
London, S.W.1.

Subject cc MASTER
OPS

PRIME MINISTER'S
PERSONAL MESSAGE
SERIAL No. T152/89

Dear Prime Minister,

I thank you very much for your message congratulating me on my appointment as Prime Minister of Japan. I fully share your view on the excellent relations between our two countries in many fields. Indeed, our partnership has been strengthened not only in finding a solution to our bilateral issues but also in coping with international affairs.

I highly appreciate your great contributions to this happy state of affairs. On my part, I am glad to be able to work for furthering our mutually fruitful partnership, recalling my experiences as a member of the Japan-UK 2000 Group and the Japan-British Parliamentary League.

It will be my great pleasure to welcome you and to exchange views with you on the occasion of your forthcoming visit to Tokyo in September.

Yours sincerely,

Toshiki Kaifu
Prime Minister of
Japan

EMBASSY OF JAPAN

LONDON

19th June 1989

Prime Minister

20/6

Dear Prime Minister,

I have been asked by Mr. Sousuke Uno, Prime Minister of Japan, to forward a message to you.

... I have pleasure in enclosing this message herewith.

Yours sincerely,

Kazuo Chiba

Kazuo Chiba
Ambassador

The Rt.Hon. Margaret Thatcher, MP,
Prime Minister and First Lord of the Treasury,
10, Downing Street,
London, S.W.1.

SUBJECT a MASTER
OPS

PRIME MINISTER'S
PERSONAL MESSAGE
SERIAL No T116/89

Dear Prime Minister,

I thank you very much for your message congratulating me on my appointment as Prime Minister of Japan.

I feel flattered by your kind words about my work as Minister for Foreign Affairs. For whatever contribution I have made to friendship and co-operation between Japan and the United Kingdom, I owe much to you and your colleagues. In fact, I agreed with Sir Geoffrey in January 1988 to make efforts to establish a "dynamic and plain-speaking partnership" between our two countries, and that, I believe, added impetus to the progress of our relationship.

I am quite pleased to be able to work with you, as Prime Minister this time, in furthering good partnership between our two countries. It is my earnest desire to have frequent opportunities of consulting each other on issues of mutual concern.

I do look forward to our talks at the Paris Summit and to welcoming you on the occasion of your forthcoming visit to Tokyo in September.

Yours sincerely,

Sousuke Uno
Prime Minister of Japan

20. VI.

親愛なるサッチャー首相閣下

既に御承知のこととと存じますが、私は、我が国における政治不信の拡がりに対し自らの責任を痛感し、政治に対する国民の信頼を回復するため、今年度予算が成立した時点で自らの身を引く決意を固めました。

日英関係の一層の発展を主要な外交課題の一つとして、閣下とともに、その強化と緊密化に取り組めましたことは、私にとって大きな喜びであります。この間閣下より賜った御支援と御協力に心より感謝申し上げます。一年半の在任中、長年の懸案であった酒税法改正問題が解決したほか、政治対話の進展を含め、あらゆる分野において両国間の交流は著しく拡大しました。更に、本年九月には閣下の訪日が予定されている等、日英関係の将来にかくも明るい展望が開けつつあることは、極めて望ましいと考えます。

私個人にとりましても、様々な機会を通じ、閣下との間に個人的友情を育む

ことができたことは、無上の喜びであり、特に昨年五月の貴国訪問の際、閣下より心温まるおもてなしを受けたことは、終生忘れ得ぬ思い出であります。

また、閣下とは、先進民主主義諸国の一員として、サミット会合を通じ世界の平和と繁栄に貢献する責務を分ちあって参りました。私は、同会合において閣下が示された、西側の連帯に対する揺るぎない信念とコミットメントに、深い感銘を覚えております。

私は、総理大臣の職を離れた後も、日英関係の一層の発展のため尽力する決意であります。閣下におかれても、私の後継者に対し、私同様の御厚誼と御支援を賜りますようお願い致します。

閣下の益々の御活躍と御健勝をお祈り致します。

敬具

平成元年五月十一日

日本国内閣総理大臣

竹下登

連合王国首相

マーガレット・サッチャー　閣下

Subject filed on Japan: Snt sit Pt 2.
cc MASTER
OPS

PRIME MINISTER'S
PERSONAL MESSAGE
SERIAL No. 110/89

(Translation)

Prime Minister
A farewell message from Mr. Takeshita
CDP. 8/6

Dear Prime Minister,

As you may already know, I have decided to resign as Prime Minister as soon as this year's budget passes the National Diet. I reached that decision with acute awareness of my responsibilities for the spread of distrust in politics in my country, and in the hope of restoring public confidence.

It has been a great pleasure for me to work with you on Anglo-Japanese relationships as one of the major objectives in our respective diplomatic efforts, striving together for stronger and closer ties between the two peoples. I thank you most sincerely for the support and cooperation that you have extended to me in this period. During the one and half years of my office, we have solved the long-standing question of liquor tax reform and expanded bilateral exchanges in all fields, including the enhancement of political consultations. I am very happy to see bright prospects for the future of Anglo-Japanese relationships, such as your visit to Japan scheduled in September.

Moreover, it is the greatest joy for me to have been able to cultivate, through various occasions, a personal friendship with you. In particular, the memory of your

The Right Honourable
Margaret Thatcher
Prime Minister

warm reception accorded to me on the occasion of my visit to your country in May last year is something that I will cherish for the rest of my life.

As members of advanced democracies, I have also had the pleasure of sharing with you the responsibility of contributing to world peace and prosperity through the Summit Meeting. I was deeply impressed by the firm belief in and commitment to the Western solidarity which you manifested on that occasion.

Even after my resignation, I am determined to continue to work for further development of Anglo-Japanese relations. I would be very grateful if you would extend to my successor the same friendship and support as those which you were kind enough to offer me.

Please accept my best wishes for your continued success and good health.

Sincerely yours,

Noboru Takeshita

~~Subject~~

Seen by CDP

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EMBASSY OF JAPAN
LONDON

8th June 1989

Dear Prime Minister,

I have been asked by former Prime Minister Noboru Takeshita to forward a letter to you.

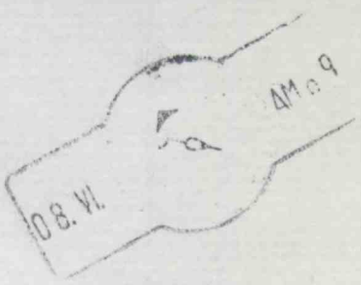
I have pleasure in enclosing this letter herewith.

Yours sincerely,

Kazuo Chiba

Kazuo Chiba
Ambassador

The Rt.Hon. Margaret Thatcher, MP,
Prime Minister and First Lord of the Treasury,
10, Downing Street,
London, S.W.1.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the department for Enterprise

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PRIME MINISTER

MY VISIT TO JAPAN: 17-24 MAY

1 Following my visit to Japan in March 1988, I paid a further visit on 17-24 May to renew contact with Japanese Ministers, to promote British exports, and to underline our continuing welcome for Japanese investment in the United Kingdom.

2 I came away convinced that, while Japan remains a challenge, it is also an opportunity which British business is increasingly taking. It was clear to me from meetings with Japanese Ministers, from discussions with Japanese investors and potential investors in the United Kingdom, and from talking to a range of British exporters, large and small, that there has been a steady increase in business, and that the scope for further increase remains very great. This reflects wider Japanese interest in the way in which we in Britain have set an example of economic resurgence, an interest which was reflected in the close attention given to your video message to International Digital Communications.

3 Despite the uncertain political situation, I was able to meet all the principal Japanese Ministers whom I had wished to see. My first meeting was with Foreign Minister Uno, whom I had met last year and who has since been appointed Prime Minister. He and I had a very full discussion, ranging over all aspects of the United Kingdom's relationship with Japan; and I was again impressed, as others have been, with his outward

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looking stance and his evident realization of the increasing complexity of Japan's relationship, as a major economic power, with the United Kingdom, the European Community, and the United States.

4 I also had meetings with Mr Mitsuzuka (MITI), Mr Kataoka (Posts and telecommunications), Mr Murayama (Finance) and Mr Kamei (Transport). Discussions were friendly and relaxed, and will have served, I hope, to pave the way for further steps in the development of trade and co-operation (particularly in aerospace, science and technology in third country project business and also tourism) while also underlining the real need for the process of Japanese market-opening to continue in sectors where restrictions remain.

5 A large part of my visit was devoted to promotion of Japanese inward investment in the United Kingdom, which has seen the arrival here of companies such as Honda, and in which Toyota (whose main board members I met in Nagoya) represents the hundredth Japanese company to invest in the United Kingdom. It was clear from the audience whom I addressed at the Inward Investment Seminar at Osaka that Japanese interest in investment in Europe remains intense, and that the United Kingdom is, for many, the preferred location. I made clear that we would welcome further Japanese investment, while underlining that the decision to invest here should be left to Japanese companies, free from pressure (whether from the European Commission or from MITI) to spread investments over the European Community as a whole. Mr Uno and Mr Mitsuzuka both took this point and evidently understood it, which I found reassuring.

6 I made a point of raising our continuing concern to see progress in the opening of Japanese financial markets to UK participants. Thanks to the pressure we have maintained, there

was evident recognition that movement must be made; and I came away with a generally positive impression, not least as regards progress towards regulatory reform in fields such as investment trust business. But my meeting with the Chairman of the Tokyo Stock Exchange was frankly unsatisfactory; and, while it may be true that the Exchange will act quickly when its members reach a consensus, the general line taken by the Chairman was disappointing. I said to him, and to Ministers I met subsequently, that this was an issue which could, if no progress were quickly made, become - like whisky taxation last year - a publicised symbol of Japanese recalcitrance in market-opening, with consequences for Japanese participation in London financial markets. I also said that it was an issue which I was sure you would wish to raise with the Japanese Prime Minister at the Economic Summit in July, and if necessary during your visit to Tokyo in September.

7 While the lack of progress on the Stock Exchange was disappointing, I remain convinced that specific problems of this kind, whether in the financial field or elsewhere, should not distract us from the much more important macro-economic picture of Japan as a very powerful economy which in large measure we are obliged to take as we find it, and whose opportunities we must exploit. Although Japan will never be an easy market for UK exports, there is increasing room for profitable trade: indeed UK exports to Japan have increased by 40% in the first quarter of this year. For all these reasons, most British companies must be urged to make a new assessment of the Japanese market, and develop a strategy for it. This is a central message of my "Opportunity Japan" campaign, which aims at working with the grain of the Japanese market, whatever the difficulties. My visit left me quite clear that we must continue with this process.

dti
the department for Enterprise

8 I am copying this minute to the Foreign Secretary, the Chancellor of the Exchequer, the Secretaries of State for Transport, Employment, Scotland, Wales and Northern Ireland, and to Sir Robin Butler.

D Y
June 1989

DEPARTMENT OF TRADE AND INDUSTRY

the enterprise initiative

MM5APZ

Cab DS

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

2 June 1989

Dear Rob,

JAPANESE PRIME MINISTER

I enclose letters from the Prime Minister to Mr Takeshita and Mr Uno. I should be grateful if they could be telegraphed to Tokyo for delivery as soon as possible.

Yours ever,

C. D. POWELL

R. N. Peirce, Esq.
Foreign and Commonwealth Office

SUBJECT cc MASTER
OPS

File MJ
cc FCO

10 DOWNING STREET

LONDON SW1A 2AA

THE PRIME MINISTER

PRIME MINISTER'S
PERSONAL MESSAGE
SERIAL No. T106/89

2 June 1989

Dear Prime Minister,

I send you my warm congratulations on your election as Prime Minister of Japan.

You take up your new responsibilities at a time when Japan is assuming an increasingly important role in world affairs. As Foreign Minister you made a great personal contribution to the successful development of relations between the United Kingdom and Japan. There are many fields in which our co-operation has grown. I hope that we shall be able to work closely together to further this co-operation and strengthen the partnership and understanding between our countries.

I look forward to renewing our acquaintance at the Paris Summit in July, and in particular during my visit to Japan in September.

Yours sincerely

Margaret Thatcher

His Excellency Mr. Sosuke Uno

SUBJECT cc OPS
MASTER

file MJ
cc FCO

10 DOWNING STREET

LONDON SW1A 2AA

THE PRIME MINISTER

2 June 1989

PRIME MINISTER'S
PERSONAL MESSAGE
SERIAL No. T105/89

Dear Mr. Takeshita,

As you leave office as Prime Minister of Japan, I should like to express my warm appreciation of all you have done to strengthen our bilateral relations. I am particularly grateful for your personal commitment to securing reform of the liquor tax, as part of the bold tax reforms which were a major achievement of your administration.

Your visit here in May last year was a valuable contribution to the broadening of Anglo-Japanese co-operation. I look forward to working with your successor as Prime Minister to build on the foundations you have helped lay for a closer partnership between the United Kingdom and Japan. In the meantime I send you my best wishes for the future.

Yours sincerely

Margaret Thatcher

His Excellency Mr. Noboru Takeshita

Foreign and Commonwealth Office

London SW1A 2AH

1 June 1989

Dear Charles

New Japanese Prime Minister

At long last the Liberal Democratic Party have agreed on a successor to Prime Minister Takeshita. Foreign Minister Uno will be elected on 2 June as LDP President at a joint meeting of LDP Dietmen of both Houses of Parliament. It is expected that his election as Prime Minister will be formally confirmed at a plenary session of both Houses later the same day.

The Foreign Secretary believes that it would be appropriate for the Prime Minister to send messages both to Mr Uno and to the outgoing Prime Minister, Mr Takishita. Although Mr Takeshita will leave office under a cloud, it is apparent that he will not now face the risk of prosecution for his involvement in the Recruit scandal. Mr Takeshita deserves some recognition for the efforts which he made to resolve the whisky problem.

I enclose draft messages to Mr Uno and Mr Takeshita.

Yours ever

(R N Peirce)
Private Secretary

C D Powell Esq
10 Downing Street

DSR 11 (Revised Sept 85)

DRAFT: minute/letter/teleletter/despatch/note

TYPE: Draft/Final 1 +

FROM:

Prime Minister

DEPARTMENT: TEL. NO:

BUILDING: ROOM NO:

Reference

Your Reference

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TO:

HE Mr Noburo Takeshita

Copies to:

SUBJECT:

As you leave office as

At the end of your tenure of the post of Prime Minister of Japan, I should like to express my warm appreciation of all you have done to strengthen our bilateral relations.

I am particularly grateful for your personal commitment to securing reform of the liquor tax, as part of the bold tax reforms which were a major achievement of your administration.

Your visit here in May last year was a valuable contribution to the broadening of Anglo-Japanese cooperation. I look forward to working with your successor as Prime Minister to build on the foundations you have helped lay for a closer partnership between the United Kingdom and Japan. In the meantime I send you my best wishes for the future

Yours

DSR 11 (Revised Sept 85)

DRAFT: minute/letter/teleletter/despatch/note

TYPE: Draft/Final 1 +

FROM:
Prime Minister
DEPARTMENT:
TEL. NO:
BUILDING:
ROOM NO:

Reference
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Your Reference

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Confidential
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PRIVACY MARKING

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Enclosures flag(s) .....

TO:
HE Mr Sosuke Uno

Copies to:

SUBJECT:

I send you my warm congratulations on your election as Prime Minister of Japan.

You take up your new responsibilities at a time when Japan is assuming an increasingly ~~significant~~ important role in world affairs. As Foreign Minister you made a great personal contribution to the successful development of relations between the United Kingdom and Japan. There are many fields in which our cooperation has grown. I hope that we shall be able to work closely together to further this cooperation and strengthen the partnership and understanding between our countries.

I look forward to renewing our acquaintance at the Paris Summit in July, and in particular during my visit to Japan in September.

DRG

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Liz, Also cc to No10. (duty clerk)

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MY TELNO 433: JAPANESE POLITICAL SITUATION

SUMMARY

1. NO PROGRESS ON CHOOSING TAKESHITA'S SUCCESSOR: SIGNS THAT THIS IS BECOMING A GENERATIONAL STRUGGLE WITHIN THE LDP. BUT SITUATION CLEARER IN OTHER RESPECTS: PROSECUTORS INVESTIGATION LIKELY TO END WITH CHARGES AGAINST TWO MP'S ONLY, NAKASONE TO GIVE DIET TESTIMONY NEXT WEEK, NEW LEADERSHIP CHOSEN FOR KOMEITO. KEY ISSUE FOR LDP NOW IS HOW TO GET ITS HOUSE IN ORDER FOR THE UPPER HOUSE ELECTIONS IN JULY.

DETAIL

2. THE POLITICAL CRISIS IS OPERATING AT VARIOUS LEVELS, INCLUDING THE PROSECUTORS' INVESTIGATION AND RELATED ISSUES, THE LDP SUCCESSION, AND THE PROSPECT OF SOME LASTING REFORM TO THE POLITICAL SYSTEM. ALL INTER-LOCK WITH EACH OTHER.

3. SUCH CLARITY AS HAS EMERGED IN THE LAST WEEK HAS COME FROM THE PROSECUTORS. ON 17 MAY THEY BEGAN FORMAL INTERROGATION OF FORMER CABINET SECRETARY FUJINAMI AND A KOMEITO MP IKEDA ON SUSPICION OF BRIBERY. ON 18 MAY THEY SEARCHED THE OFFICES AND HOMES OF THE TWO MEN. INDICTMENT OF BOTH IN THE NEXT DAY OR SO SEEMS INEVITABLE. THE PROSECUTORS ARE HOWEVER ALSO LETTING IT BE KNOWN THAT NO OTHER POLITICIAN IS LIKELY TO BE CHARGED WITH BRIBERY, ALTHOUGH SOME MAY BE IN TROUBLE FOR IRREGULARITIES OVER POLITICAL DONATIONS FROM RECRUIT AND IT IS POSSIBLE THAT NAKASONE MAY BE QUESTIONED ABOUT FUJINAMI. ON THE STRENGTH OF THIS, NAKASONE SAID ON 16 MAY THAT HE WAS WILLING TO TESTIFY UNDER OATH IN THE DIET. HE WILL DO SO IN THE LOWER HOUSE BUDGET COMMITTEE ON 25 MAY. PARADOXICALLY, THIS RESUMPTION OF LOWER HOUSE BUSINESS COINCIDES WITH A NEW

OPPOSITION BOYCOTT OF THE UPPER HOUSE SINCE NAKASONE REFUSES TO TESTIFY THERE TOO. IF THIS CONTINUES, THE BUDGET WILL GO THROUGH AUTOMATICALLY ON 27 MAY BUT A FURTHER INTERIM BUDGET MAY BE NEEDED TO COVER THE GAP AFTER THE PRESENT ONE RUNS OUT ON 20 MAY.

4. KOMEITO LEADER YANO RESIGNED ON 17 MAY, OFFICIALLY BECAUSE OF IKEDA'S INTERROGATION AND OTHER PROBLEMS IN THE PARTY BUT IN FACT MAINLY BECAUSE OF HIS OWN INVOLVEMENT IN THE SEPARATE MEIDENKI SCANDAL. HIS SUCCESSOR IS KOSHIRO ISHIDA, HIS FORMER DEPUTY, A SAFE BUT NOT PARTICULARLY DYNAMIC CHOICE. HIS YOUNGER RIVAL OKUBO, FORMER SECRETARY-GENERAL, WAS PASSED OVER THIS TIME AND BECOMES DEPUTY CHAIRMAN. YUICHI ICHIKAWA IS THE NEW SECRETARY-GENERAL. INCLUDING TAKESHITA, YANO IS THE THIRD PARTY LEADER THIS YEAR TO LOSE HIS JOB AT LEAST PARTLY BECAUSE OF RECRUIT.

5. THE LDP SUCCESSION HOWEVER REMAINS MUCH LESS STRAIGHTFORWARD. FOLLOWING ITO'S FIRM REFUSAL OF THE JOB, THE LEADERSHIP SOON CONCLUDED THAT THERE WAS NO POINT IN TRYING TO CHANGE HIS MIND. SINCE ABE WENT INTO HOSPITAL ON 15 MAY AND WILL STAY THERE FOR AT LEAST TWO WEEKS, THE LDP DEPUTY SECRETARY GENERAL HASHIMOTO HAS BEEN TAKING SOUNDINGS WITHIN THE PARTY. THESE WILL CONTINUE AT LEAST UNTIL 22 MAY, BUT HAVE SO FAR PRODUCED NO CONSENSUS FOR ANYONE OTHER THAN ITO. THE OPTIONS SEEM TO BE:

A) TO TRY AGAIN TO PERSUADE ITO: BUT HE IS NOTORIOUSLY STUBBORN. SOME OF THOSE URGING THIS SEEM TO BE USING IT AS CODE TO SUPPORT ITO'S DEMANDS FOR PARTY REFORM, VIZ ABOLITION OF THE FACTIONS, HANDING POWER TO A YOUNGER GENERATION, MAKING ALL THOSE INVOLVED WITH RECRUIT RESIGN AS MP'S.

B) TO APPOINT AN ELDER STATESMAN: TO THE FOUR CANDIDATES MENTIONED IN MY TUR HAS BEEN ADDED A FORMER SPEAKER, MICHITA SAKATA. BUT NONE OF THEM YET COMMANDS WIDESPREAD SUPPORT IN THE PARTY. A KEY ISSUE IN THE CHOICE BETWEEN THEM IS LIKELY TO BE WHO COULD BE NEXT PRIME MINISTER BUT ONE.

Kanemaru
Fukuda
Gotoda
Komoto

C) TO APPOINT A YOUNGER MAN: BUT THIS WOULD DESTROY THE HOPES OF ABE AND HIS GENERATION AND MEAN POWER MOVING DOWN IN THE PARTY. (HASHIMOTO HOWEVER IS AT PRESENT DOING HIMSELF NO HARM.)

D) TO KEEP ON TAKESHITA. WE HAVE HEARD THIS PUT FORWARD BY A COUPLE OF SOURCES BUT DOUBT IF IT WOULD BE ACCEPTABLE OR CREDIBLE FOR TAKESHITA EITHER TO GO TO THE PARIS SUMMIT OR TO LEAD THE LDP IN THE UPPER HOUSE ELECTION.

6. SO FAR THEREFORE THE PROBLEM REMAINS IN THE ''TOO DIFFICULT'' CATEGORY. UNDERLYING THE MANOEUVRING THE GENERATIONAL STRUGGLE FOR CONTROL OF THE PARTY SEEMS TO BE EMERGING MORE CLEARLY. MANY YOUNGER MP'S ARE IMPATIENT WITH THE CONTINUED DOMINANCE OF THE ABE-TAKESHITA GENERATION BOTH OUT OF PERSONAL AMBITION AND A FEELING THAT THE LDP'S ELECTORAL PROSPECTS DEPEND ON A CLEAN BREAK WITH THE RECRUIT-TAINTED PAST. ALTHOUGH DIET TESTIMONY WOULD EARLIER HAVE BEEN SEEN AS A SUFFICIENT CONCESSION BY NAKASONE, SOME NOW FEEL HE SHOULD GO FURTHER TO ATONE RATHER THAN LEAVE FUJINAMI TO CATCH THE FLAK. THERE IS EVEN RENEWED TALK OF AN EARLY GENERAL ELECTION. IN SPITE OF ABE'S ILLNESS HOWEVER THERE IS NO SIGN THAT THE LEADERSHIP ARE READY TO RELINQUISH EFFECTIVE CONTROL OF THE FACTIONS. THE CHOICE OF KOMOTO AS PRIME MINISTER MIGHT YET ENABLE ABE TO TAKE OVER IN DUE COURSE.

7. THE RECRUIT SCANDAL HAS SO FAR HAD ONLY LIMITED EFFECT ON THE ECONOMY AND DAY-TO-DAY GOVERNMENT OF THE COUNTRY BUT HAS FOCUSSED PUBLIC DISCONTENT WITH THE CURRENT POLITICAL SYSTEM. THE LDP POLITICAL REFORM COMMITTEE PRESENTS ITS RECOMMENDATIONS ON 19 MAY. AS WELL AS MUCH TIGHTER CONTROLS ON POLITICAL FINANCES THEY INCLUDE CHANGE TO THE ELECTORAL SYSTEM IN THE MEDIUM TERM. THE POST-LOCKHEED REFORMS PROVIDE A WARNING AGAINST EXCESSIVE OPTIMISM, BUT THE IMPLEMENTATION OF FURTHER REFORMS COULD BE ONE OF THE MORE SIGNIFICANT LONG-TERM EFFECTS OF THE PRESENT MUDDLE. (goroda)

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MIPT: JAPANESE POLITICAL SITUATION: COMMENT

SUMMARY

1. TAKESHITA'S RESIGNATION PROVOKED BY CONTINUING DEADLOCK OVER THE BUDGET. IT IS HOWEVER FAR FROM SOLVING ALL THE LDP'S PROBLEMS OR REMOVING ALL UNCERTAINTIES. A CARETAKER ADMINISTRATION WILL PROBABLY CONTINUE TO RELY HEAVILY ON THE BUREAUCRACY FOR POLICY ADVICE. IMMEDIATE CONSEQUENCES FOR THE UK: TOKYO STOCK EXCHANGE AND LORD YOUNG'S VISIT.

DETAIL

2. MY EARLIER TELEGRAMS REPORTED THE CONTINUING DIFFICULTIES THE GOVERNMENT WAS FACING IN GETTING THE BUDGET THROUGH THE DIET. EVEN THOUGH SOME AT LEAST OF THE OPPOSITION PARTIES WOULD NOT HAVE BEEN AVERSE TO A COMPROMISE, THEY HAVE BEEN UNABLE TO SOFTEN THEIR POSITION BECAUSE OF THE SHEER STRENGTH OF PUBLIC OPINION. OVER THE WEEKEND, TAKESHITA'S POSITION SUDDENLY WORSENED FURTHER:-

- THE OPPOSITION REJECTED AN LDP OFFER TO HAVE NAKASONE ANSWER QUESTIONS ON RECRUIT IN THE DIET BEFORE THE PROSECUTORS COMPLETED THEIR ENQUIRIES, BUT NOT UNDER OATH,

- TAKESHITA WAS FORCED TO ADMIT THAT, IN ADDITION TO THE DONATIONS HE HAD EARLIER REVEALED, HIS OFFICE HAD BORROWED YEN 50 MILLION FROM RECRUIT AT THE TIME OF HIS ELECTION TO THE LDP LEADERSHIP,

- THE CHAIRMAN (ISHIHARA OF NISSAN) OF KEIZAIDOYUKAI, A MAJOR ECONOMIC FEDERATION, HINTED PUBLICLY THAT TAKESHITA SHOULD RESIGN,

- LDP SECRETARY-GENERAL ABE RETURNED TO HOSPITAL FOR A FURTHER 10 DAYS,

- THE COMMUNISTS MORE THAN DOUBLED THEIR VOTES IN THE ELECTION FOR MAYOR OF NAGOYA, AGAINST AN INCUMBENT BACKED BY THE LDP AND ALL

NON-COMMUNIST OPPOSITION PARTIES.

3. AGAINST THIS BACKGROUND, TAKESHITA APPEARS TO HAVE DECIDED THAT THERE WAS LITTLE PROSPECT OF REACHING A COMPROMISE ON THE BUDGET THIS WEEK, BEFORE HE LEFT ON HIS TOUR OF ASEAN. TO DO SO WOULD REQUIRE CONCERTED PRESSURE ON NAKASONE TO GO FURTHER ON THE ISSUE OF TESTIMONY IN THE DIET. THERE WERE SIGNS OF INTENSE MANOEUVERING BETWEEN THE TAKESHITA AND NAKASONE FACTIONS OVER THIS, BUT THE FRESH REVELATIONS ABOUT A LOAN FROM RECRUIT WEAKENED TAKESHITA'S AUTHORITY TO NEGOTIATE. AT THE SAME TIME, THERE WAS GROWING CONCERN IN THE ADMINISTRATION OVER THE EFFECTS OF THE BUDGET DELAYS ON THE AID PROGRAMME AND PUBLIC WORKS AS WELL AS A FEELING THAT THE UNCERTAINTY WAS HARMING JAPAN'S INTERNATIONAL STANDING. TAKESHITA'S RESIGNATION IS THEREFORE THE PRICE FOR GETTING THE BUDGET PASSED: IT WILL ALSO BE PRESENTED BY THE LDP AS A RESPONSE TO PUBLIC DISSATISFACTION OVER RECRUIT AND OTHER ISSUES. EVEN WHILE LETTING THROUGH THE BUDGET HOWEVER, THE OPPOSITION WILL KEEP UP THEIR ATTACKS OVER RECRUIT AND WILL STILL HOPE FOR SIGNIFICANT GAINS AT THE UPPER HOUSE ELECTIONS IN LATE JULY/EARLY AUGUST.

4. OVER THE NEXT FEW WEEKS, TAKESHITA IS SET TO PRESIDE OVER THE LAMEST OF LAME-DUCK ADMINISTRATIONS. WITHIN THE LDP SOUNDINGS ARE ALREADY UNDER WAY ABOUT A POSSIBLE SUCCESSOR. ITOH HAS THE MERIT OF BEING WELL CLEAN AS FAR AS RECRUIT IS CONCERNED, BUT HE IS 75 AND UNWELL. HIS ADMINISTRATION WOULD BE HEAVILY PREOCCUPIED WITH PRESENTING AN APPEALING PACKAGE OF POLITICAL REFORM IN ORDER TO REDUCE LDP LOSSES IN THE UPPER HOUSE. THE POLITICIANS ARE LIKELY ALSO TO DEVOTE INCREASING ENERGY TO DECIDING ON THE SUCCESSOR TO ITOH: AT PRESENT ABE STILL LOOKS IN THE RUNNING - OR THE PARTY MIGHT MOVE ON TO THE NEXT GENERATION. EITHER ITOH OR - MORE PROBABLY - HIS SUCCESSOR WILL ALSO HAVE TO PREPARE FOR A GENERAL ELECTION PRESUMABLY STILL TO BE HELD NEXT YEAR RATHER THAN THIS. CONSIDERABLE POLITICAL UNCERTAINTIES THEREFORE REMAIN.

5. ONE RESULT IS LIKELY TO BE THAT THE BUREAUCRACY CONTINUES TO EXERT THE ADDED INFLUENCE IT HAS REGAINED FROM THE POLITICIANS DURING THE CRISIS. IN MANY AREAS INCLUDING ECONOMIC MANAGEMENT, THIS HAS PREVENTED THE CRISIS FROM SERIOUSLY AFFECTING THE RUNNING OF THE COUNTRY. ON THE TOKYO STOCK MARKET, SHARES ACTUALLY ROSE ON THE NEWS OF TAKESHITA'S ANNOUNCEMENT, APPARENTLY FROM SENTIMENT THAT IT REDUCED SOMEWHAT THE UNCERTAINTY. THE LDP'S DEEP UNPOPULARITY DOES HOWEVER MAKE IT DIFFICULT TO PROGRESS ON TRADE OR ECONOMIC ISSUES - EG MARKET ACCESS AND STRUCTURAL ADJUSTMENT WHERE THE INTEREST OF LDP SUPPORTERS WOULD BE AFFECTED. SIMILARLY

IT WILL BE A DISADVANTAGE TO US THAT TAKESHITA'S PERSONAL PLEDGE TO THE PRIME MINISTER ON THE STOCK EXCHANGE WILL BE LESS RELEVANT - THOUGH IT IS STILL ON THE RECORD, AND THERE WILL BE AN OPPORTUNITY DURING LORD YOUNG'S VISIT TO EMPHASISE OUR EXPECTATION OF AN EARLY ANSWER.

6. THE ONLY BRITISH MINISTERIAL VISIT WHICH MIGHT BE AFFECTED BY ALL THIS IN THE NEXT MONTH, IS LORD YOUNG'S (17-24 MAY). INITIAL SOUNDINGS SUGGEST THAT THE BUDGET SHOULD BY THEN HAVE GOT THROUGH THE LOWER HOUSE BUT COULD STILL BE UNDER DISCUSSION IN THE UPPER HOUSE. AS THINGS LOOK AT PRESENT, THE CABINET WILL NOT RESIGN UNTIL THE BUDGET IS ADOPTED. IN ANY CASE, MITI OFFICIALS BELIEVE THERE IS QUITE A GOOD CHANCE THAT MITSUZUKA WILL RETAIN HIS PRESENT JOB AFTER THE CHANGE. SO FOR THE MOMENT I RECOMMEND THAT WE CONTINUE WITH THE VISIT AS PLANNED, BUT WE SHALL NEED TO KEEP AN EYE ON HOW THINGS DEVELOP.

WHITEHEAD

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.JAPAN POLITICAL AND ECONOMIC
.(BACKGROUND)
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MY TELNO 362: JAPANESE POLITICAL SITUATION

SUMMARY
D
1. TAKESHITA ANNOUNCES HIS DECISION TO RESIGN ONCE THE 1989 BUDGET IS ADOPTED.

DETAIL
2. AFTER A ROUND OF PARTY AND CABINET MEETINGS THIS MORNING, TAKESHITA HELD A PRESS CONFERENCE TO ANNOUNCE HIS INTENTION OF RESIGNING AS SOON AS THE DIET ADOPTED THE 1989/90 BUDGET. HE SAID THAT HIS DECISION DERIVED FROM HIS FEELING OF RESPONSIBILITY AS PRIME MINISTER AND LDP LEADER FOR THE RECRUIT CRISIS IN GENERAL AND FROM REGRET THAT PROBLEMS CONCERNING HIS OWN INVOLVEMENT HAD ADDED TO PUBLIC LACK OF CONFIDENCE. HE AVOIDED GIVING ANY HINT ABOUT THE NAME OF HIS SUCCESSOR, AND THE LDP WILL NOW BEGIN ITS USUAL PROCESSES OF CONSULTATION. MOST OBSERVERS SEE NO ALTERNATIVE TO A TEMPORARY ADMINISTRATION HEADED BY MASAYOSHI ITOH (75), CURRENTLY CHAIRMAN OF THE LDP GENERAL COUNCIL, A FORMER FOREIGN MINISTER AND BY ALL ACCOUNTS UNTAINTED BY RECRUIT.

3. TAKESHITA SAID THAT HE INTENDED TO GO AHEAD WITH HIS ASEAN TOUR (29 APRIL - 7 MAY) ''IN ORDER TO ASSURE THE CONSISTENCY AND CONTINUITY OF JAPANESE FOREIGN POLICY''. OTHER GOVERNMENT MINISTERS WILL ALSO PROCEED WITH TRAVEL PLANS IN THE JAPANESE HOLIDAY WEEK (INCLUDING UNO TO MOSCOW).

4. THE OPPOSITION PARTIES HAVE AGREED TO RECOMMENCE DEBATE ON THE BUDGET EVEN THOUGH THEY ARE OFFICIALLY MAINTAINING THEIR DEMAND THAT NAKASONE BE SUMMONED TO TESTIFY ON RECRUIT.

5. SEE MIFT FOR COMMENT.

WHITEHEAD

DEPARTMENT OF HEALTH AND SOCIAL SECURITY
Richmond House, 79 Whitehall, London SW1A 2NS
Telephone 01-210 3000
From the Secretary of State for Social ~~Services~~ Security

cc P.C.
P.U.
(2)

The Rt Hon Sir Geoffrey Howe QC MP
Foreign and Commonwealth Office
Downing Street
London
SW1A 2AL

24 April 1989

Prime Minister
Interesting
ABB 24/4

Dear Geoffrey.

THE ELDERLY IN JAPAN

My recent visit to Japan and Korea was extremely fruitful and I am grateful to your embassy officials to whose efforts that was largely attributable.

There is one issue of overwhelming significance for social security of which you, and other colleagues, will wish to be aware because of its wider economic and social implications.

Major changes are occurring in the age distribution of the population in Japan. At present the proportion of the population aged over 65 years is lower than in any other major industrial country, and is a third lower than in the United Kingdom which is near the top of the range. However, the proportion of the elderly population is rising rapidly and by the end of the century will be close to the average for the major European countries, probably even higher by 2020. The scale and speed of the change can be seen in the following figures:

Percentage of the population aged 65 or over

	1950	1980	2000	2020
Japan	5	10	16	24
United Kingdom	11	15	15	18

Meanwhile, growth in the working age population of Japan will begin to slow down significantly in the early 1990s as a result of a decline in the birth rate twenty years earlier, and this population will be falling by the end of the century. Taken together, these two trends imply a change in the ratio of contributors to pension recipients of 7:1 to 2:1 over the next 30 years.

E.R.

It is these pressures which underlie proposals presently before the Diet to increase pension age from 56 for women (already being increased to 60 by the year 2000) to 65 by the year 2015, and from 60 for men to 65 by 2010. Even with these changes, pension contributions (employer and employee combined) are expected to be increased from 12% of earnings to 26%. Contributions to the health insurance scheme, presently 8%, will no doubt also need to be increased massively, though I did not explore this issue.

I am copying this letter to the Prime Minister, other members of E(A), Kenneth Clarke and Sir Robin Butler.

JOHN MOORE

24.IV.
PM

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R / plo copy to PS/No10
~~to Sir P Cradock~~
Jayl
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MY TELNO 336: JAPANESE POLITICAL SITUATION

SUMMARY
1. TAKESHITA'S MAIN IMMEDIATE PROBLEM IS GETTING THE BUDGET THROUGH THE DIET - CURRENTLY THE SUBJECT OF COMPLEX MANOEUVRING. IF HE CAN ACHIEVE THAT, EG BY A COMPROMISE OVER NAKASONE TESTIFYING ON RECRUIT, HIS NEXT MAIN TASK WILL BE TO PUT THE PARTY IN A BETTER POSITION TO FIGHT THE JULY UPPER HOUSE ELECTIONS.

2. THE CRISIS HAS LED TO POSTPONEMENT OF SOME MAJOR POLITICAL DECISIONS AND SENIOR MINISTERIAL TRAVEL BUT IN GENERAL HAS HAD LITTLE EFFECT ON THE ECONOMY OR DAY-TO-DAY GOVERNMENT. EVEN IN WORST-CASE ANALYSIS LITTLE POSSIBILITY OF COALITION GOVERNMENT WITH RADICAL POLICIES.

DETAIL
3. MY TUR (NOT TO ALL), REPORTED TAKESHITA'S RELATIVE SUCCESS IN RESPONDING TO REVELATIONS ABOUT HIS OWN INVOLVEMENT WITH RECRUIT. HIS TOP PRIORITY MUST NOW BE TO SECURE PASSAGE OF THE 1989/90 BUDGET. SINCE 1 APRIL JAPAN HAS BEEN OPERATING WITH A 50 DAY TEMPORARY BUDGET. IF THE MAIN BUDGET CAN BE PASSED IN THE LOWER HOUSE BY 21 APRIL, IT WILL AUTOMATICALLY COME INTO EFFECT 30 DAYS LATER. THE GOVERNMENT MAY NOT STICK PRECISELY TO THIS TIMETABLE BUT HAS RULED OUT A FURTHER TEMPORARY BUDGET BECAUSE IT WOULD SERIOUSLY DELAY MAJOR PUBLIC WORKS PROGRAMMES AND ALSO BE SEEN AS A POLITICAL DEFEAT.

4. A CONTINUED BOYCOTT OF THE PROCEEDINGS BY THE OPPOSITION WOULD NOT LEGALLY PREVENT THE GOVERNMENT FROM USING ITS MAJORITY TO PASS THE BUDGET. THE LDP HAS NOT RULED THAT ROUTE OUT. IT WOULD HOWEVER RUN COUNTER TO ESTABLISHED POLITICAL CUSTOM AND, WITH THE POPULARITY OF HIS CABINET AT A 9-13% RATING IN OPINION POLLS, TAKESHITA COULD HARDLY CLAIM A POPULAR MANDATE FOR SUCH AN UNUSUAL STEP AT THE MOMENT. MANY OBSERVERS BELIEVE THAT SUCH ACTION WOULD IN THE END PRECIPITATE A GENERAL ELECTION AND THERE IS SPECULATION ABOUT A DOUBLE ELECTION OF

BOTH HOUSES IN LATE JULY/EARLY AUGUST. HOWEVER THE LDP IS ACUTELY CONSCIOUS THAT THIS IS NOT THE MOMENT TO GO TO THE COUNTRY AND TAKESHITA HAS PUBLICLY COME OUT AGAINST THIS. SOME OF THE YOUNGER MP'S HAVE BEEN CALLING FOR NAKASONE TO TESTIFY AND TAKESHITA TO RESIGN, AS A WAY OF AVOIDING AN ELECTION. THEIR LEADERS HAVE BEEN WORKING HARD TO CALM THIS KIND OF NERVOUSNESS IN THE PARTY.

5. FROM TAKESHITA'S POINT OF VIEW THE MOST SATISFACTORY OUTCOME WOULD SEEM TO BE SOME ACCOMMODATION BETWEEN THE LDP AND SOME OPPOSITION PARTIES OVER TESTIMONY IN THE DIET BY NAKASONE. IT IS STILL TOO EARLY TO SEE EXACTLY WHAT FORM THIS MIGHT TAKE. TAKESHITA MUST BE CAREFUL TO AVOID UPSETTING THE NAKASONE FACTION AND SO PRECIPITATING A SPLIT WITHIN THE LDP. THE RELATIVE UNITY OF THE LDP AND THE ABSENCE OF A CREDIBLE, ''CLEAN'' SUCCESSOR TO TAKESHITA CONTINUE TO WORK STRONGLY IN HIS FAVOUR. THE DSP AND KOMEITO ALSO MUST BE CAREFUL NOT TO EXPOSE THEMSELVES TO PUBLIC CRITICISM BY LETTING THE LDP OFF THE HOOK WITHOUT PAYING A PRICE.

6. THE LDP IS DOING ITS BEST TO EMBARRASS AND DIVIDE THE OPPOSITION PARTIES. IT HAS FOR EXAMPLE REVEALED ITS OWN CONTRIBUTION OF FUNDS TO THE SOCIALISTS (JSP) - MADE IN ORDER TO OBTAIN GOODWILL FOR THE SMOOTH OPERATION OF THE DIET. THE OPPOSOTION PARTIES, HOWEVER, SEE A MAJOR OPPORTUNITY IN THE CURRENT UNPOPULARITY OF THE LDP. THE LEADERS OF THE 4 NON-COMMUNIST PARTIES PLEDGED THEIR UNITY AT A HIGHLY PUBLICISED MEETING IN KYOTO ON 7 APRIL, BUT THEY DID NOT RESOLVE THE MAJOR POLICY DIFFERENCES BETWEEN EG THE JSP, WHO ARE OFFICIALLY COMMITTED TO UNARMED NEUTRALITY, AND THE DEMOCRATIC SOCIALISTS (DSP), WHO SUPPORT THE SELF DEFENCE FORCES AND THE US-JAPAN SECURITY TREATY. MOREOVER, THE KOMEITO LEADER, YANO, IS INVOLVED IN A RECRUIT-STYLE SCANDAL AND ONE KOMEITO MP WAS HEAVILY INVOLVED WITH RECRUIT ITSELF. THIS MAKES THE PARTY CAUTIOUS ABOUT EARLY ELECTIONS. ATTEMPTS TO AGREE ON JOINT OPPOSITION CANDIDATES REPEATEDLY TURN INTO LOCAL DISPUTES. IT IS , THEREFORE, DIFFICULT TO SEE THIS UNITY AS BEING MORE THAN SKIN DEEP.

7. THE OTHER JOKER IN THE PACK IS THE PUBLIC PROSECUTORS, WHO ARE APPARENTLY TO DECIDE EARLY NEXT WEEK WHETHER OR NOT OT ARREST THREE OR FOUR MIDDLE-RANKING POLITICIANS, INCLUDING FORMER CHIEF CABINET SECRETARY FUJINAMI. IF THEY DO, THEY MIGHT GO ON TO INVESTIGATE MORE SENIOR FIGURES (ESPECIALLY NAKASONE), BUT AT THE PRESENT STAGE THAT IS SPECULATION.

8. AFTER THE BUDGET TAKESHITA'S NEXT TASK WILL BE TO RESTORE LDP CREDIBILITY AND LIMIT THEIR LOSSES IN THE UPPER HOUSE ELECTIONS. HE HAS BY NOW AT LEAST THE BROAD OUTLINES OF A PACKAGE OF POLITICAL REFORM MEASURES, PROBABLY COVERING SUCH AREAS AS SHARE- DEALING BY POLITICIANS, GIFTS TO CONSTITUENTS, TIGHTER RULES ON POLITICAL REFORM. HE WILL UNVEIL THIS WHEN HE JUDGES THAT THE MOMENT IS RIGHT. THE KEY WILL BE TO DEMONSTRATE THAT THE LDP HAS ''TAKEN RESPONSIBILITY'' FOR RECRUIT AND THE AFFAIR CAN NOW BE CLOSED. IT WILL NOT BE EASY.

9. AMIDST THE POLITICAL TURMOIL OF THE LAST WEEK OR SO, IT IS TEMPTING TO ASK WHAT DIFFERENCE IT HAS MADE. SO FAR IT HAS NOT SERIOUSLY AFFECTED THE DAY-TO-DAY RUNNING OF THE COUNTRY. THE BUREAUCRATS HAVE REGAINED SOME OF THEIR POWER AT THE EXPENSE OF THE POLITICIANS. THE ECONOMY CONTINUES TO PERFORM WELL. THE INTRODUCTION OF THE CONTROVERSIAL CONSUMER TAX WAS CARRIED OUT WITHOUT ANY GREAT CONFUSION, ALTHOUGH IT REMAINS UNPOPULAR AND THERE WERE INEVITABLE PUBLIC COMPLAINTS AT UNFAIR PRICE RISES. JAPAN CONTINUES TO RECEIVE SENIOR FOREIGN VISITORS (DE MITA, LI PENG), AND TAKESHITA IS PLANNING AN IMPORTANT TOUR OF THE ASEAN COUNTRIES AT THE END OF THIS MONTH. BUT THE CRISIS IS HAVING SOME EFFECT. DECISIONS WHICH ARE POLITICALLY CONTROVERSIAL, EG ON RAISING THE RETIREMENT AGE, ARE BEING PUT OFF. THERE IS EXTRA RELUCTANCE TO MAKE ANY CONCESSIONS ON FOREIGN TRADE, ESPECIALLY AGRICULTURE, WHICH WOULD HAVE DOMESTIC POLITICAL REPERCUSSIONS. AND, TAKESHITA'S PLANS NOTWITHSTANDING, MOST SENIOR MINISTERIAL TRAVEL HAS BEEN POSTPONED. THUS MURAYAMA'S ABSENCE FROM THE RECENT G7 AND IMF MEETINGS WAS A DIRECT CONSEQUENCE OF THE CRISIS EVEN THOUGH DECISIONS ON THE SUBSTANCE OF JAPAN'S POSITION WERE LITTLE AFFECTED BY IT.

10. LOOKING FURTHER AHEAD, THE ARGUMENTS FOR APOCALYPTIC CHANGE IN THE POLITICAL SCENE DO NOT CARRY MUCH CONVICTION. PEOPLE ARE FED UP WITH THE GOVERNMENT BECAUSE OF THE CONSUMER TAX, RECRUIT AND (IN RURAL AREAS) LIBERALISATION OF AGRICULTURAL TRADE. THERE IS A HEALTHY DESIRE, SHARED BY THE YOUNGER LDP MP'S, TO REDUCE THE ROLE OF MONEY IN POLITICS. BUT THE POLLS DO NOT SHOW ANY SWING TO SUPPORT FOR MORE RADICAL POLICIES. AS THE LDP'S SUPPORT HAS DECLINED, SUPPORT FOR THE OPPOSITION PARTIES HAS INCREASED SOMEWHAT, BUT THE ''DON'T KNOWS'' HAVE STEADILY RISEN MUCH MORE MARKEDLY. THE VOTES IN LOCAL AND BYE-ELECTIONS HAVE BEEN PROTESTS AT THE LDP, NOT POSITIVE SUPPORT FOR COMMUNISM OR FOR OTHER RADICALLY DIFFERENT POLICIES.

11. A WORST CASE SCENARIO COULD BE A GENERAL ELECTION IN WHICH THE LDP LOST ITS OVERALL MAJORITY. THIS WOULD RAISE THE THEORETICAL POSSIBILITY OF A COALITION OF THE PRESENT OPPOSITION PARTIES. THE COMMUNISTS HOWEVER, ARE NOT INTERESTED IN COALITIONS, AND EVEN BETWEEN THE OTHER PARTIES, THERE ARE FUNDAMENTAL POLICY DIFFERENCES (PARA 6 ABOVE). AS THINGS STAND NOW, A DSP-JSP COALITION WOULD NOT LAST A MONTH. ON THE OTHER HAND, THERE ARE RATHER FEW POLICY DIFFERENCES BETWEEN THE LDP AND THE TWO CENTRIST PARTIES (DSP AND KOMEITO). IF THEREFORE THE LDP DID LOSE THEIR MAJORITY, MOST BETS HERE ARE ON A CENTRE-RIGHT COALITION WITH FEW POLICY CHANGES.

WHITEHEAD

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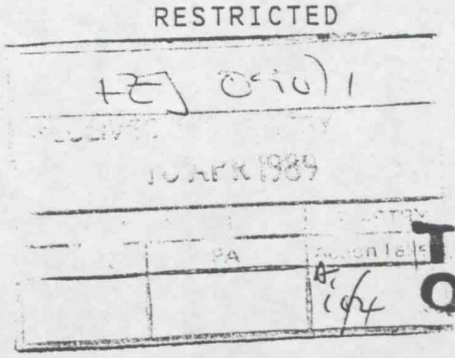

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THE JAPANESE ECONOMY

SUMMARY

1. GROWTH IN 1989 WILL BE LOWER THAN THE 5.7 SEEN IN CALENDAR 1988, BUT STILL IN THE 4-5% RANGE. THE FRUITS OF ADJUSTMENT ARE SHOWING IN BOTH DOMESTIC DEMAND AND IN THE RENEWED STRENGTHS OF EXPORTS. REDUCTION OF THE TRADE SURPLUS NOT IN PROSPECT. FISCAL POLICY LIKELY TO REMAIN UNCHANGED, BUT MONETARY POLICY MAY BE TIGHTENED BECAUSE OF INCIPIENT INFLATION AND THE STRENGTH OF THE DOLLAR. SO FAR THE RECRUIT SCANDAL HAS HAD NO EFFECT ON EITHER THE STOCK MARKET OR THE REAL ECONOMY. A US ASSAULT ON JAPAN AS AN UNFAIR TRADING COUNTRY WOULD CREATE MUCH POLITICAL RESENTMENT, AND PROBABLY INCREASE THE TENDENCY TOWARDS BILATERAL US/JAPAN DEALS.

DETAIL

2. THERE IS STILL NO SIGN OF FALTERING IN THE CURRENT EXPANSIONARY PHASE OF THE ECONOMY, NOW OFFICIALLY 29 MONTHS OLD. AFTER A REAL GNP GROWTH OF 5% IN CALENDAR 1988, PRIVATE FORECASTS FOR 1989 ARE IN THE MIDDLE OF THE 4-5% RANGE. GROWTH IS EVENLY SPREAD BOTH GEOGRAPHICALLY AND THROUGH THE MAJOR INDUSTRIAL AND SERVICE SECTORS. THE TWO MAIN CONTRIBUTORS TO GROWTH ARE VERY STRONG PRIVATE CAPITAL INVESTMENT AND PERSONAL CONSUMPTION, BUT EXPORTS HAVE SHOWN NOTABLE STRENGTH OVER THE LAST SIX MONTHS.

3. CAPITAL INVESTMENT IN MANY SECTORS IS STILL RUNNING 15-20% ABOVE LAST YEAR'S LEVELS, ENCOURAGED BY RECORD LEVELS OF PROFIT AND THE CONTINUING STRENGTH OF DEMAND. ACCORDING TO AN INDUSTRIAL BANK OF JAPAN SURVEY, 30% OF THIS REPRESENTS CAPACITY EXPANSION, WHILE THE REMAINDER IS IN NEW PRODUCTS AND R AND D. WITH THE ECONOMY AT FULL EMPLOYMENT, AUTOMATION-RELATED INVESTMENT IS PARTICULARLY STRONG. PRIVATE CONSUMPTION, WHICH APPEARS TO BE ON A SLOW LONG-TERM GROWTH TREND, IS LIKELY TO REMAIN BUOYANT DUE TO CUTS IN INCOME

AND COMMODITY TAXES FROM 1 APRIL, AND THE EFFECTS OF SETTLEMENTS LIKELY TO RANGE UP TO 5.4% IN THE ANNUAL WAGE ROUND (1% ABOVE 1988).

4. HOWEVER, CONCERN ABOUT INFLATION IS INCREASING. THE RISE IN OIL PRICES (NOT AS STRONG AN INFLUENCE UPON COSTS NOW AS IN THE 1970'S), THE FALL IN THE YEN'S VALUE, AND A GENERAL TIGHTENING IN THE LABOUR MARKET HAVE BEEN EDGING BOTH WHOLESALE AND RETAIL PRICES HIGHER IN RECENT MONTHS. ON TOP OF THIS, THE INTRODUCTION OF THE 3% CONSUMPTION TAX FROM 1 APRIL MAY RAISE THE CPI INCREASE IN 1989 TO AS MUCH AS 3% (CF 0.7% IN 1988 AND THE GOVERNMENT'S OFFICIAL FORECAST OF 2%). THIS SHOULD BE STRICTLY TEMPORARY, AND THE GENERAL BELIEF IS THAT PRODUCTIVITY GAINS IN MANUFACTURING INDUSTRY, CAPACITY EXPANSION AND THE GENERAL STATE OF COMPETITION AND PROFITABILITY IN THE DOMESTIC MARKET SHOULD KEEP INFLATION AT A MODERATE LEVEL.

5. THE MAIN CONCERN OF THE POLICY MAKERS IS TO PROLONG THE CURRENT STEADY DOMESTIC GROWTH AND TO ENSURE THAT THE RISE IN INFLATION IS ONLY TEMPORARY. AT PRESENT THERE IS NO EXPECTATION OF CHANGE IN THE CURRENT STANCE OF FISCAL OR MONETARY POLICY. HOWEVER, THE STRENGTH OF THE DOLLAR, COINCIDING WITH THE UPWARD TREND IN PRICES, IS AN UNHELPFUL FACTOR. HENCE THE BANK OF JAPAN'S VERY DEMONSTRATIVE INTERVENTION IMMEDIATELY AFTER THE G7 MEETING. IN RELATION TO THE ECONOMIC FUNDAMENTALS, THE RECENT WEAKENING OF THE YEN AGAINST THE DOLLAR SEEMS PERVERSE. SINCE IT IS MAINLY ATTRIBUTABLE TO US/JAPAN INTEREST RATE DIFFERENTIALS, ANY FURTHER TIGHTENING BY THE FED WILL MAKE IT VERY DIFFICULT FOR THE JAPANESE TO AVOID FOLLOWING SUIT.

6. THE GOVERNMENT'S PRINCIPAL EMBARRASSMENT IS THE WORSENING OF THE EXTERNAL TRADE IMBALANCE. THERE ARE COMPLEX REASONS FOR THIS, INCLUDING THE TEMPORARY EFFECT OF OVERSEAS INVESTMENT ON THE BALANCE OF PAYMENTS THROUGH THE EXPORT OF PLANT AND EQUIPMENT, BUT FUNDAMENTALLY THE POSITION IS THAT THE MANUFACTURING ECONOMY HAS COMPLETED ITS ADJUSTMENT TO THE PROCESS OF YEN APPRECIATION, AND IS NOW MORE COMPETITIVE AND PROFITABLE THAN AT ANY TIME SINCE THE PLAZA AGREEMENT. A SURVEY OF MAJOR MANUFACTURING COMPANIES BY THE EPA RECENTLY FOUND THAT YEN 128 WAS THE LEVEL AT WHICH JAPANESE EXPORTING COMPANIES REPORTED THEM PROFITABLE (NEXT TWO WORDS UNDERLINED) ON AVERAGE: THAT MOST FORESAW A CONTINUING SLOW RISE IN

THE YEN'S VALUE TOWARDS YEN 120 OR HIGHER: BUT THAT IN THE LONGER TERM MORE COMPANIES ANTICIPATED AN INCREASE THAN A DECREASE IN THEIR EXPORTS. THE TRADE FIGURES REFLECT THESE TRENDS. IN JANUARY/FEBRUARY 1989 THE GLOBAL TRADE SURPLUS EXCLUDING GOLD INCREASED BY 24% IN BOTH YEN AND DOLLAR TERMS. IMPORTS INCREASED ONLY 6% IN VALUE, WHILE EXPORTS INCREASED BY 11%. (IN THE CASE OF THE EC ALONE HOWEVER, THE PICTURE WAS REVERSED, WITH THE SURPLUS DOWN BY 6%, JAPANESE EXPORTS UP BY 5%, AND IMPORTS BY 19%). THE STRONGEST RISE IN JAPANESE EXPORTS ARE OCCURING IN ELECTRICAL MACHINERY AND EQUIPMENT, GENERAL MACHINERY AND TRANSPORT EQUIPMENT, MUCH OF WHICH IS PRODUCTION RELATED, AND NOT THEREFORE HIGHLY PRICE SENSITIVE.

7. AS WE HAVE SEEN IN 1988 IT IS DOUBTFUL HOW MUCH THESE VOLUMES WILL BE AFFECTED BY ANY FURTHER APPRECIATION OF THE YEN OR REDUCTION IN CONSUMER DEMAND IN OVERSEAS MARKETS. EXPERIENCE ALSO SUGGESTS THAT NEITHER OF THE ASSUMPTIONS THAT JAPANESE DOMESTIC DEMAND WILL DIVERT PRODUCTION FROM EXPORTS, OR THAT JAPANESE OVERSEAS INVESTMENT WILL SUBSTITUTE FOR DIRECT EXPORTS, HOLD ENTIRELY TRUE, AT LEAST IN THE SHORT TO MEDIUM TERM. GIVEN THE OPPORTUNITY AND MARKET CONDITIONS IN OTHER COUNTRIES, THE FLEXIBILITY AND ACTUAL TENDENCY OF JAPANESE COMPANIES ENCOURAGES THEM TO DO BOTH.

8. THE ESEENTIAL MESSAGE WHICH JAPAN'S PARTNERS NEED TO GET ACROSS IS THAT THE IMPORT AND CONSUMPTION SIDE OF THE ECONOMY NEEDS TO BE ENCOURAGED TO ADJUST TO YEN APPRECIATION TO THE SAME DEGREE HAS AS THE MANUFACTURING SECTOR. THERE HAVE INDEED BEEN POSITIVE SIGNS, IN THE INCREASE OF FOREIGN PRODUCTS (BOTH LUXURY ITEMS FROM EUROPE AND CHEAPER SOUTH-EAST ASIAN CONSUMER PRODUCTS) AND IN THE RISE IN JAPANESE FOREIGN TOURISM. PARTICULARLY IN RAW MATERIALS SUCH AS CEMENT AND STEEL, IMPORTS ARE NOW AN ANTI-INFLATIONARY SAFETY VALVE WHICH CAN OPERATE IF DOMESTIC PRICES GET TOO HIGH OR DEMAND TOO TIGHT. BUT CONSUMPTION GENERALLY, AND OF IMPORTS IN PARTICULAR, IS FAR BELOW ITS POTENTIAL. IN EUROPE'S CASE, THE GREATER PRESENCE AND EFFORT BY FOREIGN COMPANIES IN THE MARKET IS SHOWING REWARDS, THOUGH THERE IS STILL MUCH TO BE DONE. BUT THE JAPANESE GOVERNMENT NEEDS TO PLAY A SUPPORTING ROLE BY ACCELERATING THE SOCIAL AND ECONOMIC STRUCTURAL CHANGES WHICH WILL MAKE JAPAN MORE OF A CONSUMER SOCIETY. THIS WILL INVOLVE CHANGING CULTURAL PATTERNS AND UPSETTING POLITICAL INTERESTS, AND THEREFORE TAKE TIME, BUT THE MESSAGE OF DEREGULATION AND GREATER COMPETITION NEEDS

TO BE PRESSED HOME. THE PRICES OF IMPORTS SHOULD BE ENCOURAGED TO FALL, AND THE OPPORTUNITIES TO CONSUME INCREASED. SHORTER WORKING HOURS, LIBERALISATION IN THE RETAILING SECTOR WHICH WOULD WIDEN THE CHOICE AVAILABLE TO CONSUMERS, THE REMOVAL OF ANTI-COMPETITIVE PRACTICES IN THE DISTRIBUTION SYSTEM, AND OTHER REFORMS WHICH WILL REDUCE RELATIVE PRICES, AND AN INCREASE IN THE SUPPLY OF LAND AND HOUSING REMAIN HIGHLY RELEVANT, EVEN IF THEY NEED TO BE TACKLED ON A LONG TERM BASIS.

9. AGAINST THE BACKGROUND OF WORSENING TRADE FIGURES, A DIFFICULT PHASE IN US-JAPAN RELATIONS IS WIDELY EXPECTED HERE. A PROMINENT PLACE FOR JAPAN IN THE SUPER 301 REPORT IN MAY LOOKS PROBABLE. THIS WILL SEEM IRRATIONAL AND UNFAIR TO MANY JAPANESE IN THE LIGHT OF THE EXTENT TO WHICH THEY HAVE IN RECENT YEARS OPENED MANY MARKETS AT AMERICAN BEHEST. THIS COULD LEAD TO A CHALLENGE TO THE AMERICANS IN GATT, BUT IN MORE TRADITIONAL MOULD, THE JAPANESE MAY ALSO LOOK FOR WAYS OF APPEASING THE AMERICANS. WE WILL NEED TO BE ON THE WATCH FOR BILATERAL DEALS WHICH AFFECT UK AND EC INTERESTS.

10. THE RECRUIT SCANDAL, WHILE IT HAS DEEPLY UNDERMINED THE CABINET'S AUTHORITY, HAS HAD ONLY MINOR EFFECTS UPON THE REAL ECONOMY. ALTHOUGH BOTH THE STOCK MARKET AND THE FOREIGN EXCHANGE MARKETS HAVE REACTED ADVERSELY TO FURTHER REVELATIONS IN THE RECRUIT CASE, THE MARKETS HERE HAVE NOT BEEN AFFECTED FOR LONG, AND HAVE SOON FOCUSSED THEIR ATTENTION ON OTHER MATTERS. HOWEVER THE GOVERNMENT'S ABILITY TO PRESS FOR DOMESTIC STRUCTURAL CHANGES, WHICH WOULD ADVERSELY AFFECT THE INTERESTS OF L.D.P. SUPPORTERS HAS BEEN MUCH WEAKENED. FUNDAMENTALLY THE ECONOMY REMAINS EXTREMELY STRONG, AND UNLESS THE LDP'S MONOPOLY RULE ITSELF WERE UNEXPECTEDLY THREATENED, ANY FLUCTUATIONS IN THE ECONOMY FOR DOMESTIC POLITICAL REASONS SEEM LIKELY TO BE SHORT-TERM.

WHITEHEAD

YYYY

FCS/89/013

MEMBERS OF OD

Japan: Towards the Year 2000

1. Members of OD will have seen the JIC assessment "Japan Towards the Year 2000"*. I share the assessment's view that Japan's importance will continue to grow. It is remarkable that, in spite of its economic weight, it has had so little influence hitherto.

2. The central fact is that the Japanese save more than anyone else (roughly $437bn annually as against $106bn by the United States, $128bn by the FRG and $36bn by the UK). These savings represent future financial power: either they are invested at home, making the Japanese economy even stronger, or they become Japanese-owned assets abroad.

3. Japanese foreign policy is becoming visibly more active. Earlier this month I had a day's talks with the Japanese Foreign Minister. The difference between these talks and last year's was striking. The Japanese are now much more at ease discussing world affairs; they are more knowledgeable and they are beginning to speak with more authority. They are contributing substantial sums towards the settlement of regional problems: $5m for UNGOMAP in Afghanistan, plus $60m for resettlement - they are also contributing in the Gulf and in Nigeria. They have made clear their readines to do so in Namibia and Cambodia. The more they contribute, the more they will wish to be involved in decision-making.

*JIC(88)19

4. There is no reason why this should not be a positive development. The Japanese have followed a prudent and consistent line in international affairs, especially in their dealings with both of the superpowers. Japan can be an important source of strength to the Western consensus. Nevertheless, Japan is the first major power not to be rooted in European culture, and this may bring difficulties, not least in communication.

5. The JIC assessment said nothing about UK relations with Japan (its focus was exclusively European). In my view we have two major objectives:

a) **we should seek to bind Japan more closely into the Western consensus:**

- the UK is well-placed to contribute to this. We and Japan share a similar approach to relations with both the United States and the Soviet Union - more so than other European countries. The United States will remain the most important relationship for Japan but as they seek a wider range of contacts, we can become their leading partner in Europe;

- we need nevertheless to improve both the quantity and the quality of our dialogue with Japan. The removal of long-standing trade problems has already had a helpful effect in allowing us to concentrate on strategic issues;

- we need at the same time to do our best to foster as great a range of non-governmental contacts as we can with Japan.

/b)

b) **we must take maximum advantage of Japan's economic strength:**

- David Young's Opportunity Japan Campaign is an outstanding example of the sort of action we should take;

- Japanese investment in the UK is another important success story (more so for example than Japanese investment in Germany);

- a major effort is needed to obtain better access to Japanese science and technology.

We have made good progress towards these objectives over the last year; but what will count with Japan will be a consistent approach over the long term.

(GEOFFREY HOWE)

Foreign and Commonwealth Office
24 January 1989

(2)

FOREIGN AND COMMONWEALTH OFFICE
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DEATH OF THE EMPEROR: THE END OF THE SHOWA PERIOD OF JAPANESE HISTORY

HER MAJESTY'S AMBASSADOR AT TOKYO TO THE SECRETARY OF STATE FOR FOREIGN AND COMMONWEALTH AFFAIRS

Prime Minister

You may like to glance at paragraphs 14-17 which deal with the Emperor's responsibility for the war.

CDP 3/2.

SUMMARY

1. Emperor Hirohito died on 7 January 1989. This despatch attempts to examine the question mark over his past, the changes in the Imperial system, and its future. (paras 1-3)

2. During his early years he received a military education at odds with his temperament, which was more academic. (paras 4-6)

3. His 1921 visit to Britain and warm reception from the Royal Family conditioned his views on the role of a constitutional monarch. (paras 7-9)

4. He ascended the throne in 1926. All powerful in theory, his prerogatives were limited in practice. Unhappy with Japan's drift to militaristic adventure, he was ultimately powerless to stop it. (paras 10-13)

5. His only two interventions in political life in 1936 and 1945 were both designed to stop bloodshed. Paradoxically they only underline his limited influence generally. (paras 14-17)

6. The Occupation. A new constitution under which his formal powers were removed. His praiseworthy role as Japan's spiritual anchor in the post-war years. (paras 18-21)

7. The exchange of State Visits with Britain in the 1970s drew a line under the war. (para 22)

8. The demise of constitutional revision as a live issue; satisfaction of the Japanese people with the new Imperial system but indifference to the Emperor grows, especially among the young. (paras 23-25)

9. The initial emotional reaction of the Japanese people to his illness sparked a renewed debate about his position in Japanese life. But fears of a renaissance of the right wing are not borne out by events. The present status of the Imperial system in Japan is what the Japanese want and need. (paras 26-30)

BRITISH EMBASSY
TOKYO

23 January 1989

The Rt Hon Sir Geoffrey Howe QC MP
Secretary of State for Foreign and
Commonwealth Affairs
London

Sir

DEATH OF THE EMPEROR: THE END OF THE SHOWA PERIOD OF JAPANESE HISTORY

1. The death of Emperor Hirohito (who will henceforth be known in Japanese history as Emperor Showa) on 7 January 1989 after nearly 63 years on the throne brings to an end a reign which covered some of the most tumultuous years in Japan's modern history. Hirohito ascended the throne in 1926 when Japan was still a predominantly rural society struggling to modernise her industry. The early years of his reign coincided with the breakdown of parliamentary democracy and the rise of military influence in Japanese politics. In his name, the Imperial Armed Forces embarked on a brutal campaign of neo-colonial expansion in Asia as an antidote to economic recession at home. The suicidal war with the United States and her allies brought Japan to her knees.

2. Under the post-war Constitution Hirohito was dislodged from the pinnacle of the Japanese state. As the "symbol of the State and of the unity of the Japanese people" he watched over Japan's phenomenal post-war economic recovery. For many Japanese, his passing marks the true ending of the post-war period. Hirohito's long rule provided an element of continuity during a period of climactic social change. But he also tied the Japanese psychologically to a period of their history which they prefer to gloss over. The dawning of the Heisei era (pronounced "hay-say" and roughly translating as "constructing peace" or "peaceful achievement"), the name chosen for the new Emperor's reign, may give the Japanese a chance to face the future without some of the complexes of the past.

3. This despatch, for much of which I am indebted to Mr Millington, formerly Political Counsellor at this Embassy, seeks to answer in general terms three main questions: to what extent was Hirohito and the then Emperor system responsible for the wars in the 1930s and 1940s?; how well established are the changes in the role of the Emperor under the post-war constitution?; and, by extension, what are the prospects for the revised Emperor system in the future?

Early Years

4. By personality and temperament, Hirohito was ill-suited to the role assigned to him by destiny. The successors of the men who had led the Meiji Restoration yearned for a charismatic warrior king. Instead, they were given an introspective prince who grew up to be more at home in the science laboratory than on the military parade ground. But in his early years, every effort was made to cast him in a different mould. Hirohito was born on 29 April 1901 when his grandfather, the Emperor Meiji, was still on the throne. His parents, the mentally enfeebled Crown Prince, who briefly ruled as Emperor Taisho, and his mother, Princess Sadako, a descendant of the Fujiwara clan, who was only 16 years old at the birth of her first son, played little part in rearing the young prince.

5. As was then the custom in the Japanese Court, at the age of 3 months he was put in the care of foster parents. His upbringing for his first 4 years was entrusted to a distinguished retired Admiral from the Satsuma clan. From the outset, self restraint and endurance in the face of adversity were inculcated as the supreme virtues. At the age of 7 years, he entered the Peers School, then presided over by General Nogi, the hero of the Russo-Japanese war, who subsequently committed ritual suicide with his wife on the day of the funeral of the Emperor Meiji. On Meiji's orders, Nogi gave instructions that Hirohito should be given an education befitting a future Commander-in-Chief of the Army and the Navy. The military slant of his education continued after his graduation from the Peers School. For 7 years from 1914, Hirohito studied with five other carefully selected students at a special palace school. The teaching was heavily oriented towards moral education, especially the duty of a monarch towards his subjects, the martial arts and horse riding.

6. Hirohito appears to have shown little enthusiasm for his military studies or the emphasis in his education on physical prowess. As a child he was physically hesitant and maladroit, characteristics which became more pronounced in old age. Contemporaries described him as a frail-looking, earnest boy who never laughed. Already he had developed a taste for marine biology, an interest which deepened as he grew older. In the post-war years, Hirohito looked more at ease peering short-sightedly through a microscope at biological specimens than he had ever done sitting astride a white charger in front of the Imperial Palace while delirious crowds celebrated another Japanese military victory. His military education, which coincided with the First World War, may however have had a positive aspect. Japanese historians claim that Hirohito's subsequent reservations about Japan's military adventures in the 1930s stemmed from the lessons he had drawn from his studies of Germany's defeat in the Great War.

7. Hirohito's visit to Europe in 1921 was intended to cap his

education. For the first, and only, time in his life he emerged from what he described as the gilded cage and enjoyed a degree of personal freedom unknown in the cloistered atmosphere of the Japanese Court. His visit to Britain at a time when the Anglo-Japanese Alliance was still in force made a particularly strong impression. In later years he was to describe his eight days in Britain as the happiest moment of his life. He told his grandson, the then Prince Hiro and now the Crown Prince, as he was about to embark on his two years of study at Oxford, that he should make sure that he enjoyed himself and experienced life to the full since he would never again have such freedom.

8. Lord Curzon, Foreign Secretary at the time of Hirohito's visit, hosted a dinner at Carlton House Terrace where Pavolova danced La Mort du Cygne. Hirohito conversed with Prime Minister Asquith and Mr Lloyd George. At Buckingham Palace he was treated as one of the family. On the first morning King George V, half dressed in carpet slippers and open shirt, walked unannounced into Hirohito's suite to make sure he had everything he wanted. "I'll never forget how your grandfather (Emperor Meiji) treated me and my brother when we were in Yokohama as midshipmen. I've always wanted to repay his kindness. No geishas here, though, I'm afraid. Her Majesty would never allow it." The warmth of his reception by the Royal Family left him with a lasting affection for Britain which survived the war time years. His stay in Britain also helped shape Hirohito's conception of his role as Emperor. In a press conference in 1979 he paid tribute to his conversations with King George V. "The King talked to me in an intimate and friendly way about the British constitutional monarchy. Ever since that time I have continued to reflect on the proper part which should be played by a constitutional monarch."

9. Hirohito was quickly forced to put the lessons of his European tour into practice. Shortly after his return in November 1921 he was appointed Regent in place of his father who showed increasing signs of mental instability. At the State Opening of the Diet in 1920, Taisho had failed to deliver the speech from the throne and instead rolled it into a tube through which he surveyed the assembled parliamentarians. His father's condition steadily deteriorated. On Christmas Day 1926, Hirohito, at the age of 25, became Emperor.

Constitutional Position

10. Hirohito's education, and his visit to Europe, had instilled in him a respect for the Constitution. But the pre-war Meiji Constitution allotted to the Emperor a different role from that played by the constitutional monarchs of Europe. Prior to the Meiji Restoration of 1868, political power rested in the hands of the Tokugawa Shoguns. The Emperor, just as under the post-war Constitution, served as a symbol of the cultural unity of

the Japanese people. The leaders of the Meiji Restoration invoked the Emperor's name to legitimise their overthrow of the Tokugawa Shogunate. But no less than the Tokugawa Shoguns, they kept real power in their own hands. The Meiji leaders were aware that their programme of rapid social and economic reform required a strong state structure which would enjoy the backing of the Japanese people as a whole. They therefore sought as a conscious act of social engineering to create a constitution which would combine the legitimate force of Japanese tradition with the trappings of a modern democratic state. They seized on the Imperial institution as providing the central, unifying element in this new order. Ito Hirobumi, the principal author of the Meiji Constitution, who studied other government systems in Europe in the early 1880s, reported to the Privy Council in 1888, that "In our country religion is weak. There is not one that could serve as a principle of state. Buddhism today has fallen into decline. Shinto is based in the precepts of our forefathers and transmits them, yet as a religion it has little power to move men's hearts. In our country, as a common principle, there is only the Imperial House."

11. Thus, under the 1889 Constitution, the "sacred and inviolable" Emperor, who was the embodiment of a "single lineage unbroken for ages eternal" became the centrepiece of the "national polity" or "kokutai". Not only was the Emperor the highest power in the state but his position was reinforced by a moral code emphasising filial piety and loyalty. In this ethical system the Emperor and his people formed one harmonious organic whole. It was the concept of "kokutai" which was exploited by extreme nationalists in the 1930s to justify service to the state as the supreme virtue and to legitimise Japan's "historical mission" in East Asia.

12. Yet even under the Meiji Constitution the Emperor was not an absolute monarch. In legal principle, he may have appeared to be an absolute monarch ruling by divine right. By convention, he was a limited constitutional monarch. The proponents of unlimited imperial sovereignty never imagined that the Emperor as an individual might make political decisions. Under Article IV he embodied all state authority "combining in himself the rights of sovereignty". But the constitution enjoined him to exercise those rights "in accordance with the provisions of the present constitution". Although the Emperor retained emergency powers, Article V obliged the Emperor to exercise "legislative power with the consent of the Imperial Diet". Article LV decreed that "All Laws, Imperial Orders and Imperial Rescripts of whatever kind, that relate to the affairs of the State, require the counter-signature of a Minister of State".

13. After the war, the Emperor pointed out that he could not override his Ministers of State without destroying the constitution. "If Japan were a despotic state, that would be different, but as the monarch of a constitutional state it [was] quite impossible for me to behave in such a way." Under the

constitution, the Emperor was supreme commander of the armed forces, whose leaders had the right of direct appeal to the throne. Since operational decisions were regarded as the prerogative of the chief of staff, this in effect took defence policy out of the control of the government. As the 1930s progressed, the military increasingly exploited the independence of the supreme command to impose their expansionist politices on Emperor and Government. Time and time again the military presented the Emperor and Government with faits accomplis or bypassed or ignored the Emperor's wishes.

The War

14. A man of stronger personality than Hirohito might have tried more strenuously to check the growing influence of the military in Japanese politics and the drift of Japan towards war with the Western powers. The contemporary diary evidence suggests that Hirohito was uncomfortable with the direction of Japanese policy. Historians will continue to debate the Emperor's political role in the 1930s and early 1940s. But the consensus of those who have studied the documents of the period is that Hirohito was consistent in attempting to use his personal influence to induce caution and to moderate and even obstruct the growing impetus towards war. Paradoxically his desire to play the role of constitutional monarch led him to countenance increasingly authoritarian policies carried out in his name and a shift towards aggressive external policies of which he disapproved. The young Emperor received little encouragement from the elder statesmen to intervene directly in politics. For his part, the Emperor was conscious of the risk of exposing his advisers to the real danger of assassination. In their memoirs, the Emperor's advisers have no doubt attempted to minimise his responsibility for the course of Japanese policies in the pre-war period. But the testimony of Kido, the last Lord Privy Seal during the war years, has a ring of truth. According to Kido, the Emperor "may give words of advice and caution to the government but once the government has decided on a certain policy it has been the consistent attitude of Emperors since the Meiji era not to veto any such measure".

15. In the 1930s the palace bureaucrats, no less than their counterparts in the post-war period, did their best to avoid putting the Emperor in a politically exposed position where he would appear to be taking sides in the growing differences between the civilian government and the armed forces. They sought to preserve his position of neutrality and transcendence as a symbol of national unity. The Emperor's role in the political process was indirect. He acted as the ratifier of decisions made elsewhere but he could also attempt to act as a catalyst for crystallising consensus. This meant working indirectly through the palace bureaucrats or through private audiences with the principals. Only in two incidents prior to 1945 can it be said that the Emperor intervened directly to make his will prevail: in 1936 when he ordered the Army to quell an attempted coup and in 1945 when he insisted that the

war should be brought to an end.

16. Both these interventions were exceptions which prove the rule that the Emperor's powers were limited, whatever the provisions of the constitution. In February 1936 he believed (erroneously as it turned out) that the Prime Minister and other senior advisers had been assassinated by the Army rebels. Since the remaining members of the Government and the military leaders had taken no decision on how to react to the coup, the Emperor was able to intervene and to demand that the rebellion should be crushed. Even then he had difficulty in ensuring that his orders were obeyed. He was also successful in intervening to secure Japan's surrender in 1945 because the Government and military leaders were split over whether to continue the war or to accept the Potsdam surrender terms which gave no guarantee that the Imperial institution would survive. To the last, extremists in the Army attempted to prevent the implementation of the Emperor's decision to broadcast acceptance of the surrender. Although this would have implied disobedience to the Emperor, they justified their opposition as representing wise and true loyalty to the throne.

17. Hirohito knew throughout the 1930s and early 1940s that his moderate views had little support. It is arguable that if he had insisted on his views, he would have been reduced to complete political impotence or at worst deposed. The military owed their loyalty less to the person of the Emperor than to the Imperial institution. The military saw themselves as interpreting the real wishes of the Emperor uncontaminated by the poisonous advice of his officials. There is good evidence to suggest that if the military had concluded that the Emperor was an obstacle to the attainment of their objectives they would have been prepared to replace him with another member of the Imperial Family judged to be more amenable. Critics of the Emperor in Japan and abroad are inclined to hold him responsible for the excesses committed in his name simply because he was the Emperor. As the Head of State at that period the Emperor cannot escape all responsibility. But if a distinction can be drawn between formal and personal responsibility, the evidence suggests that at the personal level Hirohito was a moderating, albeit ultimately powerless, influence. This, at least, is the orthodoxy in Japan today. Suggestions that he should be compared with Hitler, the mastermind and active leader of Nazism and its abominations, are therefore ridiculously wide of the mark.

The Occupation and After

18. Under the terms of the Potsdam Declaration of 26 July 1945, the Allies agreed that the ultimate form of government to be established in Japan after the war would depend on "the freely expressed will of the Japanese people". After Japan's surrender, the Occupying Powers quickly decided that it would be counter-productive to remove the Emperor from the throne. In the words of General MacArthur, the Allied Commander, the Emperor had more value as a discredited god than as a martyr. To emphasise the

point, at MacArthur's bidding, although he apparently needed little encouragement to do so, on 1 January 1946 the Emperor formally denied his divinity.

19. The 1947 Constitution drawn up by the Japanese Government under the tutelage of the Occupation sharply curtailed the formal powers of the Emperor. It made the Emperor "symbol of the State and of the unity of the people" with "no powers related to government". No longer "sacred and inviolable" his position derived "from the will of the people with whom resides sovereign power". The Emperor may "perform only such acts in matters of state as are provided for in this constitution". Even in respect of these acts of state, the advice and approval of the Cabinet is required. Whereas in the pre-war period the Emperor had discretion to appoint his ministers, the constitution had now ordained that the Emperor should appoint the Prime Minister designated by the Diet. The latter in his turn is responsible for appointing the other members of the Cabinet in which all executive power is vested. Likewise, the links between the Emperor and the armed forces have been severed. The Emperor is no longer commander in chief. The Self Defence Forces have been placed under strict civilian control. Members of the Imperial Family now have no personal connections with the armed forces. Unlike in Europe, it would be unthinkable for a younger member of the Imperial Family to spend any time in uniform as part of his preparations for public life.

20. The immediate post-war period posed one of the greatest challenges to the Imperial institution in its 1300 years of history. The role left for the Emperor under the new constitution was essentially passive. Like the mirror on the altar of a Shinto shrine, which reflects the world before it, the Emperor now symbolised "the state and the unity of the Japanese people" as they are. The constitution gave him no role to create or shape the trend of the times. He was merely expected to respond passively to them. His task in the post-war period was to try and establish a new bond between Emperor and people based not on authority reinforced by religious mythology, but on subjective feelings of respect and affection. As Hirohito put it in the Imperial Rescript renouncing his divinity, "We stand by the people and we wish always to share with them in their moments of joy and sorrows".

21. Under the Occupation Hirohito set about humanising his position. His symbolic call on General MacArthur at the US Embassy in the early days of the Occupation set the tone. Later he travelled 33,000 km around Japan offering his sympathy for the suffering during the war and his encouragement to the efforts to rebuild the shattered economy. To the Allies he was a pathetic figure, as he toured the war torn country dressed in his worn and baggy suits aboard the Imperial Train, irreverently known as the "Ah So Special". He appeared ill-at-ease in his new role. He was an unimpressive, slight, stoop-shouldered figure, often with a startled or bewildered look in his thick-bespectacled eyes, as if he were embarrassed by the attention he attracted. Yet the Japanese public were clearly impressed

by the humility with which he had accepted Japan's defeat and by MacArthur's later revelation that at their first meeting he had offered "to bear sole responsibility for every political and military decision made and action taken by my people in the conduct of the war". The Emperor's comportment during this period helped reconcile the Japanese people to the Occupation and legitimised the new constitutional framework.

22. Later on, the Emperor also played a role in Japan's return to the international community. In late September/early October 1971, for example, he, together with the Empress, made the first ever overseas visit by a reigning Japanese monarch. The trip to seven European countries included state visits to the UK, Belgium and the Federal Republic of Germany. It was essentially inspired by the desire of the Emperor himself to relive the pleasant experiences of his tour of Europe in 1921, but was also seen as having a deeper significance in normalising the position of the Japanese Imperial Family. The visit failed to arouse much public enthusiasm in Europe and there were some protests over the war. However, as Sir John Pilcher reported at the time, "from a Japanese point of view, it caused far more pleasure and pride than pain" - not least because of the meticulous attention paid by our own Royal Family to preparing the visit to Britain. It was followed in 1975 by the immensely successful State Visit of Her Majesty The Queen to Japan. These visits together had the function of drawing a line under our war time hostilities.

Public Attitudes Today

23. Apart from the Communist Party, who have called for the abolition of the monarchy (a position not apparently supported by most Communist voters), in the post-war period a substantial majority of Japanese opinion has favoured the continuation of the institution of the Emperor. In the early days after the Occupation, conservatives promoted the idea of constitutional reform and urged that the Emperor should be given a more central role. Constitutional reform remains an objective written into the Liberal Democratic Party's Constitution, but since the mid-1960s, it has ceased to be a live political issue. After the controversies surrounding the Security Treaty with the United States, successive LDP governments have given priority to economic growth above ideological confrontation with the Opposition. This reflects the post-war mood of Japanese opinion. Opinion polls consistently show overwhelming support (80%) for the Emperor's position as a symbol of state. Polls taken throughout the 1970s and 1980s reveal little enthusiasm (around 5%) for giving the Emperor more authority. Only a small minority (around 10%) favour abolishing the monarchy.

24. The opinion poll evidence does however suggest that with the passage of time after the war the distance between the Emperor and the Japanese public has grown. Up to the 1960s the dominant emotion felt towards the Emperor was attachment. But from the 1970s onwards the most common response of those polled was one of indifference. This lack of emotion was

particularly strong among those under 40 years of age - the post-war generation who now constitute some 60% of the Japanese population. The younger the respondent, the less likely they are to identify emotionally with the Emperor. The latest polls published in the Asahi in 1986 on the occasion of the 60th anniversary of the Emperor's accession to the throne showed that more than half the 40 year old respondents did not feel any attachment to the Emperor, a percentage that rose to 80% for the 20 year old respondents.

25. The Emperor's increasing age must partially explain this trend of public opinion. In recent years the Emperor made fewer and fewer public appearances as he grew frailer. Younger Japanese found it increasingly difficult to relate to a man who seemed so divorced from contemporary Japan. The lack of attachment to the Emperor also reflects the changed position of the Imperial institution under the post-war constitution. At the war's end the Emperor-centred indoctrination in schools ceased abruptly. Under the Occupation-sponsored education reforms the teaching of morals, and Japanese history whichhad glorified the Emperor-system, was replaced by American-style social studies. The Emperor and the Imperial Family ceased to be front page news. Certainly, the Japanese popular press, especially magazines aimed at women, cover the activities of the Imperial Family. But by comparison with the British popular press their coverage is restrained and deferential. As the visit of TRH The Prince and Princess of Wales to Japan in 1986 illustrated, royalty can still fire popular enthusiasm in Japan. It will be a major challenge for the new Emperor to tap this vein of latent support.

The Emperor's Death

26. The Japanese have in fact surprised themselves by the strength of emotion displayed in the public reaction to the Emperor's terminal illness. As many as five million people signed books provided by the Imperial Household Agency and local authorities to wish the Emperor well. The crowds who queued outside the Imperial Palace were not just members of the pre-war generation. Many young people, especially women, joined the throng. They appear to have been drawn by a mixture of emotions: human sympathy for the Emperor as the "grandfather" of modern Japanese, a desire to be a witness at a symbolic turning point in Japanese history, a feeling that the Emperor represented in an intangible way the depth of Japan's cultural and historical roots or merely a belief that it was the fashionable thing to do. The media responded to, and helped create, this mood. Having for many years relegated the Imperial Family to the inside pages, the Japanese press mobilised all their resources to cover the Emperor's long drawn out struggle with his own mortality. Television too interrupted normal programmes to provide the latest details of the Emperor's temperature, blood pressure and pulse rate. From 20 September when the Emperor first fell seriously ill about 1000 journalists and television camera crew men maintained

a 24 hour vigil outside the Imperial Palace.

27. Uncertain how to respond to the imminent demise of "the symbol of the state", Government and industry over-reacted. In the name of "self-restraint", Japanese Ministers cancelled visits overseas and political engagements within Japan. Companies, doubtless fearful of retribution from right wing extremists, vied with one another to show that they were displaying the correct degree of respect for the dying Emperor. Even the right wing extremists themselves stopped patrolling the streets in their noisy loudspeaker vans. At first this "self-restraint" was generally accepted. But as the Emperor's terminal illness became prolonged, critical voices began to be raised that the reaction was excessive. This sentiment was not confined to those opposed to the Imperial institution. Moderate opinion was concerned that under the cover of self-restraint, reactionary forces, including within the Government, were attempting to impose on public opinion an anachronistic attitude of reverence towards the Emperor and to restrict rights assured under the constitution, including freedom of expression.

28. The unwillingness of Government spokesmen to discuss contingency arrangements for the death of the Emperor or to elaborate on the State's part in the ceremonies to mark the accession of the new Emperor aroused further suspicions. For the critics of the Government, the failure to discuss these matters openly suggested that the conservatives were exploiting the popular mood to give the Emperor a more central role and to blur the separation of religion and state under the post-war constitution. The Ministry of Foreign Affairs became embroiled in this controversy by its description of the Emperor as Head of State in the protest to the British Government over the treatment of the Emperor's illness by the British popular press.

29. However much of the sting had gone out of these issues by the time the Emperor finally died. Perhaps because the Emperor's lingering illness had given the Japanese ample time to adjust themselves psychologically, his death provoked no real dislocation of national life. Certainly some people found the Emperor's death a cause for grief; others found it thought-provoking. But even on the day itself people generally went about their business as normal. The blanket media coverage largely failed to rekindle interest, and within 48 hours public interest had all but died out. Already there were voices criticising the government and the mass media for overreacting. Close on half a million people signed the book of condolences in front of the Imperial Palace, but many clearly treated the event more as a tourist event than as an act of grief. This was not fertile ground for either the right wing or the left wing to plough.

30. Some right wingers had undoubtedly hoped that public sentiment aroused by the death of the Emperor would create

a more propitious atmosphere for the attainment of their cherished wish to revise what they see as the American imposed constitution. Whilst the Emperor was ill some right wingers argued in the intellectual magazines that the popular reaction to the Emperor's illness had revived the traditional bonds between the Emperor and the Japanese people. They maintained that the re-emergence of popular faith in the Emperor as father of his people had swept away the fallacies of Japan's post-war democracy based on the alien notion of sovereignty of the people. Such contentions sounded very hollow in the face of the calm almost disinterested reaction of the Japanese to the Emperor's death. Few Japanese desire to alter the present constitution or the place of the Emperor within it. In historical terms, the Meiji Constitution, not the constitution of 1947, was the aberration. For most of Japan's recorded history the Emperor has reigned, not ruled. The post-war constitution restores the Emperor to his traditional role. This suits most Japanese well.

I am, Sir,
Yours faithfully

John Whitehead

John Whitehead

153236
MDHIAN 8111

UNCLASSIFIED
FM TOKYO
TO DESKBY 111100Z FCO
TELNO 035
OF 110900Z JANUARY 89
AND TO IMMEDIATE HM TREASURY, BANK OF ENGLAND
AND TO ROUTINE WASHINGTON, UKREP BRUSSELS, UKDEL OECD

(CULL)
JAPAN: ECONOMIC FORECAST FOR FY 1989

1. THE GOVERNMENT ESTIMATE FOR ECONOMIC GROWTH IN 1989, AND OUT-TURN IN FY 1988, WHICH WILL BE OFFICIALLY PUBLISHED NEXT WEEK HAS APPEARED WIDELY IN THE NIKKEI AND OTHER MEDIA ALONGSIDE THE DRAFT BUDGET.

2. ACCORDING TO THESE REPORTS, REAL GNP IN FY 1989 WILL BE FORECAST AT 4.0 PERCENT, DOWN FROM 4.9 PERCENT THIS FISCAL YEAR. DOMESTIC DEMAND WILL GROW AT 4.7 PERCENT, OFFSET BY A 0.7 PERCENT DECLINE IN EXTERNAL DEMAND. WHOLESALE PRICES WILL RISE BY 0.9 PERCENT, BUT CONSUMER PRICES BY 2.0 PERCENT (AFTER 0.7 PERCENT IN FY 1988), THE HIGHER INCREASE IN THE CPI BEING ACCOUNTED FOR BY A ''ONE-OFF'' 1.2 PERCENT INCREASE AS A RESULT OF THE INTRODUCTION OF THE SALES TAX IN APRIL.

3. THE TRADE SURPLUS IN FY 1988 IS FORECAST AT US DOLLARS 93 BILLION (CF US DOLLARS 94.2 BILLION IN FY 87), FALLING TO US DOLLARS 88 BILLION IN FY 1989. THE CORRESPONDING FIGURES FOR THE CURRENT ACCOUNT SURPLUS ARE US DOLLARS 78 BILLION (84.5 BN) AND US DOLLARS 71 BILLION.

4. THE FIGURES ARE AS FOLLOWS. LAST YEAR'S OUTTURN AND FORECAST FOR FY 1988 ARE INCLUDED FOR COMPARISON.

	OUTTURN FOR FY 87	FORECAST FOR FY 88 (JAN 88)	ESTIMATED OUTTURN FOR FY 88 (JAN 89)	FORECAST FOR FY 89 (JAN 89)
REAL GROWTH RATE (PERCENT)	4.2	3.8	4.9	4.0
CONTRIBUTION OF DOMESTIC DEMAND	5.0	4.8	6.6	4.7

(PERCENT)				
CONTRIBUTION OF EXTERNAL DEMAND (PERCENT)	0.7	-L.0	-L.6	-0.7
NOMINAL GROWTH RATE (PERCENT)	5.0	4.8	5.4	5.2
CURRENT BALANCE				
(TRILLION YEN)	-	9.6	9.9	8.7
(BILLION DOLLARS)	84.5	72	78	71
TRADE BALANCE				
(TRILLION YEN)	-	10.8	11.8	10.9
(BILLION DOLLARS)	94.2	81	93	88
WHOLESALE PRICE INDEX (PERCENT)	-2.0	0.3	0.8	0.9
C.P.I. (PERCENT)	0.5	1.3	0.7	2.0

5. COMMENT. THE FIGURES SHOW THAT GROWTH AND DOMESTIC DEMAND IN FY 1988 HAVE BEEN CONSIDERABLY STRONGER THAN OFFICIALLY FORECAST A YEAR AGO. ON THE OTHER HAND, THE ADJUSTMENTS IN THE TRADE BALANCE AND CURRENT ACCOUNT BALANCES HAVE FALLEN FAR SHORT OF THE GOVERNMENT'S TARGET. THE DECLINE IN THE TRADE SURPLUS, AND THE 0.7 PERCENT NEGATIVE GROWTH IN THE EXTERNAL SECTOR IN THE GNP FORECAST FOR 1989 ARE SOMEWHAT INCONSISTENT AT FIRST SIGHT WITH RECENT DATA WHICH HAS SHOWN SUBSTANTIAL YEAR ON YEAR INCREASES IN EXPORT VOLUMES AND EVEN IN YEN VALUE OF EXPORTS SINCE OCTOBER 1988.

N.B. 11

6. FURTHER COMMENT WILL FOLLOW.

FIELD

YYYY

SUBJECT
CLIMATE
OPS

PRIME MINISTER'S
PERSONAL MESSAGE
SERIAL No. T202/88

(Translation)

28 December 1988

Dear Prime Minister,

I am most grateful to you for sending me a congratulatory message in such a prompt manner on the passage of the tax reform bills.

The Japanese Government has long made its utmost efforts for the realisation of the bills, and it was a great pleasure for me to see the Diet pass those bills including the liquor tax reform on 24th December.

The liquor tax reform proposals in which your country expressed the keen interest were approved in the original form as I informed you in my letter at the end of May this year and will take effect on 1st April next year. In this regard, I am most pleased to be able to keep my promise to you.

I sincerely hope that the trade relations between our two countries, with this reform as a good opportunity, will be further developed, thereby giving a renewed impetus to the further promotion of the Anglo-Japanese relationship.

Yours sincerely,

Noboru Takeshita

(2)

cc

EMBASSY OF JAPAN

LONDON

cc FCO

DTI

28th December 1988

Prime Minister

CSO

29/12.

Dear Prime Minister,

I am asked by Prime Minister Noboru Takeshita to transmit a message to you.

I have pleasure in enclosing herewith the text of the message.

Yours sincerely,

Kazuo Chiba

Kazuo Chiba
Ambassador

mf

The Rt. Hon. Margaret Thatcher, MP,
Prime Minister and First Lord of the Treasury,
London.

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

23 December 1988

Dear Stephen,

JAPANESE TAX REFORM: MESSAGE FROM THE PRIME MINISTER

Thank you for your letter of 23 December proposing a message from the Prime Minister to Mr. Takeshita to congratulate him on the passage through the Diet of the Japanese tax reform package.

I am sure the Prime Minister would be content to send a message but without the last main paragraph. I should be grateful if the text could be sent to Tokyo to hold for release at the right moment.

I am copying this letter to Neil Thornton (Department of Trade and Industry) and Alex Allan (H M Treasury).

Yours ever,

Charles

C. D. POWELL

Stephen Wall, Esq.,
Foreign and Commonwealth Office

Foreign and Commonwealth Office

London SW1A 2AH

23 December 1988

Dear Charles,

Japanese Tax Reform: Message from the Prime Minister

We expect that in the next few days the Japanese Tax Reform package will pass the diet and become law. This will be a major personal triumph for Mr Takeshita. The Japanese Government has been trying to secure such reform for the last ten years.

It would contribute to the Prime Minister's relationship with Mr Takeshita if she were able to send a short message of congratulations once the package is approved. This would also provide an opportunity to underline the importance we attach to proper implementation of the part of the package which will give fairer treatment to our whisky exporters.

I enclose a draft in the form of a telegram to Tokyo. If the Prime Minister is content we shall despatch the telegram to Tokyo. The top copy will be with our Resident Clerk who will despatch it on receipt of instructions. The package may be approved during the Christmas holiday period, and it would be easiest for the Embassy to have the message and delivery instructions in advance.

I am copying this letter to Neil Thornton at the DTI and to Alex Allan at HM Treasury.

Yours.

Stephen Wall

(J S Wall)
Private Secretary

C D Powell Esq
PS/No 10 Downing Street

OUT TELEGRAM

	Classification	Caveat	Precedence
	RESTRICTED		IMMEDIATE

ZCZC
TC
CAVEAT
FM
TO
TELNO
OF
AND TO

ZCZC
RESTRICTED

FM FCO
TO IMMEDIATE TOKYO
TELNO
OF 221400Z DEC 88

FM FED

MESSAGE FROM PRIME MINISTER TO MR TAKESHITA: TAX REFORM

1. Grateful if you could deliver following message from the Prime Minister to Mr Takeshita when tax reform package has been approved.

Begins

Dear Prime Minister,

I was very pleased to hear that your Government's tax reform proposals have been approved by the Diet. I know how important these proposals have been to you personally. You have achieved a success in this difficult area which, twice in the past decade, has eluded your predecessors. I should like to take this opportunity to congratulate you on a major personal and political success.

/// We have, of course taken a particular interest in your tax // reform measures because of the important issue of liquor tax in / Japan. I therefore very much welcome the news that the liquor tax reforms will be implemented from 1 April 1989. We shall need

YYYY
MAIN
ADDITIONAL
NNNN

		Catchword: to	
File number	Dept: FED	Drafted by (Block capitals): D Taylor	Telephone no: 270 2956
Authorised for despatch by:	Initials	Date/time	
For COD use only	Comcen reference	Telegram number	Processed by

Classification	Caveat	Precedence
RESTRICTED		IMMEDIATE

<<<<

to keep under review the effects of the new law, but I am confident that it will lead to increased sales of scotch whisky to Japan; and I hope that this will enable us to put this long standing problem behind us.

I also hope that this development augurs well for a further improvement in relations between our two countries.

I know that both Geoffrey Howe and David Young very much look forward to discussing how those relations can be further developed, during Mr Uno's visit to London and David Young's visit to Japan next year.

Yours sincerely

Margaret Thatcher

Ends

3. There will be no signed original.

HOWE

YYYY

MAIN

MINIMAL

JAPAN (Political and Economic Background)

FED

ADDITIONAL

PS/NO. 10.

NNNN

23 XII PM 6

PRIME MINISTER'S
PERSONAL MESSAGE
SERIAL No. T197I/88

SUBJECT
cc MASTER
OPS

(15)

RESTRICTED

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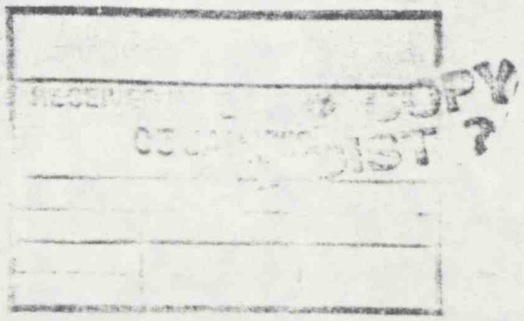
MDHOAN 1643



RESTRICTED
FM FCO
TO DESKBY 240100Z TOKYO
TELNO 933
OF 221400Z DEC 88

FM FED

MESSAGE FROM PRIME MINISTER TO MR TAKESHITA: TAX REFORM

1. GRATEFUL IF YOU COULD DELIVER FOLLOWING MESSAGE FROM THE PRIME MINISTER TO MR TAKESHITA WHEN TAX REFORM PACKAGE HAS BEEN APPROVED.

BEGINS

DEAR PRIME MINISTER,

I WAS VERY PLEASED TO HEAR THAT YOUR GOVERNMENT'S TAX REFORM PROPOSALS HAVE BEEN APPROVED BY THE DIET. I KNOW HOW IMPORTANT THESE PROPOSALS HAVE BEEN TO YOU PERSONALLY. YOU HAVE ACHIEVED A SUCCESS IN THIS DIFFICULT AREA WHICH, TWICE IN THE PAST DECADE, HAS ELUDED YOUR PREDECESSORS. I SHOULD LIKE TO TAKE THIS OPPORTUNITY TO CONGRATULATE YOU ON A MAJOR PERSONAL AND POLITICAL SUCCESS.

WE HAVE, OF COURSE TAKEN A PARTICULAR INTEREST IN YOUR TAX REFORM MEASURES BECAUSE OF THE IMPORTANT ISSUE OF LIQUOR TAX IN JAPAN. I THEREFORE VERY MUCH WELCOME THE NEWS THAT THE LIQUOR TAX REFORMS WILL BE IMPLEMENTED FROM 1 APRIL 1989. WE SHALL NEED TO KEEP UNDER REVIEW THE EFFECTS OF THE NEW LAW, BUT I AM CONFIDENT THAT IT WILL LEAD TO INCREASED SALES OF SCOTCH WHISKY TO JAPAN: AND I HOPE THAT THIS WILL ENABLE US TO PUT THIS LONG STANDING PROBLEM BEHIND US.

I ALSO HOPE THAT THIS DEVELOPMENT AUGURS WELL FOR A FURTHER IMPROVEMENT IN RELATIONS BETWEEN OUR TWO COUNTRIES.

YOURS SINCERELY
MARGARET THATCHER

ENDS

3. THERE WILL BE NO SIGNED ORIGINAL.

HOWE

YYYY

R) 1) we should have top copy 2) R/ cc to No 10 please
Mr Miller O/R

CONFIDENTIAL

Mr Taylor

154453
MDHIAN 1962
+ p/w float

I think the P.M. might send a message to Takeshita when this clean the upper house - to say well done not just for whisky but for a major political triumph & a far sighted policy. RL. 17/11

CONFIDENTIAL
FM TOKYO
TO IMMEDIATE FCO
TELNO 1012
OF 170717Z NOVEMBER 88
INFO ROUTINE DTI, HM TREASURY, BANK OF ENGLAND, UKREP BRUSSELS

MY TELNO 1008: JAPAN/ TAX REFORM

SUMMARY

1. THE APPROVAL OF THE TAX REFORM PACKAGE BY THE LOWER HOUSE ON 16 NOVEMBER IS A VINDICATION OF THE LDP'S PARLIAMENTARY TACTICS AND A FEATHER IN THE CAP FOR PRIME MINISTER TAKESHITA.

DETAIL

2. THE LDP'S (BY JAPANESE STANDARDS) STRONG ARM TACTICS IN THE DIET HAVE CARRIED THE DAY. AS REPORTED IN TUR THE LOWER HOUSE PASSED THE GOVERNMENT'S TAX PACKAGE IN PLENARY ON 16 NOVEMBER . THE BILLS WERE IMMEDIATELY REFERRED TO THE HOUSE OF CONCILLORS. THE GOVERNMENT NOW INTENDS TO OBTAIN AN EXTENSION OF ABOUT A MONTH OF THE CURRENT EXTRAORDINARY SESSION OF THE DIET, SCHEDULED TO END ON 24 NOVEMBER. THIS SHOULD ALLOW THE TAX BILLS, INCLUDING REVISION OF THE LIQUOR TAX, TO COMPLETE THEIR PASSAGE THROUGH PARLIAMENT BY THE END OF THE YEAR.

3. THE LDP ROUNDED OFF THE DEBATE IN THE LOWER HOUSE IN STYLE. AS A RESULT OF LAST MINUTE FACE-SAVING CONCESSIONS TO THE OPPOSITION, THE LDP WERE ABLE TO INDUCE THE KOMEITO AND THE DEMOCRATIC SOCIALIST PARTY (DSP) BUT NOT THE SOCIALISTS BACK INTO THE DIET FOR THE FINAL VOTE IN PLENARY. THE LDP WERE MAGNANIMOUS IN VICTORY. TO THE KOMEITO, THE CLEAN GOVERNMENT PARTY, ONLY ONE OF WHOSE DIETMAN HAS BEEN IMPLICATED IN THE RECRUIT COSMOS SCANDAL, THE LDP CONCENDED THE ESTABLISHMENT OF A SPECAIL DIET COMMITTEE TO INVESTIGATE THE AFFAIR. THEY ALSO AGREED TO THE PUBLICATION OF A LIST PROVIDED TO THE SPEAKER BY RECRUIT COSMOS, CONTAINING THE NAMES OF THOSE PUBLIC FIGURES WHO RECEIVED UNLISTED SHARES FROM THE COMPANY. THE LDP HAVE FURTHER AGREED THAT THE FORMER PRESIDENT OF RECRUIT COSMOS AND TWO FORMER CIVIL SERVANTS MAY BE SUMMONED AS SWORN WITNESSES TO GIVE EVIDENCE BEFORE THE COMMITTEE. TO THE DSP, THE LDP CONCEDED SOME ADDITIONAL TAX REDUCTIONS OF PARTICULAR INTEREST TO THE PARTY'S SUPPORTERS (DETAILS FOLLOW BY BAG). THE LDP RESISTED PRESSURE FROM THE DSP TO POSTPONE BY UP TO A YEAR THE DATE OF IMPLEMENTATION OF THE NEW CONSUMPTION TAX. THEY ARGUED THAT THE IMPLEMENTATION OF TAX REFORM

(AS FAR AS THE LIQUOR TAX WAS CONCERNED) ON SCHEDULE FROM 1 APRIL 1989 WWS AN INTERNATIONAL COMMITMENT BY THE JAPANESE GOVERNMENT. THIS WAS A DIRECT RESULT OF PRESSURE FROM THE CABINET AND THEREFORE FULLY VINDICATES THE INTENSIVE LOBBYING WHICH HAS BEEN CARRIED OUT OVER A LONG PERIOD BY HMG, BRITISH BUSINESS AND EC REPRESENTATIVES.

4. ON PAPER, THE LDP APPEARS TO HAVE GONE A CONSIDERABLE WAY TO MEET OPPOSITION DEMANDS FOR A THOROUGH INVESTIGATION OF THE RECRUIT COSMOS AFFAIR. BUT IN THE PAST, DIET COMMITTEES ESTABLISHED TO INVESTIGATE THE SCANDALS WHICH PERIODICALLY ROCK JAPANESE POLITICS HAVE PROVED TO BE TOOTHLESS TIGERS. FEW EXPECT THE NEW COMMITTEE TO HAVE SHARPER TEETH. THE CHAIMAN (HARADA) IS A SENIOR MEMBER OF THE TAKESHITA FACTION. HE WILL DOUBTLESS DO HIS BEST TO ENSURE THAT THE COMMITTEE DOES NOT STRAY INTO TOO MURKY WATERS. THE ESTABLISHMENT OF THE COMMITTEE DOES IN FACT HAVE TACTICAL BENEFITS FOR THE LDP. TAX REFORM HAS IN EFFECT BEEN DECOUPLED FROM THE RECRUIT COSMOS AFFAIR. THE OPPOSITION HAS THEREFORE LOST ITS MOST POWERFUL WEAPON AGAINST THE TAX REFOM PACKAGE.

5. THE PASSAGE OF THE TAX BILLS VIRTUALLY UNSCATHED THROUGH THE LOWER HOUSE IS A GREAT SUCCESS FOR PRIME MINISTER TAKESHITA, AND, TO A LESSER EXTENT, LDP SECRETARY GENERAL ABE, WHO LED THE PARTY'S TROOPS ON THE FLOOR OF THE HOUSE. OVER THE PAST FOUR MONTHS TAKESHITA HAS HAD SOME ANXIOUS MOMENTS. AT EVERY FRESH TWIST IN THE RECRUIT COSMOS SAGA, THE DOOMSAYERS WERE READY TO WRITE OFF THE PROSPECTS OF TAX REFORM. BUT TAKESHITA HAS STUCK TO HIS TASK WITH CHARACTERISTIC PATIENCE AND WITH A GENERALLY UNCHANGED STRATEGY. BARRING UNFORESEEN ACCIDENTS, BY THE END OF THE YEAR HE SHOULD BE IN THE ENVIABLE POSITION OF HAVING SUCCEEDED WHERE HIS PREDECESSORS FAILED, IN INTRODUCING A MAJOR OVERHAUL OF THE JAPANESE TAX SYSTEM. ALREADY HIS REELECTION AS PARTY LEADER IN OCTOBER/NOVEMBER NEXT YEAR FOR A FURTHER TWO YEAR TERM, BEGINS TO LOOK ASSURED. JAPANESE CONSUMERS WILL NOT BE ALONE IN HAVING CAUSE TO CELEBRATE THE IMMINENT ADVENT OF LOWER LIQUOR TAX ON IMPORTED SCOTCH WHISKY.

WHITEHEAD

YYYY

CONFIDENTIAL
CULL
FM TOKYO
TO IMMEDIATE FCO
TELNO 837
OF 160730Z SEP 88
INFO IMMEDIATE HM TREASURY, BANK OF ENGLAND, UKDEL IMF/IBRD
INFO PRIORITY WASHINGTON, OTTAWA, PARIS, BONN, ROME, UKDEL OECD

THE JAPANESE ECONOMY

SUMMARY

1. DESPITE A SLOWING DOWN IN THE SECOND QUARTER, THE ECONOMY REMAINS VERY BUOYANT AND WILL ALMOST CERTAINLY PRODUCE REAL GROWTH OF 4.5-5.02 IN FISCAL YEAR 1988. THIS SUCCESS HAS MEANT THAT MACRO-ECONOMIC POLICY HAS SLIPPED DOWN THE POLITICAL AGENDA, AS THE GOVERNMENT GRAPPLES WITH TAX REFORM. BUT A QUESTION MUST REMAIN ABOUT THE SUSTAINABILITY OF THE RATE OF GROWTH IN FY 1989. OTHER CLOUDS ON THE HORIZON, STILL SMALLBUT WITH POTENTIAL TO GROW, ARE THE PROSPECT THAT THE TRADE SURPLUS WILL CEASE TO FALL, AND THE IMPLICATIONS FOR BUSINESS CONFIDENCE AND THE STOCK MARKET OF A CYCLICAL UPTURN IN INTEREST RATES.

DETAIL

ECONOMIC OUTLOOK

2. ALTHOUGH THE RATE OF ECONOMIC EXPANSION SEEMS TO HAVE SLACKENED DURING THE SECOND QUARTER AND THE MID-SUMMER, NO ONE DOUBTS THAT THIS WILL BE ONLY A TEMPORARY PHENOMENON. RAPIDLY RISING REAL WAGES AND BUOYANT CORPORATE PROFITS ARE UNDERPINNING CONSUMER SPENDING AND CORPORATE FIXED INVESTMENT. BUSINESS CONFIDENCE IN THE OUTLOOK IS EXCEPTIONALLY HIGH: THE BANK OF JAPAN'S MOST RECENT BUSINESS SURVEY SHOWED THE HIGHEST BALANCE OF COMPANIES EXPECTING ''FAVOURABLE'' BUSINESS CONDITIONS SINCE THE MID-1970S, WHILST AN INVESTMENT INTENTIONS SURVEY BY THE ECONOMIC PLANNING AGENCY SHOWED THAT CAPITAL SPENDING WAS LIKELY TO RISE BY ABOUT 20 PERCENT THSI YEAR.

3. PRIVATE SECTOR FORCASTS ARE UNUSUALLY UNANIMOUS IN EXPECTING REAL GNP GROWTH IN FY 1988(IE TO MARCH 1989) OF BETWEEN 4.5 PERCENT AND 5.0 PERCENT, AND IT HAS BEEN SUGGESTED THAT THE GOVERNEMTN WILL

SHORTLY REVISE ITS OWN FORECAST OF 3.8 PERCENT REAL GROWTH (MADE IN DECEMBER LAST YEAR) TO SOMETHING OVER 4.5 PERCENT. STRONG GROWTH IN CONSUMER SPENDING AND IN FIXED BUSINESS INVESTMENT WILL BE OFFSET TO ONLY A LIMITED EXTENT BY A TAILORING-OFF IN PRIVATE HOUSING AND PUBLIC SECTOR INVESTMENT. THE EXTERNAL SECTOR IS EXPECTED TO PRODUCE A NEGATIVE CONTRIBUTION TO GROWTH, BUT TO A LESSER EXTENT THAN PREVIOUSLY EXPECTED.

4. AS A RESULT, THE GOVERNMENT SEES NO NEED FOR ANY FURTHER FISCAL STIMULUS AT THIS STAGE. THE AUTUMN SUPPLEMENTARY BUDGET WILL CONTAIN ONLY ROUTINE MEASURES DESIGNED TO TIDY-UP PUBLIC FINANCES, AND (AS IS USUAL AT THIS STAGE) THE MINISTRY OF FINANCE IS EMPHASISING THE NEED FOR AN AUSTERE BUDGET FOR FY 1989. INDEED, IN A MORE GENERAL SENSE, MACRO-ECONOMIC POLICY HAS SLIPPED DOWN THE POLITICAL AGENDA, AS THE GOVERNMENT FOCUSSES ON THE TAX REFORM ISSUE(OUR TELNO 815 , NOT TO ALL).

PROSPECTS FOR FY 1989

5. THE PICTURE FOR FY 1989 IS HOWEVER MUCH LESS CLEAR. OPTIMISTS (INCLUDING THE RESEARCH INSTITUTE FOR NATIONAL ECONOMY WHICH WAS ALMOST ALONE IN PREDICTING THE STRENGTH OF THE PRESENT BOOM) BELIEVE THAT GROWTH CAN CONTINUE AT THE PRESENT RATE FOR AT LEAST ANOTHER YEAR. OTHERS POINT TOWARDS A DOWNTURN EITHER FOR CYCLICAL REASONS OR BECAUSE OF A FEAR THAT DESPITE RECENT DENIALS BY THE JAPANESE AUTHORITIES MONETARY POLICY MAY EVENTUALLY NEED TO BE TIGHTENED. CONCERN OVER THE LATTER HAS NATURALLY INCREASED IN RECENT WEEKS WITH THE INCREASING INTEREST RATE DIFFERENTIAL BETWEEN JAPAN AND THE REST OF THE G7, PUTTING PRESSURE ON THE YEN. AND, ALTHOUGH THE GOVERNEMTN IS CORRECT IN EMPHASISING THE LACK OF STATISTICAL EVIDENCE SO FAR FOR ANY SIGN OF AN UPTURN IN INFLATION, THE TIGHTENING OF THE LABOUR MARKET AND THE POSSIBILITY THAT THE EFFECTS OF YEN STABILITY ARE STILL FEEDING THEIR WAY THROUGH TO THE WHOLESALE PRICE INDEX HAVE GIVEN CAUSE FOR SOME UNEASE.

6. THE IMMEDIATE IMPACT ON THE REAL ECONOMY OF A TIGHTENING OF MONETARY POLICY WOULD BE MAINLY PSYCHOLOGICAL, AND CAN BE EASILY OVERSTATED. IT IS LIKELY, FOR EXAMPLE, THAT THE STOCK MARKET HAS ALREADY DISCOUNTED A RISE IN INTEREST RATES TO SOME EXTENT. NEVERTHELESS, A CLEAR SIGNAL THAT INTEREST RATES WERE NOW ON A CYCLICAL UPSWING MIGHT SIMULTANEOUSLY KNOCK AN ALREADY NERVOUS STOCK MARKET AND DENT BUSINESS CONFIDENCE, ON WHICH, AS SEEN, ECONOMIC GROWTH WILL BE HEAVILY RELIANT.

THE EXCHANGE RATE

7. ALTHOUGH THEY RECOGNISE THE RISKS OF COMPLACENCY IN THIS AREA, THE JAPANESE AUTHORITIES ARE PRIDING THEMSELVES ON THEIR MANAGEMENT OF THE EXCHANGE RATE IN RECENT MONTHS, AND ESPECIALLY IN THE LAST FEW WEEKS WHEN THEY SUCCESSFULLY CONTAINED THE WEAKNESS OF THE YEN WITHOUT INCREASING THE OFFICIAL DISCOUNT RATE. THE RELATIVE STABILITY OF THE YEN DURING 1988 IS IN MARKED CONTRAST TO THE TURBULENCE OF 1987.

THE EXTERNAL SECTOR

8. THE TRADE SURPLUS FOR THE FIRST 7 MONTHS OF 1988 WAS DOLLARS 54 BILLION, SOME DOLLARS 4 BILLION LOWER THAN FOR THE SAME PERIOD IN 1987 (ON A SEASONALLY ADJUSTED IMF BASIS). THIS WOULD BE EQUIVALENT TO AN ANNUAL FIGURE OF DOLLARS 92 BILLION, ABOUT DOLLARS 10 BILLION HIGHER THAN THE GOVERNMENT'S ORIGINAL TARGET, AND ONLY A LITTLE DOWN ON 1987. EXPORTS CONTINUE TO RISE, BOTH BY VALUE AND BY VOLUME: IN JULY EXPORT VOLUMES WERE UP BY NEARLY 6 PERCENT YEAR-ON-YEAR AND IN AUGUST NEARLY 7 PERCENT (ON PROVISIONAL DATA). IMPORTS HAVE OF COURSE BEEN RISING EVEN MORE RAPIDLY FOR MOST OF THE YEAR, BUT NOT CONSISTENTLY: IN JULY THE TRADE SUPLUS WIDENED BY OVER DOLLARS 1 BILLION TO DOLLARS 7.2 BILLION. THIS SEEMED TO CONFIRM MANY COMMENTATORS' FEARS THAT THE RELATIVE WEAKNESS OF THE YEN DURING THE LAST 8 MONTHS MIGHT BE ENCOURAGING THE RE-EMERGENCE OF THE TRADE SURPLUS. ON THE OTHER HAND, THE PROVISIONAL DATA FOR AUGUST SHOW A RENEWED FALL (BY 4 PERCENT YEAR-ON-YEAR) AS A RESULT OF RENEWED STRONG IMPORT GROWTH.

9. EVEN IF THE GOVERNMENT FAILS TO MEET ITS TARGETS FOR THE REDUCTION OF THE TRADE SURPLUS IN 1988 IT MAY STILL BE ABLE TO POINT TOWARDS A REASONABLE REDUCTION IN THE SURPLUS AS A PERCENTAGE OF NOMINAL GNP, HELPED OF COURSE BY THE RAPID RATE OF GNP GROWTH. HOWEVER, FOR AS LONG AS THE REDUCTION OF THE SURPLUS IS SO DEPENDENT ON THE GROWTH OF IMPORTS, RATHER THAN THE REDUCTION OF EXPORTS, DOUBTS MUST REMAIN ABOUT THE EXTENT OF THE DURABILITY OF JAPAN'S ADJUSTMENT TO THE STRENGTH OF THE YEN: IMPORT GROWTH IS HIGHLY DEPENDENT UPON THE MAINTENANCE OF BUOYANT DOMESTIC DEMAND AND IF, FOR ANY REASON, THAT WERE TO FALTER DURING 1989 ONE MIGHT, ON PRESENT TRADE PATTERNS, EXPECT TO SEE A BALLOONING OF THE TRADE SURPLUS.

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JAPAN MONTHLY ECONOMIC REPORT: AUGUST SUMMARY

1. AFTER NINE MONTHS OF EXCEPTIONALLY RAPID GROWTH UP TO MARCH THIS YEAR, THE RATE OF EXPANSION OF ECONOMIC ACTIVITY HAS PROBABLY SLOWED. PRELIMINARY ESTIMATES FOR REAL GNP IN THE SECOND QUARTER SUGGEST ZERO GROWTH, OR EVEN A SLIGHT DECLINE. THIS IS PARTLY BECAUSE OF SEASONAL FACTORS, BUT IT IS ALSO LIKELY TO REFLECT A STRONG NEGATIVE CONTRIBUTION FROM THE GROWTH OF IMPORTS, AND A SLOWDOWN IN HOUSING CONSTRUCTION. YEAR ON YEAR, HOWEVER, GROWTH WILL STILL BE IN THE 4-5% RANGE, AND THE EPA DESCRIBES THE ECONOMY AS BEING ''AT CRUISING SPEED''.

2. AS EXPECTED, NON-RESIDENTIAL PRIVATE INVESTMENT IS TAKING OVER AS THE MOST DYNAMIC ELEMENT IN THE ECONOMY. DOMESTIC MACHINERY ORDERS ROSE BY 23.6% IN THE SECOMD QUARTER (INCLUDING A 19.4% INCREASE FROM MANUFACTURING INDUSTRY). IN CONTRAST, RETAIL SALES HAVE BEEN MARKING TIME (A 0.1% FALL IN THE SECOND QUARTER, FOLLOWED BY THE SAME FALL IN JULY MONTH ON MONTH) ALTHOUGH THE JULY FIGURE WAS STILL 4.5% ABOVE THE LEVEL A YEAR PREVIOUSLY.

3. ALTHOUGH ANXIETY ABOUT THE PROSPECT OF AN UPTURN IN INFLATION HAS MOUNTED, BECAUSE OF THE WEAKENING OF THE YEN AND EVIDENCE OF TIGHTENING IN THE LABOUR MARKET, THE FIGURES DO NOT YET SHOW ANY DETERIORATION. THE CPI ROSE BY 0.5% YEAR ON YEAR IN JULY AND WHOLESALE PRICES FELL BY 0.9, SHOWING NO SIGNIFICANT DIVERGENCE FROM THE PATTERN OF THE LAST SIX MONTHS.

4. THE SEASONALLY ADJUSTED TRADE SURPLUS ROSE TO US DOLLARS 7.2 BILLION IN JULY, UP BY US DOLLARS 1 BILLION FROM JUNE AND THE FIRST INCREASE SINCE JANUARY. EXPORTS ROSE BY 2% IN DOLLAR VALUE TERMS (THE SECOND CONSECUTIVE MONTHLY RISE), AND IMPORTS FELL BY 4.2%. THE INCREASE REINFORCED THE FEARS OF THOSE WHO SUSPECT THAT THE

RELATIVE STABILITY OF THE YEN SINCE THE END OF LAST YEAR MAY NOW BE ENCOURAGING A RESURGENCE IN EXPORTS. THE CURRENT ACCOUNT SURPLUS FELL TO A NEW LOW OF US DOLLARS 5.0 BILLION IN JULY , BUT THIS WAS AFTER A CONTROVERSIAL DECISION BY THE MOF TO CHANGE THE BASIS OF CALCULATING TOURISM RECEIPTS IN THE INVISIBLES ACCOUNT.

5. MARKET INTEREST RATES EDGED STEADILY UPWARD DURING AUGUST, REFLECTING INTERNATIONAL TRENDS, AND PRESSURE GREW ON THE BANK OF JAPAN TO INCREASE ITS DISCOUNT RATE FROM ITS PRESENT POST-WAR LOW OF 2.5%. THIS HAS BEEN INTENSIFIED SINCE THE END OF THE MONTH BY THE SPECULATIVE DOWNWARD PRESSURE ON THE YEN. ON 2 SEPTEMBER THE FINANCE MINISTER MIYAZAWA FLATLY DENIED THAT THERE WAS ANY NEED TO CHANGE MONETARY POLICY, BUT THIS HAS DONE LITTLE TO DAMPEN EXPECTATIONS THAT A RISE MAY BE INEVITABLE. SOME COMMENTATORS ARE SUGGESTING THAT A RISE IN THE DISCOUNT RATE, AND POSSIBLE INTERVENTION BY THE BANK OF JAPAN, ARE BEING HELD IN RESERVE TO DEFEND THE YEN 140 LEVEL

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TAKESHITA'S JAPAN

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ARE WE GOING TO LEARN, AT LAST, SOME OF THE SECRETS OF THE GREAT JAPANESE PYRAMID?

It so happened that, while browsing recently through the new books at Picadilly's Hatchard's, I came across one book which invites the British businessman in learning Japanese by spending only 10 minutes a day. By all means, a good investment if it helps to prevent you to be eaten raw by your Japanese partners and to be, instead, fried. Communication is certainly one of the secrets of the Great Pyramid of Japan.

All the same, for the Japanese everything British has one again become fashionable these days. The Royal Shakespeare Company drew full houses in Tokyo; the semi-public television NHK broadcasts Shakespeare's plays, while the dream of any Japanese actor, actress, or director, be they of the stage or of the cinema, is to study and be trained in England; the BBC programmes are publicized and have a regular listeners; the Encyclopedia Britannica is part of the Japanese honest, everyday man's education, and a set is often given as a wedding present; one of the top pop singers groups has founded its success by imitating the dazzling roller-skate tricks of 'Starlight Express'; British political commentators enliven the local press by trying to explain the esoterics of British home politics, with a dash of partisan, and frequently poisonous, humour. Golf is a craze, whisky drinking

is a national hobby, Harrod's (is it not yet Japanese?) is a way of life and a must for a souvenir photograph, while Thatcheronomics is a subject of wonder, and sometimes of envy for a Takeshita cabinet struggling on all fronts: liberalize imports, reform the fiscal system, education, and agriculture, as well as decentralization.

All this will probably be said in his own smiling way by Prime Minister Noboru Takeshita when he will next visits London. An easy smile perhaps, but masking iron teeth. As a biographical brochure specifies:*"gentle on the outside and iron-hard within, or 'gaiju-nigo' " : that is Takeshita"* . The Prime Minister will also talk ardently about his native prefecture of Shimane, where he spent some years as a teacher; of Izumo shrine, the oldest Shinto shrine in Japan, and of Matsue, a veritable miniature Kyoto, the name of which is associated with a foreigner, Lafcadio Hearn, who was perhaps the first to give a few glimpses and an interpretation of Japan. This citizen of the world, who died a Japanese in his ancient Japanese style house by the moat of the old Matsue castle, and who was in love with the true Japan, can certainly be a model of cross-fertilization and bridge-making, all of which we are in dire need.

But, behind the smile, and besides the factss that he is an adept skier, a judo expert, a family man and a writer, who is Takeshita the leader? And what sort of Japan is Mr. Takeshita's Japan?

FATTER AND FASTER....

A snapshot of Japan today cannot come off as a surprise. Japan is still in super shape, fatter than ever and, nevertheless, running faster than ever

toward the 21st century, whereas the rest of the world wonders if they can keep going until tomorrow.

All the traditional economic indicators show how Japan is stealing the show on the world stage, even if Britannia comes back strongly and dominates on Broadway. Japan's per capita income is the highest of the world and stands at ¥2,178,000 (or US$17,016). A total of 59.11 million Japanese were employed, out of a population of 121 million. As for the number of wholly unemployed people, it stood in December last year at 1.50 million, a downward figure compared to last year. Regarding production, the nominal GDP stands at US$1,970. Japan's share in world trade is estimated at 10% or US$2 trillion. Speaking now of a sensitive issue, the Japanese trade surplus was estimated, on the Japanese side, at US$92.8 billion — with no spectacular and fast trimming down in sight. Another staggering figure is the (official) amount of outflow of long term capital: US$131.5 billion.

By and large, Japan has thus become the largest investor and creditor of the world. One example of this outflow of Japanese capital can help to grasp the magnitude and the impact of it. According to a report prepared by Kenneth Leventhal & Co and recently published by The Los Angeles Times, Japanese investors spent a record US$12.7 billion on real estate in the USA last year — an increase of 70% over 1986. This amount, specifies the same report, does not include all real estate transactions and other investments in other areas. This is only the tip of one of the chain of Ali Baba caverns throughout the world. When the Japanese go shopping, the sky is not even the limit; it is a known fact that the Japanese do intend to invest more both in space and outer space.... But what about investing more in the developing countries and helping them more?

To this snapshot can be added a map, the map of the distribution of the factories of the Japanese affiliates, as of April 1986: 545 in the USA (creating more than 180,000 jobs), 242 in Europe (representing 70,000 jobs), of which the greatest number, of which 53 are located in the United Kingdom.

Under these conditions one cannot but wonder, along with Herman Kahn and other professional crystal gazers, if the XXIst century will not have to be Japanese after all.

Of course, some could complain about this mushrooming Japan, but one should also quickly recognize that if Japan is present everywhere, with a finger in here, or a foot in there, giving more power and leverage to the Japanese in the global game, benefits should flow the other way around for the Japanese partners, competitors, friends and foes alike. It should ultimately accelerate the internationalization of Japan. Wishful thinking? Not quite, all the more because Japan wants — and is pressured on all sides — to internationalize, i.e. to better integrate the global economic, political, social and cultural game.

TO INTERNATIONALIZE, OR TO REMAIN 100% PURE SILK JAPANESE — OR BOTH?

'Internationalization' is indeed one of Mr. Takeshita's pet projects, i.e. to open more the doors to foreign products and technology, to use more foreign specialists, such as teachers, researchers, lawyers, etc.... and altogether play better the game of reciprocity and international exchanges.

But how can the Japanese really, deeply internationalize when, at the same time, their Prime Minister is strongly advocating a return to the source of Japanese traditions, harping — as only a second-rank black belt in judo and a politician of 37 years experience can do — on the somewhat magical and nostalgic concept of *"Furusato"* ? This key concept and key word reverberates in the hearts of the Japanese, meaning everything at the same time: the native place, the hometown, the warm and soft womb formed by ancestors, family, friends, and all the interwoven human and social relationships — and one more secret chamber in their Great Pyramid.

Whereas his predecessor, Mr. Nakasone, envisioned Japan as a member of the 'Global Village', Mr Takeshita avows that*"True internationalization begins at home, in the* ***Furusato"*** . Therefore he presses upon his compatriots to assert their own identity while *"internationalizing their mindset"* , to humanize (and relocate Tokyo), at the same time *"internationalizing the countryside"* .... Ambitious programme. Painful gymnastics. A revolution? A mutation even?

Can Mr. Takeshita, and with him 127 million Japanese, succeed in their Great Leap Forward internationalization by leaping far backwards? They have to, and they might well succeed in this new challenge put to them, with a little help from the outside. After all, wasn't the Meiji revolution, which saw the birth of the present Japan 120 years ago, made possible by combining the best in the Japanese with the best in the Western world? Furthermore, Mr. Takeshita has got plenty of experience, power and patience to make his draw. In addition, and quite fortunately, he is not yet prisoner of an image and a nickname. Besides, as his chairmanship of the Japan Yacht Association could be taken as a proof, he should an expert helmsman who

could deal with any typhoon coming his way, unlike his predecessor, Mr. Nakasone who was complaining, in his own words, to be forced to *"ride a bicycle against the north winds"* .

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Jean-Marc Pottiez

WILL THE 21st CENTURY BE JAPANESE ?

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PART 1 :

HOW THE JAPANESE LOOK AT THE FUTURE

FROM RECEIVER TO TRANSMITTER

Like it or not, we have to face the fact that the Japanese will certainly end up top of the industrialized nations at the end of the 20th century (only 12 years from now!). They are now part of this rather exclusive club, if not quite of the jet-set, and visibly enjoy it. But, as success comes their way, they are sometimes overconfident, and stumble. As one of the American Ambassadors whom the Japanese most respect and admire commented: the

dream of the Governor of the Bank of Japan is to play golf with the Governor of the Bank of England. And so, his administration supported the choice of Manila rather than Tokyo as host for the headquarters of the Asian Development Bank.... And the ADB was set up in Manila.

The Japanese tend also to lecture, as good students so often do. From receiver they now evolve into transmitter. As Mr. Koichi KATO, a member of the ruling Liberal Democrat party in the House of Representatives candidly observed: *"Japan can no longer seek out viable models for its own development from the world around it. We shall have to set our own goals to achieve what best serves the aspirations of our people."*

DO WE KNOW HOW MUCH JAPANESE WE ARE ?

How then, from now on, will the Japanese deal with us non-Japanese, and how should we deal with them?

At first we would do well to recognize how far they have permeated our daily lives and even our persons.

Japanese are everywhere in the world: plugged to our walls and even to our ears, riveted to our eyes, integral parts of our homes, offices, everyday life, landscapes and mindscapes. We consume, eat, drink, dress, drive, read, breathe Japanese, or sleep with, play games with, dream with, wake up with, work with something Japanese.

So how could we possibly discard them, as some protectionists and Japan-bashers want to, without skinning ourselves?

We know how much the Japanese (like each one of us) have a little of the American, British, French, German, Italian, Spanish, Russian, African, and so on, in them But do we know how much Japanese we are ourselves, at all levels, and even beneath the skin, at the unconscious level?

To learn a bit more the Japanese should not only help us to survive in economic, scientific or technological competition, but be equally valuable in knowing ourselves a bit better. A difficult and painful exercise though it might be, but which should also enable us non-Japanese to reach the 21st century, as well as to better prepare ourselves for a real and enriching coexistence, and if we want to save our space ship earth from the course of destruction set by the bloodiest among the bloodiest of all centuries, i.e. the 20th century, which has seen two world wars, two oil crisis, the holocaust of Hiroshima and Nagasaki, endless genocid, concentration camps, gulags, raging famines, drought, desertification, environmental onslaught.... The list is not closed yet.

Will the Japanese really dominate during this coming 21st century, as the futurologist, the frequently over-optimist and myopic Herman Kahn, and a majority of professional crystal-gazers have predicted? One fact cannot be denied: the Japanese do wish to do so; this goal is part of their official policies, and 127 million of them take it as a personal challenge. But, for them, the battles of the future are won today, with yesterday as a training shooting base.

A GREAT LEAP FORWARD
BEGINS WITH A GREAT LEAP BACKWARD

How successful can the Japanese be in meeting all the challenges set for themselves, by themselves? Figures and statistics can prove their successes. Slogans too, like the "Japanese Miracle" or "Japan As No. 1", which are now clichés, and part of history and legend as well. But one might prefer to look at Japan in another way. If one could feed a 5th generation computer (one of the vanguard research the Japanese are working on) with all the data we have on hand, and try to visualize in both a holographic and even symbolic form the hidden Japan, the secret Japan, the Japan hidden deep in the obscure chamber at the core of its Great Pyramid — remaining, of course, conscious that some malediction could very well be called down on oneself, on anyone foolish enough to think that one could get close to the heart of Japan without being burnt — perhaps then.... through the obscurity, ghosts, mists, dark forces, banzai charges, kamikazes or divine winds, silk screens, smiling or demonic masks, cherry blossom petals, and a Niagara of manufactured goods.... through reality as well as through the Japanese collective unconscious.... one could see, at last, a strange half-human, half-robotized cosmic vessel emerging.... a 4,000 year old Japan shooting towards the sky and the 21st century, fully equped with its ultra-modern engines fuelled by human blood, sweat and tears, with not only all its ancestors and traditions on board, but some of the culture and values of the rest of the world as ballast. This cosmic vessel, Japan, is a museum too. It

speeds up and roars like a rocket, but paddles around in the unconscious abyss and past like a coelacanth. We all feel, we Japan watchers, that the Japanese move in a space and time different than ours. Japan could very well be a different planet.

In a sense, therefore, we could say that the Great Leap forward of Japan toward the 21st century will also be (in the Tao or Zen sense) a Great Leap backward, and inward; the explosion will be also an implosion, and the omni-directional and cosmic-bound venture will begin by a recentering. Throughout it will be a process of Japanization — that is to say, the Japanese once again, will try to be, behave, beehive, behamothly, minutely, in their own way, the Japanese Way.

TO BE, BEEHIVE, BEHAVE : JAPANIZATION AND INTERNATIONALIZATION

If Japanization will again be in order, can the Japanese, as they did in the Meiji period, 120 years ago. How much, how deep? Will they really internationalize and play in a fairer manner the game of reciprocity and interdependence? By being themselves at their best, by being-behaving-beehiving their Japanese Way — won't they also risk being themselves at their worst?

At least physically, and partly in their daily behaviour, the Japanese seem to have changed. Their tastes, their way of life, of dressing, eating, sitting and sleeping — just like some of us — have evolved too. What about

their metabolism, their way of thinking, their genes? — Well, who knows? Women and youth are certainly changing faster than the men, who are more captives of the social and economic systems. Once I have heard in the elevator an older Japanese gentleman who mumbled: *How dare she?* — when a young girl rushed out before he did. As for the lack of communication and understanding between generations (similar in this respect throughout the world), a friend of mine once complained about *"those teenagers and children who look like more like ETs to us..."* . Isn't the same everywhere?

What non-Japanese should by now be aware of is that the Japanese do need us — as much as we need them.

They need us above all as a mirror, to confirm their identity and for interaction and internationalization. It is vital that the Japanese and we should never lose contact, for fear of falling again into the vicious, evil circle of misknowledge-contempt-hate-conflict-war.... History is here to remind us that the Japanese should never be left alone to brood in their corner of the world, and to fall prey to dark forces again. Communication at all levels, particularly at the individual level, is very much needed, and more urgent than ever, now that the Japanese are successful and tend to patronize and lecture. This should be not too difficult since they consider themselves, however much on our periphery, to be one of the centers of the world, and rightly so. The paradox (and Japan is, because of its diversity, complexity and highly stretchable fabric, the country par excellence of paradoxes and contrasts) that there is not only one center but several centers in Japan. The Japanese society, and in part the Japanese mind, are fundamentally both a

Brownian movement, at rest, and a nuclear reaction, in action; this formidable energy is contained by the rock walls of their social pyramid, with the Emperor and the ideal of the Great Japan at its apex. Hence the delay in establishing concensus, in synchronizing initiatives, strategies and actions. The Japanese do seem to be late in starting to move (there is indeed a delay in the ignition), but when they do, it can be devastating.

So, the Japanese have decided to move into the era of true internationalization, i.e. to play in a fairer manner the global game and try to internationalize everything and everyone from the apewx to the bottom of their pyramid. We should not be mistaken in this respect: this is not only a fad, but a password and a governement policy too: internationalization of the economy, politics, diplomacy, and, quite recently, of culture; internationalization of the administrative and bureaucratic systems, down to the regions and the countryside; internationalization of the mindset of the Japanese, etc.

Nevertheless — one could ask oneself — if the Japanese leaders as well as the policy and decision or opinion makers seem to be really sold on this internationalization programme and are setting the course for the future Japan, what about the Japanese as individuals and citizens? Are they ready for the big jump into foreign and unknown territory?

STAY WARM IN THE WOMB OF MOTHER EARTH

Strangely enough, and quite contrary to what is imagined by

observers in a hurry, the Japanese are not that interested in long-term planning and shooting at far-off targets tomorrow, but much more in the swarming and scrambling of today.

Everything — their mental attitudes, their education focussed on the collective more than the individual, their sense and aesthetics of the ephemeral, the transitional, the fragile, their whole behaviour, their socio-cultural heritage, their environment, their dynamics and their own way of scrambling, spreading out and unfolding in space and time (like those Japanese paper flowers dropped into water), propelled as well as inspired by the special talents and energy stored in their genes throughout 4,000 years of intense Japanization — predisposes them to refuse the jump into the strange, the foreign, the unknown, the un-Japanese, the durable, the eternal, the metaphysical, or the abyss of such a future. Why should they seek eternity in an hypothetical divine, since they are condemned to hard labour and life imprisonment in an overcrowded pyramid. Better stay warm in the thickness of earthly things, in the womb of Mother Earth and their society than turning to heaven for comfort.... As a matter of fact, for them, heaven is nothing but a continuation of the earth, a Zen garden with whirling rocks and stones amidst ripples of golden sand, where remarkably earthly divinities are assigned to residence in the service of their master — Man. Whenever they need them, the Japanese have only to clap their hands (as in the Shintô religion), and dismiss them the same way. Self-service and fast-food is Japanese on an even higher level.

Religion must be easy, for life is so complicated; the future must be

minimized, for the benefit of today: this is how the Japanese are able to win more so than often. One key factor is their built-in ability to stretch out. How do they do it?

REACH BACK, COIL TIGHT, SPRING FORWARD, AND STRETCH OUT

When they want to prepare themselves for a big decision and then throw themselves into the fire of war or action (which is about the same for them), the Japanese — like the Africans in some way — have to turn far backwards, to the living source of their traditions, to their past, to their ancestors, and then coil tight so as to spring forward and stretch out as far as they can. Why so? Because back and deep down there is their inspiration, courage, strength, energy, i.e. the best of themselves.

I remember how puzzled I was when, interviewing some Japanese political leaders or industrial tycoons, only 15 years ago, they seemed to be indifferent to long term planning or to prospects. For instance, when I pressed the founder of Honda Motors, Sôichirô HONDA, to lift the veil a bit on their future inventions and tell me if they were tinkering with an electric, a nuclear, a solar, or a revolutionary type of engine, he answered with a laugh: *"No, no, not at all. You are mistaken. All we are presently interested in is in reducing the gasoline consumption of our engines."*

However (would you object, as I did), didn't the Japanese invent super-tankers, at a time when everything — from the narrowness of the

isthmuses and the Suez canal to the infrastructures of the existing harbours — was against such a challenge and such a bet on the future?.... True enough. But super-tankers are, somehow, only the result of an enlargement, an improvement of an already existing product and technology. And for this, precisely, is what the Japanese are reputed to be good at. They excell in blowing up or down, in 'gigantizing' or miniaturizing and compacting. Since individually they are made of a highly stretchable material, they can also stretch anything they touch. All right, they can stretch the world, but can they invent a new world? — Not yet.

Already, by and by, the Japanese world is changing fast; not only the industrial, scientific or technological lanscape, but also the mindscape.

Forced by wild competition at home and overseas, the Japanese are trying to carry out a formidable cultural, social and individual revolution, which they never had time to tackle during their race for modernization since Meiji. Now they stretch out in whole new directions and plan in the long term, whereas we, the not so highly stretchable non-Japanese, are fighting for survival and planning on a day to day or mid-term basis. Even the socialist countries who used to make of plannification and control (control of behaviours and thoughts included) their Bible.... But one feels that, in their spectacular stretching out towards internationalization and the 21st century, the Japanese are somehow forcing their talent, taste and nature.

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PART 2 :

SECRETS AND PROBLEMS OF THE JAPANESE SCIENCE AND TECHNOLOGY

CREATIVITY : CAN BRAINS BE SQUARED AND IMPROVED LIKE WATERMELONS ?

The biggest challenge now for the Japanese is now to plan and induce creativity, particularly in basic science and research. But do not science and research, and in a similar manner the arts, need a mysterious combination of individualism, a taste of hell and joy, of love and hate, of joie de vivre and despair, of fermentation and tranquillity, of teamwork and solitude, and, above all, a zest for madness? Is not the piling up of building blocks as necessary as the action of kicking them down when necessary? Conditions favorable to a combination of these elements are not readily obtained — yet — in the pyramidal, warm and wet greenhouse of Japan. Perhaps the Japanese could be tempted to induce creativity by a technique similar to biotechnology, which is able to create wonderful things, like tens of thousands of tomatos from one seedling (as they are doing in the scientific and technological city of Tsukuba), or square watermelons, in order to

facilitate packaging and transportation. Could they succeed to do so? This is open to doubt. Instead, a cultural, mental, educational, social evolution, or even revolution, seems to be needed. In this respect, paradoxically, the Japanese need to Westernize more, whereas the West need to theorize, intellectualize and speculate less, — while working more, and in a better organized way. Thus the twain could perhaps meet some day.... hopefully in the 22nd century?

One must recognize that the Japanese themselves are critical of their mass education and mass behavior, together with their technological approach in attempting to cultivate and change brains like water melons. One of the most forceful critic in this respect is the recent Nobel Laureate of Medicine and professor at MIT, Susumu TOMENAGA, who received the award for his discoveries concerning the way antibodies react to infection in the human body.

(.....QUOTE.....)

TO BE FOGGY AND FLEXIBLE, OR TO BE BRILLIANT AND BRITTLE ?

As for the basic attitude of the Japanese towards the future, how they organize, plan, work — and apparently win more than usual —, an interesting explanation is being given by one of the few Japanese futurologists, who was trained by the British and the French: Yûjirô HAYASHI. He created and heads his own institute, and also devotes some of his time to the Toyota Foundation

— HY: *"The Japanese came to long-term planning by necessity. They were forced to, because of internal and external competition, in order to ensure their survival.*

"By comparison with the Americans or the Europeans, we Japanese don't bother about the long term; we are more interested in the short and mid-term. We wait, observe where the wind is coming from, consult each other, adapt quickly, and then race full steam ahead. I talked to Japanese managers of a computer plant set up somewhere in Europe, and then came to know our basic differences. For instance, the Europeans first establish a plan, come up with a strategy, and then act. If they fail, they come back to the starting point. The Japanese are more passive, or less rigid. Of course, they, too, begin with a plan, but this plan is generally quite vague and flexible, so much so that this plan very often stirs fear in any foreigner who might be part of the project. Thenceforward they move, and adapt quickly to any circumstance or obstacle, since they are so very flexible, whereas foreigners are too rigid.

— JMP: *"There has been much talk about the Japanese being more intelligent than others, particularly because of their more developed left brain hemisphere, or their good education and performance in mathematics.... Do you think the Japanese brains are different?"*

— YH: *"No, I don't think that the intellectual abilities of the Japanese are much different, perhaps only their ability for observation, or their extreme patience and perseverance. They are said to be gifted in imitation, but one should add that they are selective in their imitation, and they often*

improve on what they imitated. Some say also that we are lacking in creativity... They may be right. But I personally think that in their capacity for imitation and assimilation resides the original gift of the Japanese."

— JMP: *"Why such a limited number of Nobel Prize laureates in Japan?"*

— YH: *"It is true that Americans and Europeans are on top of the number of laureates. But one thing which can be said, if it's worth an explanation, is that the major part of our research reports are not published in a foreign language, and thus are less exposure overseas."*

— JMP: *"But do you think there could exist in Japan some geniuses totally unknown to the governement, the academic and scientific worlds, or to talent hunters?"*

— YH: *"Yes, indeed, one could find in Japan a good number of 'genial tinkerers' ('**machi-no-hatsu meika**'). That is precisely why a number of foundations, like the **Toyota Foundation**, try to discover them, especially outside the universities. We are most interested in young talent, in Japan as well as in foreign countries. Now, to come back to the Nobel Prize, one should stress that it covers basic science, not technology. In that respect the Science and Technology prize given each year by the Science and Technology Foundation founded, in 1985, by Konosuke MATSUSHITA should be considered a complement to the Nobel Prize."*

— JMP: *"How could the Japanese change, become more assertive intellectually, more individualistic?"*

— YH: *"As you know, the Japanese are not used to thinking by*

themselves; they don't have, as you say, a "philosophical head". They are gregarious; they think, decide and act only in reference to each other. Therefore, when I was teaching I used to request my students to think by themselves. And now to my former students who are going to study overseas I beg them NOT to come back , but to work and marry where they will be trained differently.... I must confess that I've not been that successful up to now."

However, Dr. HAYASHI should be comforted by the fact that more and more Japanese artists — together with some former diplomats, and perhaps some journalists — have chosen to live in a country of their choice. For the others, they must come back to climb up the social ladder; and anyhow, the stress would be too great if they could not come back to their warm greenhouse.

"THE SAME OLD SONG BEHIND A NEW FACADE ..."

'Futurism', the Italian movement which dominated Europe in the period 1910-1916, and was imported into Japan by the Russians, was enthusiastically received by the Japanese; its message — to *"magnify the life of today, tumultuous and continuously transformed by victorious science"* , as heralded by the founder, Marinetti, and his "moonlight killer" friends, could not but appeal to the Japanese. Besides, the Japanese are intoxicated with everything new, and pride themselves on being part of anything

'avant-garde', and, possibly, to be No. 1 in any field; but, into this futurism movement, as well as into Expressionism, Cubism, Dadaism and all the avant-garde and foreign-imported styles or schools which flourished in their greenhouse since the twenties, consciously or not, the Japanese have always fused their lyricism or romanticism, thereby expressing in their own way, through the mask of colours, shapes, forms and media, their feeling for nature, or their vision of man.

Of course, the Japanese artist feels absolutely free, and is able to kill the moonlight, or to paint the sun green — as was recommended as an act of liberation by Kôtarô TAKAMURA in his Expressionist pamphlet *"Midori iro no taiyô"* — ("The Green Sun"). But in the darkest and most secret of his heart, for him as for any Japanese, the sun is red forever and lost forever in a white solitude.

Either in a subdued and tranquil way, or in a seismic way, each Japanese tends to end up always resembling the painter Harue KOGA, who was befriended by the novelist and Nobel laureate Yasunari KAWABATA, and who described him in the following manner (as quoted by Professor Shûji TAKASHINA, in the Japan Foundation Newsletter):

"KOGA never stopped creating avant-garde works. He was driven by the idea of performing in the role of an innovator, and his style constantly changed; as a result many people might consider him a conjurer like myself.... But despite KOGA's firm desire to incorporate the spirit of modern European culture in his work, he never forgot the song of his childhood, the Buddhist teachings, which he preserved deep in his soul. This old song of his

childhood resonates in my heart as well. Perhaps we became such good friends because we shared the same old song behind a new façade.

This "same old song behind a new façade".... Western artists, like Van Gogh or Renoir, could not but be in love with it — as are contemporary artists. Millions of consumers seem to be also seduced by this same *"old song"* , which is fused and radiates from each of the "Made in Japan" products, be it a giant bridge or a stroke of an ink painting, a sky-scraper or a lacquer box, a Zen garden or a tray of raw fish presented like a flower arrangement, a pottery or a microchip.

Each and every Japanese tap the same sources of inspiration in their hearts, which coincides so often with the heart of their Great Pyramid. To jump at the avant-garde is thus, willy-nilly, to turn to the the rearguard, to dive deep down, to go back to tradition — or to one's own beginning, as T.S. Eliot so often calls upon us to do in his poems, like, for instance, in **Little Gidding :**

"What we call the beginning is often the end
And to make an end is to make a beginning.
(....)
We shall not cease from exploration
And the end of all our exploring
Will be to arrive where we started
And know the place for the first time."

)o(

PART 3 : BUILDING THE LAUNCHING PAD FOR THE 21st CENTURY JAPAN

* (SYNOPSIS :)

1. BLUEPRINT FOR A RAINBOW FUTURE

a. Analysis & comparaison between the various reports, guidelines, recommendations, policies and scenarios for the future, as PM NAKASONE's blueprint for Japan as a member of the Global Village, PM TAKESHITA's his *'Furusato'* Programme, and other scenarios of the MITI, the Keidanren (i.e. the recycling of the trade surplus by creation of a Japanese "Marshall Plan") and other institutions, research institutes (Nomura, Mitsubishi), or foundations like the Toyota are or Matsushita foundations.

b. The "Human Frontier Programme"

c. Individual visions, initiatives & strategies . Ex.: Matsushita and his school for future leaders.

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PART 4 : 5th GENERATION COMPUTER & INTELLIGENT ROBOTS — BUT STILL THE SAME OLD HUMAN RESSOURCE

* (SYNOPSIS :)

1. HOW THE JAPANESE WILL SURPRISE US WITH THEIR TECHNOLOGICAL PROUESSE

a. List of the new technological breakthoughs and investments.

b. R&D organization, structure, budget and policy.

c. Political, social, economic, military, cultural imp[lications of the New Japan in gestation.

d. Will the brain drain affect more Japan, or will Japan drain the best brains & talents from the rest of the world?

2. THAT SAME OLD HUMAN FACTOR....

a. Individual attitudes of the Japanese towards science & technology. Robots & the Japanese compared, for instance, to the Judeo-Christians or the Moslems.

b. The MITI has sponsored research on futuristic construction materials, for instance by importing and dissecting of imported foreign corpses. It looks like a Brave New World is in preparation in Japan. What

possibly can stop the Japanese?

3. THE INTERNATIONAL FACTOR

a. Japan in an era of increasing interdependence and painful coexistence.

b. Japan and the USA. The Star War Programme, the next-generation support fighter FSX, the recent Mitsubishi digital-radar. Hopes & reticence on both sides.

c. The free flow of scientific information & knowledge. The future 'Sponge type' of the planetary system and society, versus the 'Bunker' type world of ideology, defense imperatives and safeguard of secrets

4. CONCLUSION: JAPAN AS A MODEL?

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Jean-Marc POTTIEZ

Tokyo, 15.04.88

file Dts

bc: PC

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

3 June 1988

JAPAN: FINANCIAL MARKETS

Thank you for your letter of 2 June about Mr Nakahara's theory. I have no objection at all to your copying the papers to those mentioned in your letter. His analysis does seem to be of considerable interest.

C. D. POWELL

R. Q. Braithwaite, Esq., C.M.G.
Foreign and Commonwealth Office

lw

ccle

Foreign and Commonwealth Office

London SW1A 2AH

2 June 1988

C D Powell Esq
10 Downing Street
London SW1

Dear Charles,

JAPAN: FINANCIAL MARKETS

1. Thank you for your letter of 31 May. I found the enclosures very interesting. But I am not the best person to judge the merits of Mr Nakahara's theory, and with your permission I should like to copy these papers and this letter to Geoffrey Littler, John Whitehead in Tokyo, Anthony Loehnis at the Bank of England and Robin Mountfield in the DTI.

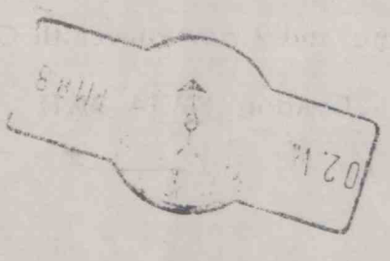
2. Mr Nakahara's proposal for something like a single regulatory framework to cover all important stock markets and financial markets raises formidable practical difficulties: the Canadians tried to float something on these lines at a recent Sherpa's meeting, but didn't get very far and did not persist. However, it is not a priori unreasonable to look at world financial markets as a single market operating in three different time windows. To a lesser extent the same is true of stock markets. It is not wholly satisfactory that one section of this market operates under rules which seem designed to protect the operators in the market, while the regulatory frameworks in the other two are directed primarily towards investor protection. This affects us in two ways: it makes it difficult for our firms to enter the market; and like it or not, we share the risk that what Mr Nakahara describes as the Japanese bubble will one day burst. There may also be something in Mr Nakahara's argument that the curious financial circumstances of Tokyo (zero inflation in most product areas, combined with roaring inflation in land prices) works to our competitive disadvantage. And of course the price of land in Tokyo has become one of the biggest barriers to firms trying to enter the Japanese market.

3. It goes without saying that these reactions are off the top of my head. I would welcome more expert views from the Treasury and the Bank. It is too late to consider raising any of this at the Toronto Summit. The Prime Minister might, however, find it interesting if an opportunity arose to talk informally to Mr Takeshita about land prices in Tokyo, which are a subject of acute domestic concern to him as well as having indirect implications for us. We could provide some background if necessary.

Yours ever,
Rodric

R Q Braithwaite CMG

Japan - Int Sit #2



PRIVATE AND CONFIDENTIAL

May 31, 1988

Mr. Charles Powell
No. 10 Downing Street
London, SW1A 2AA

CDP
2/6.

Dear Mr. Powell,

flap

By now I imagine you have received my position paper on the subjects which I had the privilege of discussing with you in London the other day. I hope you have had a moment to look through it, and will be very pleased if you have found it useful.

I am taking the liberty of forwarding you this pertinent addendum, a translation of two articles which appeared recently in the highly respected Sankei Shimbun and Asahi Shimbun, and which serve to underscore the gravity of the situation.

There are two points which I feel are especially important in considering this situation and the appropriate responses to it:

1. it has become necessary to distinguish 'good' real estate and stock investors from 'bad", both in Japan and abroad
2. small private real estate speculators have become a rising threat on the Tokyo Stock Exchange, conducting pooling operations and cornering maneuvers, neither of which is effectively prohibited by the Securities Exchange Act, and taking advantage of the fact that Japan has no regulations requiring the filing of stock acquisitions of more than 5%, unlike the US, which is therefore protected from this phenomenon.

It is vital that regulatory action be taken before real damage is inflicted on the system and on traditional investors themselves.

Once again, if you have any questions or comments on this, I invite you to get in touch with me.

Sincerely yours,

N Nakahara

Nobuyuki Nakahara

April 26, 1988
Asahi Shimbun

- Hawaiian People Shuddered at Strong Yen -

Overheated Real Estate Investment

- Withdrawal of a bill restricting foreign investment -
- Increases worry of the people in Hawaii -

Reporter's Note: The people in Hawaii are worried that the fever of cornering real estate with the strong yen by Japanese will never go away. This is because it was decided at the state legislature which closed its session on April 25 that a bill designed to restrict foreign investment in Hawaii, which was suggested by the Mayor of Honolulu, would be withdrawn. This cornering started last year, centering on some better residential quarter on the Island of Oahu where Honolulu is located and expanding from condominiums to golf courses. As a result, land prices and municipal property taxes have soared extremely while friction with the residents over the use of a golf course was produced. It was reported that after receiving a report of worry from the residents, the state government started to keep an eye on investments in the future, especially those aimed at private housing and to embark on a thorough investigation into the situation. (Written by Koichi Dai in Honolulu)

* * * *

At the Kailua (phonetic) district in the back of Island Oahu, just behind Honolulu City, a public hearing was recently held by the city council and a district neighbors committee. Kailua is where Mr. Genjiro Kawamoto, president of Marugen, a building

management company headquartered in Tokyo Ginza, purchased a few dozens of land and houses.

Annet Kinycut (phonetic), 47, one of the public hearing committee members, appealed by saying: "I am afraid lest housing prices and municipal property taxes rise so high that our children and grandchildren cannot afford to buy any longer."

Marugen is well known to have purchased 39 out of 295 units of the new expensive condominium constructed in the center of Honolulu City by paying $110,000 to some $200,000 for each unit in one day. Marugen also expanded itself into unit housing in the better housing quarter at the east of the city. According to a local newspaper, Marugen bought up 160 housing units within half a year. The company has so far invested a total of 80 million. The amount of about $42 million it paid for the purchase of 5.5 acre plot and a picnic house at Portlock (phonetic) is the highest figure paid to one housing unit in the history of Hawaii, and the figure surprised the people in Hawaii.

The area with a beautiful coastal line running from Kahara to Hawaii Kai is also conspicuous with Japanese investment. One of the city residents said: "Hearing Japanese is buying, many local real estate agents buy old houses, remodel them and sell them at the price doubling the original price." One resident complained, "Why do they need houses so much? This only can be said speculative investment."

The regulation bill introduced to the state legislature by Honolulu Mayor Frank Fasshi (phonetic) was aimed at containing such an attack by Japanese real estate agents. "This (Hawaii) is not so big as California. The island is so small that the law requires land development to be carried out with prudence. It has a limit to housing development," said the mayor. City Financial Bureau Chief Linda Smith made a wry face and said, "If an investment continues the way it is

now, Japanese could buy the whole Island Oahu in a year."

The Japanese hunt for houses somewhat waned while the bill was submitted to the state legislature. However, since it was decided to withdraw the bill, the residents fear that "the hunt will surely rekindle."

The hunt for golf courses also is likely to be accelerated because the conversion of an agricultural area for a golf course contained in the bill will be exempted from regulations. Out of 15 private golf courses including those under construction, 12 have already fell into the hands of Japanese.

Consequently, a new friction with the local comunity has surfaced including criticism against the management attitude of those Japanese golf courses which raised their green fees and give top priority to Japanese tourists who pay higher fees, and troubles related to the construction of a golf course. Moreover, extreme criticism also was made: "The Japanese are given top priority while local members are treated like second-rate citizens," said Mayor Fasshi.

Some golf courses are selling membership in Japan, and some people voiced the fear that these golf courses might exclude local golfers in the future. Local members in Hawaii are given life membership. However, the membership being sold in Japan can be transferred, and this can be a target for speculative investment.

There are troubles accompanied by preparation of a golf course site. A 69-year-old Japanese-American, Ryoei Higa, who follows the plow at a 50-acre leased land in the Waianae (phonetic) district at the west of Oahu Island, received a notice last December which reads "to evacuate the land within six months."

The leased agricultural and has been sold to a meatman living at Asakusa, Tokyo without knowledge of Mr. Higa, and a golf course would be made at his leased land. Although Mr. Higa who has finally set his

farming on its way after many years of hard labor wants to have talks with the new Japanese landowner, no response has been received to his request.

When an agricultural area is converted to a golf course in Hawaii, it has to be presented at a public hearing held by the city planning committee and to be reviewed by the state zoning committee.

The new landowner notified the city government of its withdrawal from the land before taking necessary procedures.

Local residents' organizations who oppose the transfer of framing areas to golf courses from the standpoint of protection of natural environment and welfare of local residents stood up to support Mr. Higa. Local English language newspapers also played a big show in covering this incident. Originally, this area is full of fram houses and low-income earners. Local residents express their fear by saying, "If the target of tourism development expands to this far, there will be no place for us to go."

An electric appliance company from Akihabara in Tokyo is now proceeding with construction at the east of Oahu of a golf course designed to be of the highest class in Hawaii. It seems that the strong yen will continue to move on in its encroachment into Hawaii.

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Saturday, May 7, 198

Sankei Shimbun

Special Report '88:

Vile Price Manipulator Rampant in Stock Markets

- Plotters are real estate agents -

Reporter's Note: In Tokyo Kabutocho, the counterpart of Wall Street, where in the wake of the extremely high stock price spree the footstep of "the 30,000 Nikkei average era" can be heard, the mysterios cornering of stocks in sucession is becoming a topic of conversation. The majority of the cornering groups have not been identified, and the people of targeted companies whose stock price suddenly starts rising sharply at one day are in great fear. It appears that the ringleader is real estate agents who used ample cash earned in an easy way from the recent skyrocketting land price boom to corner stocks. Their methods of buying up stocks by force while ignoring the achievements and future prospect of a company are similar to those employed by vicious real estate agents. Perhaps, their plot is to earn profits through stocks since land is no longer attractive for them. A new word "stock price manipulator" is already coined.

* * * *

Shaking Matsuzakaya and Nagasakiya

Stock cornering by speculative groups has not started right now. Above all, it is no exaggeration to say that stock cornering has been a daily happening in the stock market where the boom of the financial management and fight between speculators prevailed in the past few years. However, the introduction of a new method - cornering stocks by force - has become the talk of Kabutocho, especially about who the ringleader is and what are the purposes of stock cornering.

In the midst of such a happening, stock cornering has been shaking the long-established department store, Matsuzakaya headquartered in Nagoya, and the supermarkets, Nagasakiya and Chujitsuya, both headquartered in Tokyo.

Nagasakiya disclosed when it announced its account settlement for the February 1988 term on April 19 that five business corporations and two individuals had purchased 14 million of its stocks or 9.7% of the total stocks outstanding, with each having between 1 million and 2.5 million stocks. In the case of Chujitsuya, about 25 million stocks or 27% were cornered. Both have asked their own main bank to buy their stocks defensively in efforts to secure the majority of the stocks.

According to securities market sources, the firm which is cornering the stocks of these three consumer distributors is the major real estate agent well known in its overseas real estate investment, "S Company." Mr. Masamitsu Takeuchi, managing

director of Matsuzakaya whose 1.5 million stocks or 9.7% of the total stocks outstanding are cornered, said: "There has been no change in the ranking of the top ten major stockholders, and we have neither identified stock cornering groups nor negotiated with them."

Speaking of a department store, Department Daimaru headquartered in Osaka also has become the prey of stock cornering by a real estate agent whoes cornering of Daimaru stocks is still under way. Daimaru has once disclosed that Daiichi Real Estate Co. headquartered in the Shinjuku Ward of Tokyo has acquired 9 million stocks or 3.7% of the department's total stocks outstanding to become the third largest stockholder of Daimaru. But the department explained the purpose of Daiichi's stock purchasing as "pure investment."

According to an investigation conducted by a private research institution, Daiichi Real Estate has invested a total of 40 million yen in stocks and tries to kill two birds with one stone; that is, to form assets and secure new customers by holding stocks of companies listed on the first sector of the Tokyo Stock Exchange. Daiichi has so far acquired stocks of dozens of companies including Kyodo Shiryo Forage Co., Tekken Construction Co. and Keihin.

Makes Financial Power Talk

A little interesting among those companies targeted for stock cornering is that Mitsui Futo Quay Co. headquartered in Kawasaki City, Kanagawa Prefecture is also one of the targets. The company's stock price which was worth around 380 yen three years ago started rising sharply since two years ago. In March the price shot up to an extremely high 7,300 yen, and it was not known until the end of March when the legally required transfer of the title to the stocks was carried out that the company called Kenji Corporation whose name has never been heard held 4,439,000 stocks or 28.4% of the company's total stocks outstanding.

Securities sources speculate that real estate agents pull the strings and manipulate stocks behind any stock cornering valued more than 2 million yen. Mitsui Futo also has not received any demand from cornering groups and does not know what to do with them.

A securities market analyst said, "Anyway, they first ask some outside people or company to gather stocks or take over the great lump of stocks worth several million yen from another groups which run out of money in the middle of stock cornering. Once they think they have made the grounding enough for cornering, then they suddenly unveil and declare themselves as a major stockholder. Nothing you can do about it."

Among the examples of recent stock cornering cases involving real estate agents are the purchase of 10.3% stocks in Unica by Nippon Land which was well known for its cornrering of stocks of Toyota Auto-Textile Machinery Maker, the originator of Toyoto Motor Co., Harada Reat Estate's cornering of Tomoegumi Ironworks' 7.3% stocks, Fuji Construction Co.'s 11.8% cornering from Riken Vitamin, Japan Trust's 12.5% cornering from Koike Oxygen Industrial Co. and Nagahide Housing's 10.6% from Trinity Industry.

However, it does not necessarily mean that all real estate agents are vicious land manipulators. Indeed, no legal restrictions can be applied to their business dealings under free economy. A semi-major securities house person said, "A common characteristic among these people is that they buy up stocks by ignoring the achievements and future growth of a company in the same way as vicious land manipulators who resort to their financial power to gather up land by force."

A securities analyst said, "In old days people buy up a samll number of stocks to have the rumor spreaded and later sold them out. But now, surplus money and low interest rates have expanded the scale to hundred millions of yen. Those who are buying today are not trying to make profits tomorrow but three years later."

"Abortive Flower" of Money Game

Are there any common characteristics among those companies targeted for cornering?

Analyzing these characteristics, Mr. Yoshihiko Arakawa, marketing general manager of Shin Nihon Securities Co., said: "Generally speaking, those companies have a poor management and low capital. Their main banks are not strong. Because they have internal trouble, it is easier for stock manipulators to make friends with their employees. They have hidden assets including land."

While stock cornering by real estate agents is under way, the stocks of Heiwa Real Estate Agent headquratered in Chuo Ward of Tokyo, which is one of the main members of the Tokyo Stock Exchange - the main house of the stock market, were cornered by Auto Life headquartered in Minato Wark of Tokyo which markets air conditioners. It was disclosed that as of the end of March Auto Life became the second major stockholder having 3,330,000 stocks. Since the new main building of the Tokyo Stock Exchange was completed at the end of last April, this news attracted conjectures.

Anyhow, Japan is experiencing an unprecedented money surplus. The scenario for a series of cornering goes likes this: A dummy company is used to gather up stocks, and when the price of the stock goes up and customers start selling them, they buy more stocks. The targeted company itself steps in to buy stocks defensively, which further jack up the stock price. When the security power of the stock increases, the manipulators borrow money to buy more stocks. They make unreasonable demands or sell the stocks at higher prices. This is surely an annoyance to the targeted company and general stockholders. A securities analyst warned: "I just hope that general investors do not get hurt by the "abortive flower of a money game."

# # # #

JAPAN Sketches pt 2

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

31 May 1988

Dear Rodric,

I recently saw a Mr. Nobuyuki Nakahara, President of a Japanese company called Toren. He was put on to me by Grey Gowrie.

Mr. Nakahara took me through a long argument, illustrated by detailed charts, which sought to explain how the Japanese managed to remain competitive in world markets despite the rise in the value of the Yen.

I asked him to write to me about it in greater detail, if only because I was rather fascinated by a Japanese who seemed to want to do down his own side! I enclose his letter and the supporting documents which he sent me, in case they are of interest to you and the Embassy.

I am copying this letter and enclosure (less the charts) to Geoff Littler.

Yours ever,

Charles

C. D. POWELL

Rodric Braithwaite, Esq., C.M.G.,
Foreign and Commonwealth Office

charts sent to Braithwaite

May 24, 1988

PRIVATE & CONFIDENTIAL

Mr. Charles Powell
No. 10 Downing Street
London , SW1A 2AA

Dear Mr. Powell

It was my great privilege as well as pleasure to see you on May 10 and explain to you some of the well-engineered financial aspects of the "Japan, Inc.," based on the enormous land price increase / stock price increase spiral.

The main objectives of this barely noticed mechanism are:

1. Rapid expansion of banks, securities companies and other financial institutions, and their quick ascendancy abroad.
2. Alleviation of adverse impact of the strong yen on export companies, which finally resulted in the successful maintenance or even expansion of their export potential.
3. Guaranteed availability of foreign money through:
   a. purchase by foreigners of Japanese new securities issues due to favorable outlook for the stock market, and,
   b. Japanese borrowing abroad taking advantage of stand-by letter of credit issued by Japanese banks with Japanese real estate as collateral and addressed to foreign banks.
4. Extremely favorable equity financing, in terms of both capital availability and cost of capital, at very high stock price which was brought about by:
   a. artificially restricted supply of stocks on the stock exchange through fixed interlocking shareholdings among banks and other companies, and
   b. absence of basic effective regulations such as filing of stock acquisitions of more than 5%, prohibition of pool operations and prohibition of cornering the market.

I have prepared for you and enclosed herewith a position paper with a set of proposals to correct these abnormal situations. I hope you will find them useful.

It would be very good if you can exhort our people to put the Tokyo Securities Exchange on the same regulatory standards as the New York or London Stock Exchange in view of the fact that the Ministry of Finance is holding meetings of Securities Deliberation Council, an advisory body to Finance Minister, on unfair stock trade practices in June. Possibly the Toronto Summit would provide an opportunity. To give you a sense of the current of opinion in Tokyo today I enclose a translation of a newspaper article.

In conclusion I would like to mention that copies of my Position Paper are also being forwarded to economic advisers to Vice President Bush and Governor Dukakis, as well as officials of the White House and leading members of the Congress.

Please feel free to contact me any time over the telephone so that I can be of some help to you.

Yours sincerely,

N. Nakahara

Nobuyuki Nakahara

CC : Lord Gowrie

(Telephones/Japan: 81-3-286-5005, office;
702-5577, Residence)

Position Paper

1. Post-war Japan experienced land price explosions of increasing proportions in the mid-60's, the early-70's and the mid-80's.

2. These three explosions were triggered respectively by the "Income doubling policy" under the Ikeda cabinet, the "Japanese Islands reform policy" under the Tanaka cabinet, and the "Privatization policy" under the Nakasone cabinet, through open-bid sales of small pieces of government-owned choice land to private sectors.

3. The land price explosions were made possible by:

   a. the Bank of Japan's accommodative monetary policy resulting in huge credit expansion, and

   b. banks' and other financial institutions' somewhat questionable and often concealed or roundabout real estate loans extended in the form of:

      i) revolving short-term "working capital" loans requiring no collateral to listed or unlisted real estate companies, construction companies or other companies engaged in the real estate business, without the end use of funds being specified, i.e., "concealed" real estate loans,

      ii) revolving short-term "financial" loans requiring no collateral to listed or unlisted finance companies, lease companies, and credit card companies, most of which are offshoots of banks and other financial institutions and often have an equity ratio of less than 5%, without the end use of funds being specified, i.e., "roundabout" real estate loans, and

      iii) short-term loans requiring real estate or stocks as collateral to unlisted real estate companies, construction companies or other companies engaged in real estate business, having an equity ratio of a mere 2-3% in many cases. Similar loans are also extended by finance companies, lease companies and credit card companies, as

mentioned above. Since those unlisted real estate-related companies, whether large or small, are not required by law to have their books audited by the CPA or to announce their annual reports officially, names of lenders and respective lending amounts are not publicly available, and hence lending practices tend to be less strict than is the case with listed companies. The rather generous evaluation of collateral value is a case in point.

4. The land price explosions almost always pushed up stock price due to:

   a. increased availability of credit, and

   b. an increase in the value of traditional / export companies through the increased value of the numerous tracts of real estate owned by company occupied for offices, factories etc.

5. Stock price increases are to a great extent self-feeding, due to:

   a. the increase in the value of considerable amount of stocks that traditional / export companies own for investment and so-called "interlocking shareholding" purposes. Interlocking shareholding means reciprocal shareholding among companies linked by important business relations, and often involves banks (which are allowed to own up to 5% of any company's shares) and insurance companies (similarly up to 10%) as principal holders of shares. Interlocked shares are tacitly understood among holders to be non-tradable under normal business conditions.

   b. interlocking shareholdings, which effectively remove about 50% of total shares issued in the stock market. It is estimated that only 20-25% of total shares issued - roughly equal to shares owned by individuals - are available for trade and in circulation on the stock exchange. This "20% market" or at best "25% market" is in sharp contrast to the "100% market" in the United States, where almost all shares issued are tradable on the stock exchange. Barring the possible effects of interlocking shareholding on earnings etc., this floating stock ratio of 1 to 4 between Japan and the United States alone may well explain the inverse PER ratio of 4 to 1 between the two countries in a most

simplified way. This artifice of chronic shortage of supply of tradable stocks is one of the main secrets of the Japanese stock market.

c. banks' and other financial institutions' somewhat questionable and often concealed securities loan. Explanations under item 3b are applicable here, too.

d. the absence of an independent SEC, and basic regulations as stipulated in the American SEC rules. To illustrate, there are no requirements for filing stock acquisitions of more than 5%, no prohibition of anachronistic "pool" and "corner" operations just to mention a few. The Japanese stockmarket is one of the few major institutions which escaped General MacArthur's great reforms,and remains essentially a "Black Continent" or jungle. There are currently about 120-150 companies, including even some local banks, which are being "greenmailed" or extorted by pool operators, often groups of real estate speculators with organized crime or ultra right wing connections, to buy back their companies' shares at a price 5-6 times as high as normal price or to extend unjustified extra loans in the case of extorted local banks. Various possible irregular stock trading practices allow for enormous stock price manipulation in such extremely thin stock market. Big securities houses can also yield oligopolistic power in stock price formation.

e. equity financing, which takes advantage of artificially high stock prices. Securities companies are eager to promote it, for it gives them not only fee revenues but an excellent opportunity to exercise "favoritism" toward major clients and influential people by legally selling them new issues at an offering price which is normally discounted by about 5% off the prevailing price. They also play a vital role in lifting stock prices to a level deemed "desirable" by issuing companies in advance, and in locating prospective corporate buyers of new issues, also in advance, to maintain "interlocking shareholding". When convertible bonds are issued, it is the securities companies' responsibility to facilitate their smooth conversion into stocks afterwards. The stocks of those companies which have not adopted equity financing are therefore unpopoular, and their PER usually stays at a considerably lower level than the market average.

6. Japanese companies, particularly banks and financial institutions as well as export companies, have an increasingly vital stake in maintaining artificially high stock prices.

7. There exist extremely close inter-relationships between the Ministry of Finance and the Bank of Japan on the one hand and financial institutions on the other hand.

   The Ministry of Finance guarantees:

   a. a minimum spread between bank deposit costs and lending rates, and

   b. fixed commission rates for securities houses.

   Banks, securities houses and other financial institutions often invite MOF and BOF officials as their board members in return. The Tokyo Stock Exchange is usually headed by a former Deputy Minister of MOF.

8. As a result of the third and most extraordinary explosion of land price, during the two-year period from 1985 to 1987, the estimated value of privately owned land for residential use increased by ¥476 trillion to ¥1,218 trillion, and the estimated value of the Tokyo Stock Exchange Section 1 increased by ¥143 trillion to ¥326 trillion, or more than 40% of the world stock market value. The market value of NTT alone is larger than AT&T, IBM, GM, GE and Exxon put together. The combined total increase of ¥619 trillion, or $5 trillion, by far exceeded the American GNP. If an inheritance tax of 20% were imposed upon the above-mentioned privately owned residential land, at a valuation of ¥1,218 trillion, the estimated 1987 national debt of ¥153 trillion could be wiped out overnight. Young couples can no longer buy new houses even with their life-time incomes within two-hours' commuting distance from central Tokyo; nor can middle class inheritors afford to pay the exorbitant of inheritance tax assessed on their residential land.

9. These unprecedented capital gains were not merely paper gains. Personal capital gains taxes amounted to ¥8.6 trillion for 1987, an increase of 57% over the previous year, compared to the national budget of ¥54 trillion.

10. These gains also served to reinforce Japanese financial and industrial competitiveness and to promote the acquisition of foreign assets -- real estate, corporations and artwork.

11. Capital gains from foreign real estate acquired by Japanese interests serve to extend the entire mechanism described above beyond Japanese borders.

12. The land-based financial engineering of "Japan Inc." accompanied by the enormous land price increase / stock price increase spiral has achieved the following purposes:

    a. the rapid expansion of banks, securities houses and other financial institutions, and their quick ascendancy abroad, thanks to:

        i) expanded credit demand, and

        ii) extremely favorable equity financing in terms of both availability of capital and its costs.

    b. alleviation of the adverse impact of the strong yen on export companies, which finally resulted in the successful maintenance or even expansion (especially in Asian NICS countries) of their export potential, thanks to:

        i) an increase in their overall corporate value which enabled them to gain sufficient time for rationalization, switch-overs to more profitable product lines and other adjustments, and

        ii) extremely favorable equity financing in terms of both availability of capital and its costs.

        In 1987, total Japanese equity financing amounted to ¥ 12.5 trillion or $100 billion, while US firms raised $62 billion in 1986 through new stock issues. Last year Toyota raised $800 million, while Shin Nippon Steel is planning $ 1 billion equity financing in the Euro-dollar market this fall.
        Capital costs are estimated at .75% reflecting a very low dividend to price ratio.

c. Guaranteed availability of foreign money through:

i) the purchase by foreigners of new Japanese stock issues, which amounted to ¥ 4.2 trillion in 1987 due to the favorable outlook for the stockmarket, and

ii) Japanese borrowing abroad, taking advantage of stand-by letters of credit (effective for 3, 5, or even 10 years) issued by Japanese banks with Japanese real estate as collateral and addressed to foreign banks. This also avoids the foreign exchange risks involved in acquiring foreign assets.

Summary

1. There are direct causal and also mutually supporting relations between land price increases and stock price increases.

2. Stock price increases are inflated by:

   a. so-called "interlocking shareholdings" among Japanese companies, and

   b. the absence of basic regulations concerning the stock market

3. Maintaining artificially high stock price has increasingly become of crucial interest to financial institutions which own more than 43% of total shares issued.

4. The land price increase (which now includes foreign land acquired as well) / stock price increase spiral - in fact land price and stock price have been moving in parallel - has done a great deal to enhance Japanese financial and industrial competitiveness, especially since the yen appreciation accelerated after the Plaza agreement.

Recommended Immediate Action

Firstly, the topic of the bubble in Japanese land and stock prices should be taken up at the G5, G7 or Summit level, or in any other appropriate forum.

Secondly, Japan should be invited to respect international practice and Western countries should act to monitor Japanese observance, as below:

REQUEST TO JAPAN

1. Regulation of questionable lending practices according to United States or international standard.

   A. Real estate loan practices.
   Any real estate loan should be made according to the international standard:
   a. the total amount of loan should be within the expected cash flow from the prospective real estate to cover both interest payment and repayment schedule;
   b. loan should be long-term loan; and
   c. real estate collateral should be required, and its evaluation should be based on 1) conservative estimate of current real estate price, and 2) evaluation ratio of 40 - 60%

   B. Equity ratio criteria
   Full consideration should be given to business equity ratio.

2. Regulation of irregular stock transaction practices according to United States or international standard.

   A. Rules applicable to stock acquisitions of more than 5%
   B. Prohibition of pool operations
   C. Prohibition of cornering the market.

RESTRICTIONS OR BANS IN THE U.S. AND U.K.

1. Requirements for acquisition and ownership of assets in the United States.

   A. Immediate and regular filing of most recent duly audited annual report (including consolidated one whenever applicable) according to SEC forms.

   B. Minimum equity ratio of 5% by June 1988 and 10% by June 1989 and thereafter.

   C. No records of stock acquisitions of more than 5%, pool operations or cornering the market up to date.

2. Restrictions of activities of any banks, insurance companies, securiies companies and other financial institutions which have loans outstanding or any other business relations with:

   A. Those companies which fail to meet the requirements as provided for in item 1 above.

   B. Those companies which have acquired more than 5% of stocks or which have practiced pool operations or which have cornered the market.

FROM TOKYO TO FCO

TELNO 4 SAVING

UNCLASSIFIED

Addressed to FCO Telegram No 4 Saving of 13 May 1988

Repeated for information to:

Paris, Rome, Bonn Washington, Brussels, Dublin, Stockholm, UKRep Brussels, UKMIS Geneva, UKDEL OECD, Ottawa, Bangkok, Canberra, Peking, Seoul, Jakarta, Singapore, Manila, Kuala Lumpar, Governor Hong Kong, BTC Hong Kong, Osaka.

JAPAN: ECONOMIC REPORT: APRIL 1988

- Real GNP grew by 1.7% in the first quarter of 1987. During 1987 as a whole, real growth was 4.2%, compared with 2.4% in 1986 (paras 1-4).

- A new medium term economic plan to be lauched soon calls for an average annual real growth rate of 3.75% between 1988 and 1992, and for the current account surplus to fall to less than 1.5% of nominal GNP by the end of the period (para 5).

- Two further reports on the need for tax reform were published in April, but detailed proposals, including a final decision on the type of indirect sales tax, will not appear until later this month. Although the tax reforms are intended to be revenue neutral when completed, the introduction of cuts in direct taxation ahead of the indirect sales tax may provide a fiscal stimulus later this year (paras 32-35).

- Industrial and business activity remained buoyant, with industrial production and retail sales growing by 5.6% and 5.0% respectively during FY 1987 (paras 6-14).

- Unemployment averaged 2.78% during FY 1987, virtually unchanged from the average in the previous year. The average wage increase in the Shunto was 4.4%, suggesting that strong growth in real wages may be likely this year (para 15-17).

- The consumer price index rose by 0.5% during FY 1987, after a nil increase in 1986. The wholesale price index fell by 2.0% (paras 18-19).

- The trade surplus and the current account surplus totalled $94.3 billion and $84.5 billion respectively during FY 1987. Both figures were about $2 billion higher than original government projections. The invisibles deficit widened slightly, to $9.7 billion, during the year (para 20-22).

- Export volume rose by 0.1% during FY 1987, and the quarterly data show an upward trend, with volume rising by 0.9% year on year in the March quarter (para 24).

MONETARY

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- The net inflow of long term capital amounted to $15.4 billion in the March quarter. Japanese investors remained wary of overseas securities, whilst foreigners returned as net buyers of Japanese stocks (paras 25-26).

- The broad measure of money supply grew by 11.2% in FY 1987. The Bank of Japan said that it would continue its present accomodative monetary stance, but added that the money supply was growing too rapidly from a longer term point of view (para 27).

- The yen remained stable against the dollar during April and closed at Y124.82 (para 28).

- The Tokyo Stock Exchange Nikkei index reached a record high during April (exceeding the level of last October) and closed at 27,434.

GNP DATA (TABLE 1)

TABLE 1: GROSS NATIONAL EXPENDITURE
(Real, seasonally-adjusted, base year = CY 1980)
Percentage change over the preceding period

FISCAL YEARS				1986 QUARTER ENDING				1987	
	1984/5	1985/6	1986/7	SEPT	DEC	MAR	JUNE	SEPT	DEC
Consumers' Expenditure	2.6	2.8	3.6	1.7	-0.6	2.0	0.7	1.0	0.4
Private Housing	0.5	2.9	10.9	6.2	5.2	1.2	3.0	10.2	12.5
Private Investment	11.5	13.2	4.5	0.5	1.8	2.5	1.8	2.7	4.1
Private Inventories	100.4	7.0	-74.7	19.0	61.7	-83.8	530.1	-21.0	52.9
Government Current Expenditure	2.6	1.6	6.8	1.1	14.3	-11.3	1.2	-0.3	0.2
Government Capital Expenditure	-2.9	-6.3	6.6	1.1	0.9	0.7	1.7	3.1	6.6
Government Inventories	--	79.0	174.0	-50.5	-215.7	-	-145.2	-	-
External (Net)	49.4	20.9	-35.0	-3.0	3.2	20.8	-41.0	11.8	-34.7
Exports	15.6	2.1	-3.6	-0.5	-0.6	2.5	-1.8	6.7	-1.7
Imports	9.8	-2.3	5.5	-0.1	-1.2	-0.7	6.4	6.2	2.3
GNE (Percentage change)	5.1	4.4	2.6	0.9	0.7	1.5	0.0	2.0	1.7
GNE (Y Billion)	281,398.9	293,903.6	301,679.7	300,254.9	302,299.0	306,780.1	306,805.8	313,030.0	318,374.7
Memo item: Nominal GNE	6.7	6.0	4.2	1.1	0.4	1.1	-0.2	2.7	1.6
(Y Billion)	303,016.0	321,158.2	334,651.5	334,056.2	335,402.0	339,158.5	338,543.5	347,574.0	353,107.7

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CONFIDENTIAL
FM TOKYO
TO FLASH Z FCO
TELNO 441
OF 261000Z APRIL 88
INFO IMMEDIATE DTI, UKREP BRUSSELS

YOUR TELNO 160 (QUERY) TO UKREP BRUSSELS:EC/JAPAN ALCOHOLIC BEVERAGES

1. WE HAVE IT FROM VERY RELIABLE SOURCES, INCLUDING THE MOF, THAT OZAKI WILL NOW BE PREPARED TO DISCUSS DETAILS OF TAX RATES, DURING HIS SOUNDINGS IN BRUSSELS AND LONDON,BUT THAT THIS WILL NOT BE THEIR BOTTOM LINE. OZAKI'S REMIT WILL BETO
TO REPORT REACTIONS TO TAKESHITA, WHO WILL DECIDE THEIR POSITION BEFORE HE SEES MRS THATCHER. THE MFA AND MOF ANTICIPATE HOWEVER THAT A DIRECT REQUEST FROM THE PRIME MINISTER FURTHER TO IMPROVE THE OFFER MIGHT WELL BE FORTHCOMING, AND THAT, PROVIDED IT IS WITHIN CERTAIN LIMITS, TAKESHITA WILL AGREE TO SELL THIS TO THE LDP IN ORDER TO SETTLE THE ISSUE.

2. OUR INFORMATION ALSO SUGGESTS THAT AN OUTCOME AS GOOD OR BETTER THAN THAT INDICATED IN PARA 4 OF TUR MAY BE OBTAINABLE, PROVIDED WE PLAY OUR CARDS RIGHT. OUR OBJECTIVE, I SUGGEST, SHOULD BE TO AVOID SHOWING OUR HAND TO OZAKI IN BRUSSELS AND LONDON SO THAT WE CAN CAREFULLY CONSIDER OUR POSITION AND MAXIMIZE PRESSURE UPON THE JAPANESE BEFORE TAKESHITA'S MEETING WITH THE PRIME MINISTER,BUT THAT WE SHOULD CUT A DEAL WITH TAKESHITA IN LONDON IF POSSIBLE.

3. OUR OBJECTIVE WILL BE UNDERMINED TO THE EXTENT THAT OZAKI PICKS UP ANY HINT OF COMPROMISE OR DISUNITY IN THE COMMUNITY'S POSITION ON 28 APRIL, AND WE RECOMMEND THAT THE COMMISSION NOT BE TOLD OF THE EXTENT OF THE SWA'S FLEXIBILITY IN PARA 4 OF TUR, LEST THAT GET BACK TO OZAKI. FURTHERMORE, THE COMMUNITY SHOULD PLAY A PURELY QUESTIONING AND LISTENING ROLE AT THE MEETING ON 28 APRIL. IF THE COMMISSION GOT INTO THE POSITION OF COMMENTING ONE WAY OR THE OTHER ON PARTS OF OZAKI'S PROPOSALS (YOUR PARA 1(III)), HE COULD ALL TOO EASILY PICK UP HINTS OF COMPROMISE IN OUR POSITION.

4. TO RETAIN UK CONTROL AS FAR AS POSSIBLE WE SHOULD NOT MAKE TOO MUCH OF THE FACT THAT OZAKI'S OFFER IS ONLY A TRIAL BALLOON, LEST THIS ALSO ENCOURAGE
OTHER MEMBER STATES AT TODAY'S COORDINATION MEETING TO THROW IN ADDITIONAL DEMANDS (EG ON TAX RATE FOR WINE) OR TIE THE COMMISSION'S

HANDS IN ITS TALKS WITH OZAKI. IT WOULD BE REASONABLE TO ARGUE AGAINST OFFERING COMMENTS ON OZAKI'S PROPOSALS SIMPLY ON THE GROUNDS OF NEEDING TO COORDINATE COMMUNITY POSITIONS AFTER THE LONDON MEETING, BEFORE OFFERING COMMENTS TO THE JAPANESE ON THEIR PROPOSALS.

5. FOR THE PURPOSE OF THIS MEETING, THE SWA POSITION AS DESCRIBED IN YOUR PARA 2 SEEMS QUITE ADEQUATE.

WHITEHEAD

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MR GILLMORE
MR MCLAREN
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FRAME

MR WESTON CAB OFF

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the department for Enterprise

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

CDP
19/2.

Dear 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 tarriff 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.

Yours ever,
David

the Enterprise initiative

Season Interval Pt 2

FCS/88/024

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)

Foreign and Commonwealth Office
5 February 1988

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FM WASHINGTON
TO DESKBY 140900Z FCO
TELNO 79
OF 140130Z JANUARY 88
INFO IMMEDIATE TOKYO, PARIS, BONN, ROME, OTTAWA, UKREP BRUSSELS
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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).

ACLAND

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PS/CHANCELLOR TREASURY
LITTLER TREASURY

LOEHNIS BANK OF ENGLAND

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SCPC.

(2)

Foreign and Commonwealth Office

London SW1A 2AH

30 December 1987

Prime Minister
You may like to glance at the summary.
CDP
31/12

Dear Charles

Japan: The Nakasone Years 1982-87

The Prime Minister may wish to see the attached despatch from Sir John Whitehead on Mr Nakasone's five years as Prime Minister of Japan.

Yours ever

(R N Culshaw)
Private Secretary

C D Powell Esq
PS/No 10 Downing Street

THE NAKASONE YEARS : 1982-87

SUMMARY

Nakasone was a new type of Japanese Prime Minister in the post-war period. But we shall probably see others somewhat like him in the years ahead. He was not unique; above all he was not un-Japanese. (para 1)

His instincts were well to the right. But his time in office, given the constitutional and political constraints on him and the stage of development of Japanese policies, meant that this right-wing approach came through in the form of greater self-assertion in foreign policy and greater self-reliance over defence; but all within a framework which found general approbation within the Western community. Despite the impact of Nakasone over the past five years, continuing Japanese reticence in these fields is mirrored by our own ambivalence and that of many other countries towards more forceful Japanese involvement in many fields. (para 2)

He was a strategic thinker in the political and politico-military fields; he was no economist, even though economic and commercial policy took up much of his time. His legacy is a clear statement: the twin pillars of Japanese foreign policy are that Japan is a member of the Western community and part of the Asian Pacific region. Nakasone saw the broader picture but in practice his efforts were concentrated on managing the relationship with the United States and seeking where possible to improve relations with countries along the Eastern seaboard of Asia, particularly Korea, China and ASEAN. Relations with Japan's other near neighbour, the Soviet Union, remained frozen. (paras 3-4)

In his dealings with the United States he was more successful in the political and defence fields (where style and a willingness to take initiatives gave the Americans the impression of an ally

/more

more prepared to do their bidding than hitherto) than in economic and commercial matters (where sound, long-term consistent policies had produced a power with a more successful economy than the Americans). The economic threat of these Nakasone years may soon be added to by the political challenge under future "Nakasones" as Japan comes out from under the American wing. (para 5)

In Anglo-Japanese relations Nakasone was a politician with whom one could do business, although in five formative years of Japanese foreign policy under his guidance there was no bilateral visit Japan by a British Prime Minister and only one by a Foreign Secretary. He was helpful on some issues such as Cable and Wireless and Airbus; on others he could not or would not deliver. Europe and Britain were to be helped to the extent that this was necessary to show Japan's international credentials. But our interests were consistently subordinated to domestic Japanese concerns and the paramount importance of the United States in foreign affairs. (paras 6-7)

Domestically Nakasone rode on the efforts of Japanese industry and favourable world economic conditions. But in economic policy he maintained three consistent lines: a persistent effort to reduce government spending while modernising the fiscal structure; the "internationalisation" of Japan's economy, including a controlled opening of domestic markets and the encouragement of capital and direct investment overseas; and a shift in dependence for growth from the external to the domestic sector by the promotion of industrial reform. (paras 8-12)

Politically Nakasone was the first Japanese Prime Minister consciously to set about creating a public image with which a large section of the electorate could identify: "female voters may not listen to my speeches but at least they will remember my neckties". This paid handsome dividends in the landslide victory of the Liberal Democratic Party (LDP) in 1986 which earned him, as an exception to party rules, a fifth year in office. (paras 13-15)

He recognised the necessary shift in the power base of the LDP from rural areas to blue-collar workers, although many other influential politicians have not yet seen the light. He brought Japanese politics out from behind closed doors and on to the television screens. But in the final analysis he still played by factional and party rules; he nominated his own successor after consulting the party elders. (para 15-16)

Five years as Prime Minister have left him with a high reputation, experience unequalled in the present and likely future administrations over the next few years, a greatly strengthened power base in the party, and a successor who will look to him for foreign policy guidance at least for a while. Nakasone's influence will therefore persist; but it is highly unlikely that he will return as Prime Minister. (para 17)

British Embassy
TOKYO

30 November 1987

The Rt Hon Sir Geoffrey Howe QC MP
Secretary of State for Foreign and
Commonwealth Affairs
London

Sir

THE NAKASONE YEARS : 1982-87

1. When Prime Minister Nakasone handed over the reins to Takeshita earlier this month there were many commentators in the West who were full of foreboding. This betrayed their short memories, their attachment to the familiar, and their lack of long term perspective in looking at the evolution of Japanese policies. Nakasone was undoubtedly a new type of Japanese Prime Minister in the post-war period - self-confident, often aggressive, nationalist, problem-oriented, presidential style and media conscious. But it would be wrong to think of him as unique and potentially dangerous to see him as "un-Japanese". His successor is quite different in personality, style and the focus of his interests. But we shall probably see in the years ahead others somewhat like Nakasone at or near the summit of power in Japan and exerting considerable influence in the world at large.

2. Nakasone's instincts always have been nationalist and well to the right. But his time in office, given the constitutional and political constraints on him and the stage of development of Japanese policies (where distortions between commercial, economic and fiscal policies on the one hand and political and defence policies on the other still exist), meant that his right wing approach came through in the form of greater self-assertion in foreign policy and greater self-reliance over defence. These substantial shifts of emphasis were greeted with general approbation by the Western community. There have been many initiatives in the political and defence fields which would have been unthinkable only a short time before Nakasone came to power: Japan's role in assisting the peaceful transition from the Marcos to Aquino regimes in the Philippines, her greater involvement in the Gulf, the agreement covering the transfer of technology to the United States in the military field, the greater Japanese role in protecting sea lanes off her coasts, the breaking of the barrier of 1% of GNP devoted to defence which now provides Japan

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with a defence budget of more than £16 billion. But inhibitions still exist such as the unwillingness to get their noses out in front in awkward foreign policy situations (cf the Germans), their fear of sending anyone overseas in uniform, even for peacekeeping missions, and their prohibition of calls by foreign ships at Japanese ports which might be carrying nuclear weapons. For the most part these are not constitutional constraints, they are political; and the political considerations are in many cases foreign rather than domestic. One of Mr Nakasone's last acts was to turn down a suggestion by senior officials that Japan might send patrol vessels (up to 6000 tons) to the Gulf as part of its package of measures announced in October. This was done for foreign policy reasons. "Would you really have wanted Japanese patrol vessels or minesweepers in the Gulf?" was a question posed by Japanese at that time, and protestations that on balance one would fell on not entirely credulous ears. These trends of greater involvement in foreign and defence matters, given a substantial assist by Nakasone in his five years in office, are fundamentally one way streets. Japanese reticence is mirrored by ambivalence in many countries, including the West.

3. Nakasone was a strategic thinker in the political and politico-military fields. He was no economist, even though economic and commercial policy took up much of his time. His legacy is a clear statement: the twin pillars of Japanese foreign policy are that Japan is a member of the Western community and part of the Asian Pacific region. The two main planks of his country's foreign policy, relations with the United States and relations with countries along the Eastern seaboard of Asia, had emerged before he became Prime Minister. But he made three major contributions broadly within this framework:

a. he saw that Japan's fundamental interests lay in strengthening the alliance with the United States. The keystone to this improvement lay in a preparedness by Japan to acknowledge and act on the premise that the US-Japan Mutual Security Treaty required Japan to contribute much more than it had done in previous years. By means of the "Ron-Yasu" relationship with President Reagan to which Nakasone consistently gave priority during his five years in office and by deed as well as word Nakasone sought, in general with considerable success, to portray an increasingly active Japan and a loyal ally of the United States. This cleared away much of the misunderstandings of the Suzuki years in the early 1980s and the frustration of the Miki years in the 1970s.

b. He sought to broaden the US-Japan defence relationship into a less introspective alliance, one which associated itself albeit in an informal manner with the Western alliance as a whole. As Japanese foreign policy and defence interests broadened out this was a natural

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development. But Nakasone's distinctive contribution was actively to involve himself in these wider issues rather than allowing them to emerge as problems arose. The Williamsburg declaration at the summit meeting in 1983 was a mile-post along the road to closer Japanese identity with Western defence as a whole. The INF discussions brought home more forcefully than the Japanese might have wished the indivisibility of Western defence.

c. In East and South East Asia Nakasone sought to draw a line under the residual bitterness, stemming from the war, between Japan and her Asian neighbours. He inherited a trough in relations with Korea and a wary, if not suspicious, China and ASEAN on his doorstep. He moved quickly and effectively to deal with relations with Korea, making a remarkably successful visit to Seoul - Japanese flags in the streets and a Japanese Prime Minister there on official business for the first time in nearly 40 years. With ASEAN he was also reasonably successful, establishing satisfactory relationships with the Philippines, Thailand, Malaysia and Singapore and a working relationship with Indonesia. Only with China was he demonstrably less successful despite considerable efforts to improve relations. The re-writing of school textbooks to portray Japan's war against China in a less unfavourable light, China's suspicions about Japan's policies towards Taiwan, her complaints about a lack of Japanese technical assistance to China, and Japan's increased defence expenditure all helped to fuel a suspicious relationship, despite high level visits in both directions including a well publicised and apparently successful visit by Nakasone himself.

4. It was only in Japan's relations with the Soviet Union that Nakasone was almost completely unsuccessful in producing movement with one of its neighbouring countries. This was a result first and foremost of the mutual antipathy between the two peoples which existed long before 1945. But its proximate cause was the Northern Territories issue on which the Soviet Union showed no willingness to compromise in any way. The Russians probably reckoned also that Nakasone was far too involved with the United States for most of his time in office to be susceptible to moves from their side to warm up the relationship. When in his last year Nakasone made it clear that he would welcome a visit by Gorbachev, the Russians miscalculated what he might be prepared to pay for it, or else chose effectively to rebuff him by pitching their negotiating position too high. The moment could come again, but the period in the early 70s when the Japanese were genuinely interested in the development of Siberia and the Russians appeared to be prepared to return 2 of the 4 Northern Islands may not return again, at least in that form.

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5. The relationship with the United States was at the centre of Nakasone's preoccupations, whether he was dealing with foreign or domestic affairs. It is ironic that relations with the United States should be more confrontational now than they were when he came to office. US criticism is aimed most frequently at trade issues between the two countries; but there are still calls for Japan to do more in the political and defence fields too. This is not surprising; relations would almost certainly have deteriorated more sharply if it had not been for the hard work put in as well as instigated by Nakasone and the good relationship between President and Prime Minister. It is in the nature of the relationship and Japan's own development that there would be a series of rows over commercial and economic matters which have now been going on the best part of 20 years; as Japanese policies evolv and her self-confidence grows we shall probably see a series of rows, perhaps not as continuous or vociferous but nonetheless important, over political and defence issues. This is part of the growing-up process. It requires both countries to maintain the framework of their relationship intact, even though the arguments on individual issues are tough. Nakasone saw this; it is not clear that many on the Hill have appreciated the same point. Actual protectionist moves over semi-conductors as opposed to the rhetoric of previous years, the emotionalism of the Congressional reaction over the Toshiba infringement of COCOM, and debates on a potentially highly damaging trade bill have all suggested otherwise. To their credit, the US Administration seems to have retained a view of the strategic importance of the Japan/US relationship and has been helped by Nakasone's own statemanship as well as by his willingness to buy off the Americans in a number of ways from the conclusion of arrangements for the transfer of military technology to the United States alone, and the amendment of the bilateral Status of Forces Agreement to allow a higher Japanese contribution to the support costs of American forces in Japan, to an agreement to participate in SDI and to develop the next generation of Japanese fighters (the FSX) as a Japanese/American collaborative project based on an existing American airplane.

6. In Anglo-Japanese relations Nakasone was a politician with whom one could do business. Relations were generally good at the highest level and the Summit meetings of the Seven and the margins of other international meetings enabled British and Japanese leaders to keep in touch. But there is no substitute for visits to Japan itself in order to obtain an authentic feel for developing Japanese attitudes and the interplay at different power centres; in that sense it is a pity that in five formative years of Japanese foreign policy under Nakasone's comparatively dynamic guidance there was no visit by the Prime Minister and circumstances prevented you, Sir, from making more than one visit here. That is only half the rate that is provided for under the agreement on regular bilateral consultations with the Japanese, in itself an extremely leisurely contact rate with a country of the power and potential of Japan. It is good that intentions are that the rate and depth of contact should be improved.

7. Nakasone was helpful to British interests over some issues such as Cable and Wireless' bid for participation in Japan's

international telecommunications business and the sale of Airbus, but on others such as Rolls Royce's bid to equip JAL's fleet of jumbo jets with aero-engines he could not or would not deliver. Our interests, British and European, were consistently subordinated to domestic Japanese concerns or to competing United States interests, as over the semi-conductor agreement, the $1 billion special government purchasing programme and the new Kansai International Airport.

8. Domestically Nakasone's years were good ones for the Japanese economy and ones in which Japan's economic weight became much more manifest internationally. Despite a relatively moderate annual average growth of 3.6%, Japan's share of OECD output rose from 11.8% to 15.3%, and her per capita GNP in dollars from under 10,000 to over 18,000 which put her in first place ahead of the United States. Japan maintained inflation close to zero and low interest rates. The undervaluation of the yen from 1983-5 created an export boom, mainly to the US market. The fall of oil prices and appreciation of the yen shifted ~~in~~ the terms of trade markedly in Japan's favour and contributed to her massive trade surplus. In four years this increased from $32 billion to $92 billion. The high corporate profits of these earlier years later eased the transition to the high yen economy. The "surfeit of money" in the private sector led to a counter-flow of financial investment to the United States, and rocketing land and stock prices at home. In the Nakasone period alone Japan accumulated over $200 bn of net foreign assets.

9. This success owed more to Japanese industry and world economic conditions than to the specific policies of the government; but Nakasone maintained three consistent lines of economic policy: first, a persistent effort to reduce government spending at home while modernising the fiscal structure; second, the "internationalisation" of Japan's economy, which included a controlled opening of domestic markets and the encouragement of capital and direct investment overseas; and, from September 1985 policies designed to shift dependence for growth from the external to the domestic sector by the promotion of industrial structural reform.

10. The "fiscal reconstruction", as it was called, was in line with the prevailing mood in the US and Europe, and necessitated in Japan's case by the growing dependence of the government on deficit bonds to finance its current spending and the prospect of the mounting costs of an aging society. Nakasone declared his intention to eliminate deficit bond financing by 1990 and stuck to it throughout his tenure of office. (During his tenure the amount of current sector bonds was reduced from 13.2 to 8.9% of total annual expenditure.) Consistent with Japan's commitments to the United States, aid and defence were the only areas where spending was increased; the others were all cut back in successive years. As part of the same programme of administrative reform, Nakasone began the divestment of the

/government's

government's shareholdings in major companies such as NTT and JAL. He also attempted a major tax reform, in which the aim was to reduce personal and corporate taxation by spreading the burden more evenly over a "wide and shallow" indirect tax. In this objective Nakasone was stymied by opposition from retailers and other lobbies within his own party. With little achieved other than the elimination of interest free postal savings accounts (itself a small step towards the deregulation of interest rates) Nakasone handed the task of tax reform to his successor.

11. In Nakasone's handling of foreign economic relations, it was more difficult to distinguish between the style and the substance. Nakasone at least created a mood which was more conducive to foreign penetration of Japan's markets, and convinced foreign politicians that they had a friend at court who, even if his country lagged behind, would himself do his best to change things. He was the first Japanese Prime Minister properly to fill Japan's seat at the Summit meetings, and thrived on the domestic popularity which accompanied his high international profile. Thanks to his influence virtually every White Paper, and every company brochure included a section on Japan's contribution to international society. His big gestures - the Action Programme of import liberalisation, the Maekawa Report, the $20 bn recycling programme, the $1 billion special import programme - by producing the commitment ahead of the plan for implementation, were designed as much to short-cut the bureaucracy as to impress and placate the foreign critics. The pressure on bureaucrats to deliver probably helped speed up the removal of barriers at the micro-level. But overall the results of his market opening measures did not measure up either to the scale of the problem created by Japan's enormous surpluses or to foreign expectations. On industrial goods he moved fairly decisively though technical barriers remain a problem: financial services have been opened steadily, if in slow phases. In agriculture he took some first steps towards financial reform of Japan's costly producer subsidies, but in areas such as this and construction, where political support and finances are involved, Nakasone showed no zeal for liberalisation.

12. Nakasone never accepted that Japan should play a "locomotive" role in the world economy: but as the limitations of the import liberalisation programme as a means of correcting the trade balance became apparent, he responded to foreign pressure by announcing his own master plan for structural reform designed to shift resources in the longer term from exports to the domestic sector and from saving into consumption.

13. Nakasone was the first Japanese Prime Minister consciously to set about creating a public image with which a large cross-section of the electorate could identify. But for Nakasone the word charisma would not have entered the Japanese language. He swam, he played tennis and golf, he painted, he wrote haiku, he practised zen meditation, and he made play of his knowledge of

/English

English and French. He paid careful attention to what he wore, for as he once commented, "Female voters may not listen to my speeches but at least they will remember my neckties". Like any skilled Western politician, he was always on the look-out for photo opportunities. Sportsmen and entertainers suddenly found themselves welcome guests at the Prime Minister's residence. Nakasone's frequent trips abroad provided further opportunities to keep him in the public eye. His eagerness to appear alongside President Reagan in the Summit commemorative photographs became a standing joke, but also a source of pride for the Japanese public.

14. These efforts at self-promotion paid handsome dividends. In the 1986 double election for the Upper and Lower Houses of the Diet Nakasone succeeded in converting his personal popularity into a landslide victory for the LDP, thus earning himself an additional year in office. Until 1986 the LDP appeared set on a course of ineluctable decline. Nakasone himself had suffered an electoral set-back at the 1983 general election when he had been forced to go to the polls against his will to allow Tanaka to expunge the stigma of his conviction by the courts through his re-election to Parliament. By winning 304 out of 512 seats in the Lower House, Nakasone reversed the decline in the LDP's electoral fortunes. The manner of his victory was as significant as its magnitude. Traditionally the LDP has relied for the core of its support on voters in rural areas. The country remains solid for the LDP. But rural voters represent a declining proportion of the total electorate: 8% in 1986. Today, most Japanese voters live and work in the towns and cities. Nakasone was quicker than other LDP leaders to appreciate that the party was no longer essentially the representative of the traditional agricultural interest. The largest block of LDP voters are in fact now drawn from urban, salaried workers.

15. The results of the 1986 elections bore out Nakasone's analysis of where the future interests of the LDP lie. Usually the LDP is at a disadvantage when turnout declines. But in 1986 on a slightly lower turnout than in 1983, the LDP won a higher share of the vote, especially in the urban areas. Party identification in Japan is on the decline: 40% of the electorate do not identify with any political party. The LDP owed its electoral victory to its success in attracting the vote of 60% of these unaffiliated voters. The opinion poll evidence suggests that Nakasone's personal style of leadership exercised a strong attraction for these floating voters.

16. But despite his modern image in many respects, Nakasone in the final analysis still played by factional and party rules. He owed his own nomination to the support of the former Prime Minister Tanaka. So influential was the former Prime Minister that Nakasone's first administration was unkindly dubbed the "Tanakasone cabinet". And at the end he nominated his own successor after consulting party elders.

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17. Five years as Prime Minister have left Nakasone with a high reputation, experience unequalled in the present and likely future administrations over the next few years, a greatly strengthened power base in the party, and a successor who will look to him for foreign policy guidance at least for a while. Nakasone's influence will therefore persist; but it is highly unlikely that he will return as Prime Minister.

18. I am copying this despatch to the Chancellor of the Exchequer, the Secretary of State for Trade and Industry, the Secretary of State for Defence, HM Representatives in Washington, Bonn, Paris, Seoul, Peking, Ottawa, Rome, Moscow, UKREP Brussels and OECD Paris, and HM Consul-General in Osaka.

I am, Sir,
Yours faithfully

John Whitehead

John Whitehead

FILE
JA

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

30 November 1987

THE NEW JAPANESE PRIME MINISTER

The Prime Minister was grateful to be shown Sir John Whitehead's despatch on Mr. Takeshita, which she found very interesting.

(C.D. POWELL)

R.N. Culshaw, Esq., M.V.O.,
Foreign and Commonwealth Office.

COVERING CONFIDENTIAL

Foreign and Commonwealth Office

London SW1A 2AH

25 November 1987

Dear Charles

The New Japanese Prime Minister: Noboru Takeshita

The Prime Minister may wish to see the attached despatch from Sir John Whitehead on the new Prime Minister of Japan, Noboru Takeshita.

Yours ever

(R N Culshaw)
Private Secretary

C D Powell Esq
10 Downing Street

COVERING CONFIDENTIAL

THE NEW JAPANESE PRIME MINISTER: NOBORU TAKESHITA

SUMMARY

Relatively unknown to the outside world and rather inexperienced in foreign affairs. His strengths lie in the domestic field where he could be more effective than Nakasone, while relying on the latter for foreign policy advice. (para 1)

His early career: upbringing in one of the most backward areas of Japan. But a good education and an early entry into local politics. Transition to national politics in 1958, aged 34.

Political takeoff as Chief Cabinet Secretary aged 47. His performance as Finance Minister. (paras 8-12)

His style: patience, consensus, but determination - though with some lack of self-confidence. From conviction and genuine personal modesty he sees the Prime Minister's role essentially as being that of principal mediator. (paras 13-15)

Some priority tasks: land pricing policy, tax reform, US/Japan relations. Europe too is taken account of. No bold initiatives likely. But better placed than Nakasone to implement domestic economic and social reforms, which are necessary if Japan is to continue its integration with the industrialised Western world. (paras 16-17)

British Embassy
TOKYO

The Rt Hon Sir Geoffrey Howe QC MP
Secretary of State for Foreign
and Commonwealth Affairs
LONDON

5 November 1987

Sir

THE NEW JAPANESE PRIME MINISTER: NOBORU TAKESHITA

1. Few outside Japan had heard of Takeshita until about a year ago. Even now despite his election as the twelfth post-war Prime Minister of Japan on 6 November there are many Western observers living in Japan who think he lacks the qualities to be a successful Prime Minister. In Western terms this is probably true; and by comparison with Nakasone he lacks flair, drive and a willingness to take some risks. He is a low-profile operator. His style will mean that initially at least Japanese policies will appear in many fields to have less grip, pace and transparency at a time when our interest is in seeing more of those qualities in Japanese policy making. In international affairs he is less confident and less assertive than Nakasone. But he is a more able domestic politician than Nakasone. With the latter's advice to lean on in foreign policy and with the guidelines for domestic reform already laid down by the Maekawa report and the advisory bodies set up to consider that report's recommendations in detail, Takeshita could be the right sort of man to produce the consensus needed to implement this badly needed reform. This should have a greater but less charismatic impact on the role of Japan in the world, There is a sense in which Takeshita could play the log-rolling Lyndon Johnson of the Great Society years to Nakasone's Kennedy. The following paragraphs, for which I am in large part indebted to Mr Millington, the Political Counsellor at this Embassy, look at the formative influences on Takeshita as well as at his philosophy and style.

2. Takeshita was born in 1924 in the village of Kakeya (population 4,583 in 1987), in Shimane Prefecture on the Japan Sea coast of Western Japan. The chronology of his life is attached. According to Japanese mythology, Shimane was the home of the gods who gave birth to the Japanese nation. Today Shimane,which Takeshita has represented in the Diet for 29 years, is one of the poorest and most backward parts of Japan (only 1% of the population have main drainage) - essentially conservative, rural and relatively untouched by the rapid post-war industrialisation of the last 30 years.

/Kakeya

Kakeya, like many comparable villages, has suffered from depopulation, a loss of 1,800 inhabitants in the last 20 years. Takeshita's upbringing in this small community struggling against a harsh climate has left a deep impression. Unlike many of his predecessors, who were brought up in larger towns and went into politics from the civil service, Takeshita retains an approach to politics fashioned by his early experiences as a member of a closely knit village community. It is characteristic that Takeshita should have taken as the theme for his campaign for the Party leadership a call to give all Japanese a sense of pride in their "furusato" or local communities.

3. Takeshita was the eldest son of the village 'sake' (Japanese rice-wine) brewer. His father was Mayor of the village and a member of the Shimane Prefectural Assembly, but his mother, a woman of progressive feminist views, seems to have awakened his interest in politics. Takeshita was not outstanding as a student. He is no intellectual. He reads little and has few cultural interests, apart from a taste for traditional Japanese painting. He is chiefly remembered by his school classmates as the manager of the school judo team (he is a 5th dan), where he displayed for the first time his talents as an organiser. Thanks to his family's relative prosperity, he was sent to the prestigious private Waseda University in Tokyo to read business studies. Waseda has been a breeding ground for many Japanese politicians. The Waseda connection in the Diet (and in local government and the business community) has provided Takeshita with a network of contacts beyond the confines of his own party.

4. Since Japan was at war, his studies were interrupted when he volunteered in 1944 to join the Army Aviation Corps. He was never engaged in active combat and did not leave Japan for the front. At the war's end he was acting as an instructor of new recruits and was a candidate to be a "kamikaze" pilot. Takeshita has said little in public about this period of his life. But he likes to describe himself as belonging to the transitional generation born just before the present Emperor came to the throne. By comparison with the leaders born in the Meiji period (before 1912) or those politicians who have grown up during Japan's period of post-war economic prosperity, he claims that his generation has fewer grandiose ideas. Sucked into the war as cannon fodder, they saw at first hand the subsequent desolation and destruction. Takeshita has stated that the difficulty of eking out a living in the immediate post-war period at a time of shortages and black-markets made him modest in his ambitions and willing to be satisfied with half a loaf rather than none. His belief in compromise as a guiding principle of politics stems from these experiences.

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5. After the war, Takeshita completed his studies at Waseda and then returned to his home village where he taught English in the local Junior High School. His pupils can have made little progress since to this day Takeshita's spoken English, as he would be the first to admit, is almost non-existent. He regarded teaching more as a means of earning a living than as a vocation. While at Waseda, he had already become active in politics. His desire to play a part in public life was spurred by his shock at the flood damage in his village caused by indiscriminate deforestation during the war. On his return to Kakeya, he concentrated his energies on his village branch of the Youth League, a national organisation set up to help with the task of post-war reconstruction in the countryside. By 1951, at the age of 27, he had become the Chairman of the Shimane Prefectural Youth League and in that year was elected to the Prefectural Council. Takeshita served for seven years on the Council. He spoke rarely in council meetings but was assiduous in using his position in the Youth League to build up contacts throughout the prefecture. Thus, when he ran for the Diet for the first time in 1958, he received the highest number of votes of the LDP members elected from Shimane. In the process he displaced from the top of the list Sakurauchi, a former Foreign Minister, who is now Chairman of the Nakasone faction (and of the Japan/British Parliamentarians League).

6. Takeshita is the first leader of his party to have entered Parliament after the Liberal/Democratic Parties and merged in 1955 to form the present Liberal Democratic Party (LDP). Unlike his predecessors as party leader, his approach to politics is therefore not coloured by any earlier political affiliations. Nor has he known a time when the LDP has been out of office. On being elected to the Diet (in the same year as his friend and rival, former Foreign Minister Abe), Takeshita gravitated to the faction led by Eisaku Sato. This was a logical choice since Sato too came from Western Japan. In the Sato faction, Takeshita quickly struck up a close friendship with Shin Kanemaru, who although ten years older, had entered the Diet at the same election. This relationship was subsequently sealed by the marriage of the oldest of Takeshita's three daughters (his only son died after being born prematurely) to Kanemaru's oldest son. Kanemaru, a wily political tactician, who was Takeshita's predecessor as Secretary General of the LDP and Deputy Prime Minister in the outgoing Nakasone government, has acted as Takeshita's political mentor and principal advisor in his quest for the party leadership. He has taken over as Chairman of the faction now that Takeshita has become Prime Minister.

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7. Takeshita's early parliamentary career followed the classic pattern of an ambitious young politician. In 1963, five years after entering the Diet, he had his first taste of office when he served for a year as Parliamentary Vice Minister at MITI. Such posts are allocated to young politicians on a rotation basis. They carry few responsibilities for policy but give their occupants the opportunity to learn at first hand how the Japanese civil service operates. As Parliamentary Vice Minister, younger politicians act as a conduit between the Government and the LDP in parliament. It is in this area that Takeshita has won his reputation as a skilled operator of the Japanese political system. He first distinguished himself in 1964 as Deputy Chief Cabinet Secretary (a junior Ministerial post) under Prime Minister Sato when he played an important role in the liaison between the government as a whole and LDP members of the Diet. He had a further chance to develop his talents as a parliamentary manager while subsequently serving for an unusually long period between 1966 and 1971 as Deputy Chairman of the LDP's Diet Affairs Committee, the equivalent of Deputy Chief Whip. As a result, he accumulated an encyclopedic knowledge of his party and of civil servants in key positions in the bureaucracy. Takeshita has put this to good use in building up his own power base within the LDP. He knows better than anyone to whom to turn to get problems solved. His experience in the Whip's office also enabled him to establish close relations with leading members of the Opposition parties. Nakasone felt that Takeshita was too ready to make concessions to the Opposition. But in consequence they may not give the new Prime Minister as rough a ride in the Diet as they have given Nakasone.

8. The crowning achievement of his early career, and his happiest moment prior to his designation as Party leader, was his appointment in 1971 as Chief Cabinet Secretary in the last Sato Cabinet, a post he held again in 1974 under Prime Minister Tanaka. Takeshita is fond of pointing out that he reached this post at exactly the same age (47 years) as Sato became Cabinet Secretary in the post-war Yoshida government. He admits that it was at this point that he first began seriously to set his sights on becoming Prime Minister. After Sato's retirement, Takeshita joined the Tanaka faction. Although he served as a prominent member of Tanaka's early government, his reputation was unscathed when Tanaka was forced out of office on account of criticism of his dubious financial dealings culminating in his involvement in the Lockheed scandal. Takeshita served as Construction Minister in 1976 in the subsequent Miki government, a post he exploited to good effect to forge close links with the building industry.

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9. Political contributions from the construction industry are today an important source of funds for Takeshita and his faction. His youngest daughter is married to the heir of Takenaka Komuten, one of Japan's largest privately owned construction companies. Given the importance which money plays in Japanese politics, such links are a valuable asset for an aspiring politician of limited personal means. As a result of these contacts and of those established later with the financial community when he served as Finance Minister from 1979-80 and again 1982-86, Takeshita now declares an annual income from political contributions of just under ¥1 billion (around £4.28 million). In May, on the eve of his bid for the Presidency of the LDP, he was able to hold a fundraising party for which 40,000 tickets were sold at ¥30,000 a head to bring in, with additional contributions, an income for the evening of nearly ¥2 billion.

10. During his two stints as Minister of Finance Takeshita won the respect of his civil servants. He was not very articulate in public, but was incisive and effective when talking on a one-to-one basis. At set-piece meetings with senior officials in the Ministry Takeshita would merely ask a few simple questions: but later he would summon those responsible for specific policies and grill them to ensure that they had been fully thought out. At international gatherings, he was hampered by his lack of English and by his inexperience of foreign affairs. He listens to, and is prepared to follow, the advice of experts: unlike his rival Miyazawa, he adopts a pragmatic approach, unhindered by any economic or political dogma.

11. Takeshita's period in office as Finance Minister was marked by some major economic and financial milestones, including the Plaza agreement of September 1985. He presided over the establishment of the Yen/Dollar Committee in 1984 (and of our own series of bilateral consultations). These significantly increased the rate of liberalisation of the financial market in Japan. Takeshita claims credit, probably with some justification, for balancing the international pressure for liberalisation with domestic interests, even though from our point of view the pace of that liberalisation was too slow, particularly in the early stages.

12. In the late 1970s and early 1980s, party preferment continued to come Takeshita's way but his relations with former Prime Minister Tanaka began to sour. Tanaka increasingly saw Takeshita as a threat to his control of his faction while the latter saw the former as an obstacle to his own ambitions. For a long time Takeshita moved very cautiously, reluctant to take any step which would be interpreted as disloyalty. But gradually he built up support among a group of younger Tanaka faction members impatient at their faction's inability to field a candidate for the party leadership so long as the former disgraced Prime Minister continued to lead the faction.

/Takeshita

Takeshita did not make his first overt move until February 1985 when he launched the Soseikai, nominally a study group within the Tanaka faction. When Tanaka's supporters blamed Takeshita's disloyalty for their leader's subsequent stroke, Takeshita refrained, at least on the surface, from pushing ahead with his bid to take over the faction. It was not until former Deputy Prime Minister Nikaido, the caretaker Chairman of the Tanaka faction, declared his own candidature for the Presidency of the LDP in May this year without consulting his colleagues that Takeshita felt able to take the decisive step and to declare his independence of the Tanaka faction. With characteristic modesty, Takeshita rejected suggestions from his supporters that his new faction should be given a title derived from the ideographs in his own name. Instead, the faction was christened the Keiseikai, a classical Chinese term denoting an association of statesmen devoted to serving the public good.

13. This episode, and Takeshita's subsequent campaign for the party presidency, are revealing about his political style. Takeshita regards Prime Minister Sato, who was renowned for his patience and for his skill in handling people and political appointments, as his role model. Symbolically, at the request of Sato's widow, Takeshita moved into Sato's former house in Tokyo on the eve of his designation as party leader. Unlike Prime Minister Nakasone, who has practised an assertive style of leadership, Takeshita prefers to wait for decisions "to ripen like a persimmon". When the fruit is ready to be eaten, it falls naturally to the ground. He considers patience to be the greatest virtue and prides himself for never having lost his temper or spoken a word in anger. Like Sato, he listens carefully to all sides of an argument without revealing his own views. Takeshita jokes that God gave man two ears but only one mouth. He is tolerant. He believes that the LDP as the governing party must take account of the views of others. The larger the LDP's majority the greater the need to give the minority a chance to express its views. Only when he judges that a consensus has emerged does he commit himself to a particular course of action.

14. Not surprisingly, this approach to politics has opened Takeshita to the criticism, even from within his own party, of being indecisive. Characteristically, Takeshita has acknowledged that this is a potential weakness, particularly in the handling of foreign affairs, but he and his supporters also maintain that it is a strength in the context of Japanese domestic politics. They argue, not without reason, that in Japan attempts to ride roughshod over vested interests are doomed to failure. The Government needs patience and perseverence to wear away the opposition. Takeshita's supporters claim that his dogged determination to build up his faction to 118 members, the largest in the LDP, and to use this base to capture the leadership of the Party indicate that he does not lack the resolution necessary

/to

to solve difficult problems. There have however been times in the last few months when Takeshita has appeared nervous and lacking in self confidence, as if he were overwhelmed by the tasks ahead. The strains showed most clearly in the Spring of this year when he was simultaneously trying to consolidate his position as faction leader and to pilot the sales tax through the Diet. At this point he began to develop a bald patch. It is a measure of public affection for him that he was inundated with sufficient patent hair restorers to open a chemist's shop.

15. Takeshita's political style accords well with his personal modesty and his conception of the role of a Japanese political leader. He has no illusions about his own importance. His appointment as Party President was overshadowed in the Japanese press by news of the forthcoming US/Soviet Summit. When asked about this, Takeshita commented that this was just as it should be. Unlike Nakasone he is not a practitioner of the politics of conviction. Rather he conceives his function as Party leader as being to act as a bridge between the ideas generated in the bureaucracy, the interests represented by the LDP, and public opinion. He accepts that politicians have a responsibility to attempt to educate public opinion, for example in the realities of Japan's position in the international community, but considers that ultimately decisions can only be taken within the broad national consensus. In his view, a leader should stay half a step ahead of the consensus; he must never become divorced from it.

16. Takeshita's belief that the Prime Minister should act as a mediator partly explains why his manifesto for the party leadership was so devoid of specific policy proposals. His call for the pursuit of a new "diplomacy of sincerity", "polycentric national development" and the "fostering of human resources and industry for the twenty first century" gives little indication of the priorities of the new Government or how its objectives are to be achieved. In interviews, Takeshita has been somewhat more explicit in identifying land pricing policy, tax reform and US/Japan relations as his principal concerns. Although the manifesto made no mention of relations with Europe, in speaking to the press Takeshita has also recognised the need to take account of Japan/EC economic relations. But so far he has not spelt out how he intended to follow, especially in foreign affairs, the broad policy guidelines set under Prime Minister Nakasone. The decisive part played by Nakasone in securing the nomination for Takeshita will in any case enhance Nakasone's ability to influence the direction of the policies of the Takeshita government.

/17.

17. Under Takeshita's leadership, Japan is unlikely to take bold initiatives. In foreign affairs, the definition of Japan's policies may become less clear-cut. In Japan, Takeshita is regarded as a fluent speaker but an obfuscator of his true intentions. High flown phrases, which sound well in Japanese, can look hollow and meaningless when translated into English. No Japanese Prime Minister can now ignore the rest of the world. But Takeshita is likely to place greater emphasis than Nakasone on the consolidation of policies at home. This may be no bad thing insofar as the steps Japan needs to take to restructure her economy require the Government to overcome the forces of domestic resistance. With a strong base in the Party and years of experience at manoeuvring through the labyrinth of the Japanese political system, Takeshita may be better placed than Nakasone to implement the domestic economic and social reforms that his predecessors, and Japan's partners, judge to be necessary. For all his success in projecting an image of resolution abroad, Nakasone never enjoyed sufficient preeminence at home to enable him to put his policies fully into practice. As against this there is a risk that Japanese bureaucrats, who are themselves no mean political infighters, may attempt to exploit Takeshita's preference for agreed solutions to block progress on issues of direct concern to their ministries. Takeshita's lack of original ideas may make him a less stimulating interlocutor for his western counterparts. But he does have an impish sense of humour. He is less wooden than former Foreign Minister Abe; and he does not have the intellectual arrogance of Finance Minister Miyazawa. His readiness to listen and to work to solve problems could be turned to our advantage.

18. I am copying this despatch to the Chancellor of the Exchequer, the Secretary of State for Trade and Industry, HM Representatives in Washington, Bonn, Paris, Seoul, Peking, Ottawa, Rome and UKREP Brussels, the Governor of Hong Kong and HM Consul-General in Osaka.

I am, Sir,
Yours faithfully

John Whitehead

John Whitehead

TAKESHITA, NOBORU

1924	Born in the village of Kakeya, Shimane Prefecture
1930	Kakeya Primary School
1936	Matsue High School
1942	Faculty of Commerce, Waseda University, Tokyo
1944	Army Aviation Corps
1945	Demobilised from the Army as a Second Lieutenant. Returned to Waseda
1947	Graduated from Waseda. Taught English at Kakeya Middle School
1951	Elected to Shimane Prefectural Assembly
1958	Elected to the Diet as one of 5 members of parliament for Shimane
1963	Parliamentary Vice Minister, MITI
1964	Deputy Cabinet Secretary under Prime Minister Sato
1965-1971	Deputy Chairman of the LDP Diet Affairs Committee
1971	Chief Cabinet Secretary in the last Sato Cabinet
1972	Deputy Secretary General of the LDP
1974	Chief Cabinet Secretary under Prime Minister Tanaka
1976	Minister of Construction under Prime Minister Miki
1976	Chairman of the LDP National Organisation Committee
1978	Chairman of the Budget Committee in the House of Representatives
1979	Minister of Finance under Prime Minister Ohira
1980	Chairman of the LDP Electoral System Research Committee
1981	Acting Secretary General of the LDP
1982-1986	Minister of Finance under Prime Minister Nakasone

/1985

1985	Launched Soseikai study group
1986	Secretary General of the LDP
1987	Formation of the Keiseikai (Takeshita faction)
	Elected President of the LDP and Prime Minister

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10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

22 October, 1987.

THE SUCCESSION TO PRIME MINISTER NAKASONE

Thank you for your letter of 21 October about the election of Mr. Takeshita to be leader of the Liberal Democratic Party. I do not think that the Prime Minister will want to send a message to Mr. Takeshita at this stage. We will reserve it until his election as Prime Minister.

(C.D. Powell)

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

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(2)

Foreign and Commonwealth Office

London SW1A 2AH

21 October 1987

Prime Minister

CDP

21/x

Dear Charles

The Succession to Prime Minister Nakasone

The Prime Minister will have seen reports that the new leader of Japan's ruling Liberal Democratic Party (LDP) is to be Mr Takeshita, currently the LDP Secretary General. In the absence of a consensus within the party the choice was eventually made personally by Mr Nakasone. I enclose two telegrams from our Embassy in Tokyo which give the background to Mr Takeshita's selection and some biographical details. Mr Nakasone's role in his successor's selection will ensure that he retains considerable behind-the-scenes influence. Mr Takeshita's policies are likely to be similar to Mr Nakasone's.

Mr Takeshita will not be formally confirmed as President of the LDP until 31 October and he will not become Prime Minister until elected by an extraordinary session of the Diet expected to take place on 6 or 7 November. A formal message of congratulations from the Prime Minister as Head of the Government to Mr Takeshita should await his election as Prime Minister. We shall be providing further advice on this together with a draft message to Mr Nakasone shortly.

The Prime Minister might, however, wish to consider sending a brief message to Mr Takeshita on Party channels congratulating him on becoming President-designate of the LDP. (We understand that President Reagan will be telephoning his congratulations.)

Do you wish to pursue this?

I would rather wait until he is P.M.

MT

Yours ever

Arthur Culshaw

(R N Culshaw)
Private Secretary

C D Powell Esq
PS/No 10 Downing Street

(5)

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MY TELNO 811 TO FCO: THE NEW LEADER OF THE LDP: NOBORU TAKESHITA

1. TAKESHITA IS A FIT 63, LEAN, DIMINUTIVE,
HE COMES FROM A SAKE BREWERS IN THE RURAL PREFECTURE OF SHIMANE ON THE JAPAN SEA COAST OF WESTERN JAPAN. AFTER GRADUATING FROM WASEDA, A PRESTIGIOUS PRIVATE UNIVERSITY IN TOKYO, WHERE HE HAD HIS FIRST TASTE OF POLITICS, HE TOOK UP A SCHOOL TEACHING POST IN HIS HOME PREFECTURE. TAKESHITA GRADUATED FROM LOCAL POLITICS INTO THE DIET IN 1958, ONE OF THE FEW JAPANESE POLITICIANS TO HAVE DONE SO SUCCESSFULLY. SINCE THEN HE HAS BEEN RETURNED AS AN LDP MEMBERS FOR SHIMANE ELEVEN TIMES. ALTHOUGH TAKESHITA HAS BEEN ENGAGED IN NATIONAL POLITICS FOR MORE THAN 30 YEARS, HE HAS NEVER LOST TOUCH WITH HIS PROVINCIAL ROOTS. THE OPINION POLLS SHOW THAT TAKESHITA IS MOST HIGHLY REGARDED BY THOSE LIVING IN THE RURAL AREAS.

2. TAKESHITA FIRST SERVED IN THE CABINET AS CHIEF CABINET SECRETARY FROM 1971-2 UNDER PRIME MINISTER SATO. HE STILL LIKES TO DESCRIBE HIMSELF AS A FOLLOWER OF SATO, JAPAN'S LONGEST SERVING POST-WAR PRIME MINISTER. HIS PATIENT, PERSEVERING APPROACH TO POLITICS BEARS THE HALLMARK OF SATO'S INFLUENCE. FOR A PRIME MINISTER,
TAKESHITA'S PREVIOUS MINISTERIAL EXPERIENCE HAS BEEN RELATIVELY LIMITED, APART FROM A SPELL AS CONSTRUCTION MINISTER (WHICH HE HAS PUT TO GOOD EFFECT TO KEEP HIS FACTION'S COFFERS WELL LINED). HIS PRINCIPAL MINISTERIAL POST HAS BEEN AS MINISTER OF FINANCE FROM 1979-80 AND FROM 1982-1986. WHAT EXPERIENCE HE HAS HAD IN DEALING WITH FOREIGN GOVERNMENTS WAS LARGELY GAINED DURING HIS TWO STINTS AS FINANCE MINISTER.

3. NO-ONE WOULD CLAIM THAT TAKESHITA IS AN ORIGINAL POLICY THINKER. HE HAS RISEN TO THE TOP OF JAPANESE POLITICS NOT AS A RESULT OF HIS IDEAS BUT BECAUSE OF HIS ABILITY TO OPERATE THE POLITICAL SYSTEM. OFFICIALS DO NOT GO TO TAKESHITA, AS THEY WOULD TO MIYAZAWA OR EVEN TO ABE, TO RECEIVE ADVICE ABOUT POLICY. BUT TAKESHITA IS PREEMINENT IN HIS ABILITY TO FIND POLITICAL SOLUTIONS TO PROBLEMS

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WHICH OTHERS HAVE DEFINED. WHEREAS NAKASONE HAS LED FROM THE FRONT WITH HIS OWN POLICIES, TAKESHITA IS MORE LIKELY TO ATTEMPT TO GOVERN BY DEPLOYING HIS SKILL AT RECONCILING CONFLICTING INTERESTS GENERATED BY THE IDEAS OF OTHERS.

4. IT WOULD HOWEVER BE WRONG TO WRITE TAKESHITA OFF AS SIMPLY A POLITICAL MANIPULATOR. OVER THE PAST TWO YEARS HE HAS SHOWN CONSIDERABLE POLITICAL COURAGE, AND A FINE SINSE OF TIMING, IN HIS EFFORTS TO WREST CONTROL OF HIS FACTION STILL NOMINALLY LED BY FORMER PRIME MINISTER TANAKA. HIS DETERMINATION TO CARRY THROUGH HIS BID FOR THE LEADERSHIP FIRST OF HIS FACTION AND THEN OF HIS PARTY SUGGESTS THAT HIS TENACITY IS NOT TO BE UNDERESTIMATED.

5. JAPAN'S POLICIES UNDER TAKESHITA'S LEADERSHIP ARE UNLIKELY TO DIFFER MUCH FROM THOSE PURSUED BY PRIME MINISTER NAKASONE. NAKASONE'S BELIEF THAT TAKESHITA WOULD TREAT HIS POLITICAL LEGACY WITH RESPECT APPEARS TO HAVE WEIGHED HEAVILY IN HIS CHOICE OF SUCCESSOR. TO MAXIMISE THE CHANCES OF NAKASONE'S SUPPORT, TAKESHITA PERSONALLY EXCISED FROM THE DRAFT MANIFESTO PREPARED FOR HIM BY HIS POLICY ADVISERS ANY IDEAS WHICH COULD HAVE BEEN INTERPRETED AS BEING CRITICAL OF NAKASONE'S POLICIES. THE RESULTING DOCUMENT IS AN ANODYNE, IF UNEXCEPTAIONABLE, STATEMENT OF THE NEED TO RECONCILE JAPAN'S FOREIGN AND DOMESTIC POLICIES.

6. TAKESHITA AT THE HELM, JAPAN IS UNLIKELY TO PRESENT HER PARTNERS WITH ANY SURPRISES. BUT THE PRESENTATION OF JAPANESE POLICIES IS LIKELY TO BE LESS CLEAR-CUT. THE DANGER IS THAT JAPAN WILL ONCE AGAIN APPEAR INSCRUTABLE AFTER A BREATH OF FRESH AIR DURING THE NAKASONE YEARS. AGAINST THIS, THERE IS A REAL POSSIBILITY THAT TAKESHITA WILL BE BETTER PLACED THAN NAKASONE, WHO HAS NEVER BEEN FULLY TRUSTED BY HIS PARTY, TO CARRY THROUGH HIS POLICIES. ON SUCH ISSUES AS ECONOMIC STRUCTURAL CHANGE, WHAT IS REQUIRED IS NOT SO MUCH A NEW DIRECTION AS THE ABILITY TO TURN THE BLUEPRINTS INTO REALITY. TAKESHITA, FOR ALL HIS SHORTCOMINGS AS A LEADER IN THE WESTERN MOULD, MAY BE THE RIGHT MAN FOR SUCH A TASK.

7. SEE MIFT (NOT TO ALL).

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MY TELNO 809: THE SUCCESSION TO PRIME MINISTER NAKASONE

SUMMARY

1. PRIME MINISTER NAKASONE HAS DESIGNATED LDP SECRETARY GENERAL TAKESHITA AS HIS SUCCESSOR. IN THE INTERESTS OF PARTY UNITY, FORMER FOREIGN MINISTER ABE AND FINANCE MINISTER MIYAZAWA HAVE WITHDRAWN AND WILL SUPPORT THE NEW GOVERNMENT TO BE FORMED AROUND 6 NOVEMBER.

DETAIL

2. MARATHON NEGOTIATIONS THROUGHOUT 19 OCTOBER FAILED TO PRODUCE AGREEMENT BETWEEN THE THREE CANIDATES ON WHICH OF THEM SHOULD SUCCEED NAKASONE. RATHER THEN SETTLE THE MATTER BY A VOTE, THEY DECIDED TO ASK NAKASONE TO ARBITRATE. SHORTLY AFTER MIDNIGHT, NAKASONE INFORMED THE PARTY LEADERSHIP BY LETTER THAT IN HIS VIEW TAKESHPTA WAS BEST PLACED TO LEAD A STABLE GOVERNMENT BACKED BY A UNITED PARTY AND CAPABLE OF TACKLING THE FOREIGN AND DOMESTIC PROBLEMS FACING JAPAN. TO DEMONSTRATE THAT THE CAMPAIGN FOR THE LEADERSHIP HAD LEFT NO SCARS, NAKASONE CALLED ON TAKESHITA TO APPOINT HIS DEFEATED RIVALS AS DEPUTY PRIME MINISTER AND PARTY SECRETARY GENERAL. TAKESHITA SOURCES HAVE SUGGESTED THAT THE NEW LEADER WILL GIVE THESE POSTS TO MIYAZAWA AND ABE RESPECTIVELY.

3. UNTIL NAKASONE'S LETTER WAS OPENED AT PARTY HEADQUARTERS, THE CHOICE OF HIS SUCCESSOR HUNG IN THE BALANCE. FOR MANY MONTHS TAKESHITA HAD SEEMED TO BE THE FRONT-RUNNER, WITH THE LARGEST NUMBER OF VOTES, THE MOST MONEY AND THE BEST ORGANIZATION BEHIND HIM. BIT IN THE LAST DAY OR SO ABE WAS GENERALLY RECKONED TO HAVE COME UP STRONGLY AND AT THE LAST MOMENT POLITICAL COMMENTATORS WERE TIPPING HIM AS THE BEST COMPROMISE CANDIDATE. NAKASONE EVIDENTLY DECIDED HOWEVER THAT TAKESHITA, AS THE LEADER OF THE LARGEST FACTION, AND WITH THE PROSPECT OF ADDITIONAL SUPPORT FROM OUTSIDE HIS OWN FACTION, WAS THE BEST PLACED TO PROVIDE THE FOUNDATIONS OF A STABLE GOVERNMENT. NAKASONE HAS LONG MADE IT CLEAR THAT HE WOULD FAVOUR AS HIS SUCCESSOR THE CANDIDATE MOST PREPARED

TO FOLLOW HIS FOREIGN AND DOMESTIC POLICIES. DURING THEIR RECENT MEETINGS TAKESHITA MUST HAVE SATISFIED NAKASONE ON THIS SCORE. CERTAINLY, THERE WAS NOTHING IN TAKESHITA'S VAGUELY WORDED MANIFESTO WHICH SET HIM AT ODDS WITH NAKASONE. NEWSPAPER REPORTS SUGGEST THAT TAKESHITA HAS UNDERTAKEN TO CONSULT CLOSELY WITH NAKASONE ON FOREIGN AFFAIRS TO COMPENSATE FOR HIS OWN LACK OF EXPERIENCE IN THIS AREA.

4. ALTHOUGH NAKASONE WAS GIVEN A FREE HAND IN THE CHOICE OF HIS SUCCESSOR, IT IS LIKELY THAT HIS DECISION WAS INFLUENCED BY THE BARGAINING BEHIND CLOSED DOORS OVER THE PAST FEW WEEKS. IT WILL BE SOME TIME, IF EVER, BEFORE IT BECOMS APPARENT WHETHER ANY DEAL WAS STRUCK BETWEEN TAKESHITA AND NAKASONE. BUT IT WOULD BE SURPRISING IF TAKESHITA HAD NOT PROMISED TO PAY A PRICE FOR NAKASONE'S SUPPORT. WHEN NAKASONE OPTED FOR TAKESHITA, HE DOUBTLESS TOOK INTO ACCOUNT THE ROLE PLAYED BY THE FORMER TANAKA FACTION, THE OVERWHELMING MAJORITY OF WHOM NOW SUPPORT TAKESHITA, IN HELPING HIM TO BECOME PRIME MINISTER FIVE YEARS AGO AND IN SUSTAINING HIM IN OFFICE. IN JAPANESE POLITICAL TERMS IT WOULD HAVE BEEN DIFFICULT FOR NAKASONE TO IGNORE HIS POLITICAL DEBT TO TAKESHITA.

5. TAKESHITA WILL BE FORMALLY CONFIRMED AS PRESIDENT OF THE LDP AT A SPECIAL PARTY CONGRESS ON 31 OCTOBER. HE WILL NOT BECOME PRIME MINISTER UNTIL ELECTED BY AN EXTRAORDINARY SESSION OF THE DIET EXPECTED TO BE HELD ON 6 OR 7 NOVEMBER. THE NEW CABINET IS LIKELY TO BE ANNOUNCED SHORTLY THEREAFTER.

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Nakasone will remain PM until 6/7.

191224Z

PS/No 10 Downing St

COMMENT

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INFO ROUTINE OTTER

MY TELNO 785: THE SUCCESSION TO MR NAKASONE

SUMMARY

1. NO CONSENSUS HAS YET BEEN REACHED ON A SUCCESSOR TO PRIME MINISTER NAKASONE. A VOTE BY THE PARLIAMENTARY LDP ON 20 OCTOBER LOOKS INCREASINGLY UNAVOIDABLE. ALTHOUGH STILL NOMINALLY IN ALLIANCE WITH LDP SECRETARY GENERAL TAKESHITA, FORMER FOREIGN MINISTER ABE HAS BEGUN TO EMERGE AS HIS STRONGEST RIVAL.

DETAIL

2. SINCE NOMINATIONS CLOSED ON 8 OCTOBER, THE THREE CANDIDATES TO SUCCEED PRIME MINISTER NAKASONE (LDP SECRETARY GENERAL TAKESHITA, FORMER FOREIGN MINISTER ABE AND FINANCE MINISTER MIYAZAWA) HAVE MET THREE TIMES IN AN EFFORT TO REACH AGREEMENT BETWEEN THEMSELVES ON WHO SHOULD BE THE NEXT PARTY LEADER WITHOUT THE NEED FOR AN ELECTION BY LDP MEMBERS OF THE DIET SCHEDULED FOR 20 OCTOBER. THESE CONSULTATIONS HAVE MADE LITTLE HEADWAY. NONE OF THE CANDIDATES HAS FELT UNDER SUFFICIENT PRESSURE TO STAND DOWN.

3. CONFIDENT THAT HE HAS THE BACKING OF THE BIGGER (AND RICHER) BATTALIONS, TAKESHITA CONTINUES TO INSIST THAT, IF NECESSARY, THE DECISION SHOULD BE PUT TO THE VOTE. MIYAZAWA PLACES HIS FAITH IN THE INTERVENTION OF NAKASONE AND THE PARTY ELDERS TO SAVE THE LDP FROM THE DIVISIVE CONSEQUENCES OF AN ELECTION. ABE'S STRATEGY IS MORE COMPLICATED. HE LOOKS TO HIS ALLIANCE WITH TAKESHITA TO SEE OFF THE CHALLENGE FROM MIYAZAWA. BUT ABE HOPES THAT IF MIYAZAWA CONCLUDES THAT HIS OWN CHANCES OF VICTORY ARE SLIM, HE WILL PREFER TO BACK ABE RATHER THAN TAKESHITA. ABE COUNTS ON NAKASONE TO FALL IN WITH THIS STRATEGY AS THE BEST MEANS OF PRESERVING PARTY UNITY AND HIS OWN INFLUENCE WITHIN THE PARTY.

4. TAKESHITA REMAINS THE MAN TO BEAT. HIS NUMERICAL ADVANTAGE AS THE LEADER OF THE LARGEST FACTION IS A FORMIDABLE ASSET. BUT THE PRESENT FACTIONAL BALANCE WITHIN THE LDP HAS CREATED GREATER FLUIDITY THAN IN RECENT LEADERSHIP CONTESTS. THE NEED FOR A MINIMUM OF THREE FACTIONS TO STRIKE A BARGAIN TO SECURE A MAJORITY INCREASES THE SCOPE FOR INTER-FACTIONAL BARGAINING. ARITHMETICALLY ANY ONE OF 10 POSSIBLE COMBINATIONS OF THE FIVE FACTIONS COULD PRODUCE A MAJORITY. IF , AS SEEMS LIKELY, TAKESHITA AND ABE ARE UNABLE TO AGREE TO POOL THEIR SUPPORT, THE SEARCH FOR A MAJORITY COALITION COULD TAKE SOME UNEXPECTED TURNS. AS ABE HAS FEWER ENEMIES IN THE PARTY THAN EITHER TAKESHITA OR MIYAZAWA, HE STANDS TO GAIN FROM A MORE OPEN CONTEST. SINCE LDP FACTIONAL POLITICS REVOLVES ROUND POWER NOT

MR BRAITHWAITE 1
MR GILLMORE 1
MR BOYD 1
MR KERR 1
MR MAUD 1
MR SLATER 1
MISS PESTELL 1
MR FEARN 1
MR MCLAREN 1
MR FALL 2
ADDITIONAL 44
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DTI 1

[LARTER]

POLICIES, SWITCHES OF ALLIANCE ARE LITTLE INFLUENCED BY PRINCIPLES. MONEY AND THE PROMISE OF OFFICE WILL HAVE GREATER BEARING ON THE OUTCOME THAN ANY REQUIREMENT TO NEGOTIATE COMMON POLICY PLATFORMS. THE MINORITY FACTIONS CAN THEREFORE PUT A HIGH PRICE ON THEIR SUPPORT. THE 31 MAN KOMOTO FACTION, WHICH IS BEING WOOED ASSIDUOUSLY BY BOTH TAKESHITA AND ABE, IS REPORTED TO HAVE RAISED OVER POUNDS 3 MILLION AT A SINGLE RECEPTION ON 14 OCTOBER.

5. THE THREE CANDIDATES ARE COMMITTED TO CONTINUE THEIR EFFORTS TO REACH A CONSENSUS AMONG THEMSELVES UNTIL THE BALLOT ON 20 OCTOBER. THEY HAVE AGREED TO REPORT ON THEIR PROGRESS (OR LACK OF IT) TO THE PARTY LEADERSHIP ON 16 OCTOBER. THEY PLAN FURTHER TRIPARTITE MEETING ON 17 OCTOBER. IF A VOTE IS EVENTUALLY HELD, THE ORDER OF THE CANDIDATES ON THE FIRST ROUND WILL BE CRUCIAL SINCE THE BOTTOM CANDIDATE WILL BE ELIMINATED. ON THE BASIS OF THEIR OWN FACTIONAL STRENGTH THE ORDER IS TAKESHITA, MIYAZAWA, ABE. IT IS ARITHMETICALLY POSSIBLE, BUT POLITICALLY UNLI UNLIKELY, THAT TAKESHITA COULD BE ELIMINATED ON THE FIRST ROUND. THE MOST LIKELY SCENARIO IS A RUN-OFF BETWEEN TAKESHITA AND EITHER ABE OR MIYAZAWA. AT PRESENT, ABE LOOKS THE MORE THREATENING CHALLENGER. OVER THE PAST WEEK HE HAS DISPLAYED GROWING SELF-CONFIDENCE. BUT ANYTHING COULD STILL HAPPEN BETWEEN NOW AND 20 OCTOBER.

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By Bag.

FROM TOKYO TO FCO

(CULL)

TELNO 6 SAVING

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Addressed to FCO Telegram 6 Saving of 8 July 1987

Repeated for information to:

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MF

JAPAN: ECONOMIC REPORT: JUNE 1987

- Following the package of emergency economic measures announced at the end of May, the government will be introducing a Y2.08 trillion (£8.7 billion) supplementary budget and proposals for about Y1.3 trillion of tax cuts to a special session of the Diet that began on 6 July. It is expected that the budget and tax cuts will be passed with little opposition: proposals to abolish tax exemption for small savings, part of the original tax reform package, may prove more controversial (paras 24-29).

- Real GNP grew by 1.2% in the first quarter of 1987 - more strongly than expected, and considerably faster than in 1986. Consumer spending recovered to grow by 1.8%, and net external demand also increased as imports declined and exports grew rapidly (the latter partly the result of special factors) (paras 1-4).

- Commentators are now taking a more optimistic view of the outlook for the economy, at least over the next fiscal year. The JERC has forecast real GNP growth in FY 1987 at 3.2%, only 0.3% below the official Government target (paras 30-33).

- Nevertheless, industrial production fell by 0.6% in May, for the second consecutive month. MITI is forecasting a rapid recovery in June (para 5).

- The seasonally-adjusted unemployment rate rose to a new record of 3.3% in May (para 10).

- The seasonally-adjusted trade and current account balances fell to $8.0 billion and $7.1 billion respectively in May. The figures are now well down from the record levels of $9.6 billion for the trade balance and $8.8 billion for the current account balance, seen in January this year (para 14).

- The broadly defined measure of the money supply rose by 10.2% year-on-year in May, contributing to some upward pressure on interest rates and weakness in the bond markets (para 19).

- The yen continued to fall gradually against the dollar closing at Y147 at the end of June (para 20).

/GNP

GNP DATA (TABLE I)

TABLE I: GROSS NATIONAL EXPENDITURE

(Real, seasonally-adjusted, base year = CY 1980)

Percentage change over the preceding period

	FISCAL YEAR			QUARTER ENDING				
				1986				1987
	1984/5	1985/6	1986/7	MARCH	JUNE	SEPT	DEC	MARCH
Consumers' Expenditure	2.6	2.6	3.0	0.4	1.2	1.3	-0.7	1.8
Private Housing	0.5	2.9	13.1	1.5	3.3	7.0	4.9	0.6
Private Investment	11.4	12.9	4.8	0.3	0.4	0.5	2.1	2.3
Private Inventories	95.4	8.7	-59.7	-20.5	-63.0	43.9	46.8	-74.8
Government Current Expenditure	2.6	1.9	6.8	0.9	0.4	1.2	14.3	-10.9
Government Capital Expenditure	- 2.9	-6.4	7.3	0.3	3.6	1.8	1.1	1.0
Government Inventories	na	79.1	177.1	-93.5	8,119.9	-44.8	-204.0	
External (Net)	48.8	19.9	-36.6	-13.0	-27.8	-10.5	6.9	21.3
Exports	15.5	1.8	-3.2	-3.3	1.6	-0.8	-1.0	2.0
Imports	9.8	-2.4	6.3	-0.4	9.1	0.9	-2.2	-1.2
GNE (Percentage change)	5.1	4.3	2.6	-0.4	0.9	0.7	0.7	1.2
GNE (Y Billion)	281,256.2	293,332.7	300,887.2	294,483.4	297,230.1	299,438.0	301,619.4	305,263.1
Memo item: Nominal GNE	6.7	5.9	4.1	-0.1	1.9	1.0	0.5	0.7
(Y Billion)	303,019.8	320,774.8	334,025.8	324,076.8	330,161.7	333,415.3	335,199.3	337,658.4

1. Seasonally-adjusted real GNP grew by 1.2% in the three months ending March 1987 - rather more rapidly than expected, and a strong recovery from the depressed levels seen in calendar 1986. At an annualised rate growth was 4.9%.

12.

Ref. A087/1510

MR POWELL

Prime Minister
The question is:
how much of this is
genuinely new?
CDJ
29/5

The Japanese Government have today announced a programme of "emergency economic measures" to stimulate Japanese domestic demand, increase imports, improve access to the Japanese markets, and increase the Japanese contribution to development in the developing countries.

2. I attach copies of papers which the Japanese Ambassador is distributing in London on this subject. The most useful of them, for quick reading, is the one entitled 'Comments on Emergency Economic Measures'.

3. The content of the package for the expansion of domestic demand has now increased from Y5 trillion to Y6 trillion, of which Y1 trillion is described as income and other tax cuts. It is implied that over 90 per cent of the measures will be effective in the fiscal year 1987/88 (which coincides with our financial year).

4. I understand that it is proposed that the supplementary budget required to give effect to these measures should be introduced in a special session of the Diet beginning early in July; this budget should be passed by about the middle of August.

5. I took the opportunity of a meeting with the Japanese Ambassador this afternoon to ask him a number of questions in more detail about these measures, and about the extent to which they were truly additional; but it was clear that he had had no more briefing than the papers themselves provide.

RA

ROBERT ARMSTRONG

29 May 1987

2

Comments on Emergency Economic Measures

May 29, 1987

The government of Japan decided on a special package of Emergency Economic Measures at the May 29 Ministerial Conference for Economic Measures.

This eleven-point package of Emergency Economic Measures, a concrete statement of specific government policies and policy measures, is in line with the Liberal Democratic Party's April 24 Outline of Comprehensive Economic Measures and covers the three areas of expanding domestic demand, expanding imports, and contributing to the international community as outlined by Prime Minister Nakasone during his recent visit to the United States as well as at the OECD Ministerial Council. Formulated in consideration of the harsh economic situation, including the persistence of substantial imbalance in our international current account payments, these measures are intended, while promoting policy coordination with the other leading industrialized countries, to provide ambitious stimulation for domestic demand as well as to rectify the external imbalances and to facilitate more harmonious external economic relations.

In so doing, these Emergency Economic Measures are distinguished by the fact that the national government is taking a strong initiative including drastic fiscal disbursements for the attainment of these objectives.

In order to ensure the necessary budgetary provisions for these Emergency Economic Measures, a Supplementary Budget will be submitted to the Extraordinary Session of the Diet to be convened soon.

The measures include:

1. Expansion of Domestic Demand

Scale and Economic Impact

Total project expenses of public works and other works:	¥5 trillion	(=$36 billion)
Income and other tax cuts:	¥1 trillion	(=$7 billion)
Total	¥6 trillion	(=$43 billion; 1.8% of GNP*)

* Japanese nominal GNP for 1986 was ¥330 trillion (=$2.4 trillion at ¥140/$1)

Main Highlights

a. Fiscal measures amounting to more than 6 trillion yen ($43 billion) consist of measures by the national government, local governments and other public entities, and income and other tax cuts. Fiscal measures for fiscal 1987 will be ¥5.61 trillion ($40 billion, 94% of the total.)

b. Much of this represents measures by the national government. ¥1.76 trillion of general account measures by the national government, ¥0.8 trillion by public entities, and ¥1 trillion tax cuts amount to measures by the national government of ¥3.56 trillion.

c. Out of ¥5 trillion public works and other works, ¥4.61 trillion (92%) will be disbursed during this fiscal year.

d. As a part of tax reform, income tax cuts will precede the revision of the tax system.

e. The scale of the Supplementary Budget measures for the expansion of domestic demand is the largest ever, and it is being drafted unusually early in the year.

2. Import Expansion

Taking the position that "initiative begins at home," the government has adopted a strong import-promotion

measure of its own to further strengthen hitherto government and private-sector import-expansion efforts.

a. A special and extraordinary budgetary provision will be made in the Supplementary Budget to realize the additional import of foreign manufactured goods through the government procurement totalling about $1 billion.

b. Government procurement procedures will be improved.

c. Interest rates on the Export-Import Bank of Japan's manufactured import loans will be lowered.

d. The Action Program for Improved Market Access will be further promoted.

3. Contributing to the International Community

a. ODA Medium-Term Target

The implementation of the Third Medium-Term Target of doubling ODA in seven years will be advanced by two years, and 1990 ODA disbursements will be more than $7.6 billion.

b. Financial recycling to the developing countries (especially the debtor countries)

Japan will recycle more than $20 billion in new and completely untied public and private funds over the next three years.

While the actual implementation of the recycling will hinge on discussions with multilateral development banks or bilateral requests, the following is envisaged as a rough breakdown:

- government contributions to multilateral development banks together with additional private funds procured by these banks in the Tokyo financial market; about $8 billion
- co-financing with the World Bank and other multilateral development banks by the Overseas Economic Cooperation Fund, the Export-Import Bank of Japan and private banks and bilateral loans by the Overseas Economic Cooperation Fund to assist developing countries in carrying out their economic policies; over $9 billion
- direct untied loans by the Export-Import Bank of Japan; about $3 billion

c. Special measures for Sub-Sahara African and other LLDCs

Grants will be increased, including about $500 million non-project aid over the coming three years, and debt relief extended.

Emergency Economic Measures

(Provisional Translation)

May 29, 1987
Ministerial Conference
for Economic Measures

The current international economic situation is one of lackluster growth in the leading countries and continuing large imbalances in international balance of payment albeit the indication of their rectification. Despite a firm tone of business activities, the domestic economic situation in Japan remains grim in light of the continuing sluggishness, especially in manufacturing, and the difficult employment picture.

Given this grim economic situation, there is an urgent need for Japan, while continuing to pursue policy coordination with the other leading countries, to make a strong effort to vigorously expand the economy centering on domestic demand and to work to rectify its external imbalances and to structure its external economic relations more harmoniously.

These efforts will facilitate the shift to an economic structure as outlined in the Economic Council's "Action for Economic Restructuring" policy recommendations and contribute to improving quality of Japanese life.

Accordingly, the government intends to implement immediate measures for the expansion of domestic demand, accompanied by fiscal measures amounting to more than ¥6 trillion as well as external economic measures including necessary fiscal measures.

These fiscal measures of more than ¥6 trillion include measures by the central and local governments, and public institutions, and reduction of income tax and others.

I. Public Works

1. Accelerated Implementation of Public Works

Every effort will be made to accelerate the implementation of public works in an attempt to achieve an unprecedented first-half year contract figure of more than 80% for public works and other spending in fiscal 1987.

Public works allocation will be conducted as appropriate in consideration of each region's economic situation, the state of local social capital, and other relevant factors.

2. Expansion of Public Investment, etc.

The necessary Supplementary Budget provisions will be taken to ensure that the scale of public investments, etc. will be totalling ¥5 trillion through the following measures.

(1) ¥2,450 billion in additional funding will be provided for ordinary public works by making most effective use of revenues accruing from the sale of Nippon Telegraph and Telephone Corp. stock.

In deciding on these additional public works expenditure, consideration will be given to the state of the local economy, including any impact from the yen's appreciation, and the priority will be given to projects that can be promptly implemented, because they do not require new site acquisition or for other reasons, and will have a wider multiplier effect.

(2) ¥450 billion in additional funding will be provided in an effort to proceed promptly with the implementation of disaster-relief projects.

(3) ¥350 billion in additional funding will be provided in an effort to expand educational, research and development facilities and the like.

(4) ¥250 billion in additional funding will be provided for the work of the Japan Highway Public Corporation.

(5) Smooth implementation of independent works by local governments is expected, including additional measures amounting to ¥800 billion, by utilizing local governments bonds to meet the realities of local situations.

For this purpose, assignment ratio of local government bond to additional works on roads, rivers

etc. will be increased. Special consideration will be given on the issuance of local government bonds so as to facilitate the revitalization of the economy in depressed areas, etc.

(6) The Housing Loan Corporation will provide an additional ¥700 billion for loan facilities (additional 25,000 units).

II. Tax Reductions

Following consultations in the special consultative body on reform of the tax system established within the House of Representatives, we will effect a prompt and fundamental reform of the tax system, including review of the direct/indirect taxation ratio. As a part of this work, we will ensure income-tax and other tax reductions of not less than ¥1 trillion in fiscal 1987 before the system is revised.

III. Promotion of Housing Investment

Along with seeking to ensure the smooth supplies of residential sites, we will work to promote further housing investment including that for rebuilding, and reforms. Accordingly, we will undertake the measures described in Appendix 1, including improving and upgrading of the financing provisions by enhancing the Housing Loan Corporation's loan schemes.

IV. Revitalizing Local Economies

We will implement the measures described in Appendix 2 in order to cope with the severe local economic situation including employment problem, to promote and strengthen the industries inherent in the areas and to improve the quality of local life.

V. Mobilization of Private-sector Vitality and others

1. Mobilization of Private-sector Vitality

We will steadily implement the measures described in Appendix 3 in order to strengthen domestic demand by the most effective use of private-sector vitality and to promote the revitalization of local economies. In particular, in order to promote the various measures' smooth and effective implementation, revenues accrueing from the sale of Nippon Telegraph and Telephone Corp. stock will be utilized and institutional provisions will be improved, and due consideration will be given to consolidate the basis for private-sector projects in the implementation of public works projects.

These projects will be carried out with all due consideration to the stability of land prices.

2. Tax Cuts on Capital Investment

Realizing tax reform, we will make tax reductions for the promotion of capital investment in private-sector research and development activities oriented toward domestic demand.

VI. Small-business Policy

In order to support structural reform of small and medium enterprises facing the drastic changes in domestic and external economic situation including the yen's appreciation, measures for small and medium enterprises will be enhanced as described in Appendix 4, including additional designation of "specified areas" under the Law on Temporary Measures for Small and Medium Enterprises in Specified Areas, lowering interest rates on loans of government-related financial institutions, lengthening the period and expanding the scale of funds of the Special Loan Program for Small and Medium Enterprises in Specified Areas and the Small and Medium Enterprises International Economic Adjustment Special Loan.

With regard to the metal mining industry, the scope of financing eligibility under the Metal Mining Business Stabilization Lending Program will be expanded.

VII. Employment Policy

As described in Appendix 5, we will beef up employment policy with the steadfast implementation of the Employment Development Program for 300,000 People, improvements in the various assistance grants, and stronger vocational training programs, as well as with efforts to shorten working hours by such means as spreading the five-day workweek.

VIII. Ensuring that the Benefits of Yen Appreciation are Passed Along

Continuing efforts will be made to ensure that the benefits of yen appreciation are passed along and permeate throughout the economy.

1. In keeping with the basic policy of continuing to press for flexible downward public utility rate adjustments wherever possible, and for long-term rate stability and improved service commensurate with the utility's business performance and other considerations where rate schedules cannot be lowered, we will make every effort to ensure that the benefits of yen appreciation and other benefits are passed along to consumers.

2. In other consumer areas, we will continue our efforts to make relevant information available, including monitoring price trends for the principal imported consumer goods and other products (with the results expected to be available in late June), so that the impact of yen appreciation works through market mechanisms and is accurately reflected in domestic prices, thereby leading to expanded consumption and imports. We will also continue to work to create a climate enabling consumers to reap the benefits of the yen's appreciation as through holding of import fairs by local commerce associations, conducting survey on development imports by the leading department stores and supermarkets, and other related activities.

IX. Flexible Financial Policy Management and Other Related Measures

1. We will make every effort for appropriate and flexible financial policy management with all due heed to economic trends at home and overseas and to the international currency situation.

2. The interest rate for money on deposit with the Trust Fund Bureau will be lowered and the interest rates of Government-related financial institutions also reduced.

3. Private-sector financial institutions are being called upon to expand their consumer finance lending as described in Appendix 6, including developing and offering new products and new services commensurate with the diversification of consumer requirements.

X. Import Expansion, Improvement of Market Access and Others

1. A special and extraordinary budgetary provision will be made in the supplementary budget to realize the additional import of foreign manufactured goods through the government procurement totalling about $1 billion.

2. Along with seeking to improve the procedures relating to government procurement of foreign-made manufactured goods (e.g., expanding the scope of applicability and ensuring greater transparancy in the procedures for supercomputer procurement), efforts will also be made to ferret out foreign-made manufactured goods that could be

eligible for procurement by the institutions covered by the Action Program for Improved Market Access, decided in July 1985, to provide more information and publicity regarding market entry by foreign suppliers, and to have more foreign suppliers qualify as registered vendors.

3. Interest rates are to be lowered and loan periods extended to enhance Export-Import Bank of Japan lending for the import of manufactured goods.

4. Continuing efforts will be made to have the private sector import more manufactured goods, with timely follow-up activities.

5. We will continue to promote the Action Program for Improved Market Access.

6. Ambitiously promoting liberalization of interest rates, the expansion of short-term financial markets, and enhanced access for foreign finnancial institutions wishing to enter the Japanese market, every effort will be made to promote the liberalization and internationalization of Japan's financial and capital markets.

7. The limit on the value of personal goods that Japanese traveling overseas may bring back with them duty-free (currently ¥100,000) will be doubled to ¥200,000 effective this July 1.

XI. Contribution to the International Community

In view of the economic difficulties confronting many of the developing countries, including their mounting external debts and the depressed commodity prices, Japan will as a positive contribution to the international community, take the following measures to enhance the flow of capital and technology needed by these countries. The necessary budgetary provisions will be made for these measures.

1. While making the best efforts to move up the targets in the Third Medium-Term ODA expansion program, we will at least advance the original seven-year doubling target by two years and make ODA disbursements in 1990 more than $7.6 billion. We will also seek to strengthen aid management capacities.

2. Seeking to promote financial flows to the developing countries (especially those in debt), Japan will recycle more than $20 billion in new and completely untied funds over the next three years by way of making contributions to the multilateral development banks and mobilizing the resources of the Export-Import Bank of Japan, the Overseas Economic Cooperation Fund and the private-sector. For this purpose, Special Fund will be established within certain multilateral development banks like the Asian Development Bank and the Overseas Economic Cooperation Fund will provide concessional bilateral loans for

economic policy support as well as promote co-financing with multilateral development banks. The untied loan scheme of the Export-Import Bank of Japan will also be activated.

3. To further promote the transfer of technology from Japan to the developing countries, technical cooperation like dispatching of experts will be enhanced markedly drawing upon private-sector resources as well. International research and development cooperation will be also expanded utilizing research institutions both in Japan and overseas.

4. Recognizing that growing special consideraiton is needed for Sub-Saharan African and other least development countries, positive support measures will be taken such as the expansion of grant assistance including provision of non-project-type grant assistance amounting to approximately $500 million over the next three years, as well as possible debt relief.

(Appendix 1) Promotion of Housing Investment

(1) Expansion of the Housing Loan Corporation's loan facilities, etc.

1) As well as lowering the interest rates on loans, the Housing Loan Corporation is to expand and strengthen the loan program in the following measures in order to promote new construction, reconstruction and reforms of houses and to contribute to improvements in the living standards.

(a) Raising the upper limit of loan
(1.4- to 2.5-million-yen raise for larger housing etc.)

(b) Addition of loan for reconstruction of private housing
(one-million-yen addition)

(c) Increasing the special extra loans
(2.5-million-yen increase in loans for houses with lot subdivided and sold from larger lots)

(d) Raising the upper limit on the sales value of eligible houses with lot subdivided and sold from larger lots
(the maximum value set at 50 million yen)

(e) Raising the upper limit on loans for enlargement of buildings
(one-million yen raise),

- Promotion of unsecured loans related to residential facilities (establishment of a fund for promotion of residential reforms),
- Provision of loans for housing reforms to associations for apartment superintendence.

(f) Introducting into loans for private-sector rental housing the scheme to progressively increase the amount of each repayment.

2) A loan system to promote wage earners' property accumulation and their housing acquisition will be improved.

(2) Requests to the private financial institutions

The government will request the private financial institutions to play an active role in the matter of housing loans to individuals by lowering the interest rates, ensuring stable supplies of funds for housing loans, providing and publicizing such instruments as the Reform Loans which meet well the needs of the users.

(3) Necessary measures for the scheme of taxation on agricultural land in specially designated urbanization promotion areas will be taken, including provision of guidance about the operation of this scheme to local bodies. Such measures will be based on results from research and examination of achievements, in the past 5 years since the initiation of the current scheme, of the

system to defer tax collection on the agricultural lands which are in long-term and continuous cultivation.

(4) In order to increase housing construction as well as to contribute to stabilization of land prices in such metropolitan areas such as Tokyo and Kinki Metropolitan areas, the Housing and Urban Development Corporation is to increase the supply of residential land.

(5) Housing reforms and the use of housing-related machinery and equipment will be promoted by such measures as development of information providing system , cultivating talented personnel for home enlargement and reconstruction, and promoting activities to raise public awareness.

(6) Promotion of small-scale collective sewage disposal facilities

Standards for the structure of small-scale collective sewage disposal facilities will be set up by the end of the year with a view to promoting prevalence of these facilities in accordance with the current sewerage development programme.

(7) Promotion of "Home Elevators"

Introduction of small-size "home elevators" equipped in private residences for use especially by the aged and the handicapped will be promoted by putting the guide for their designing into practical use.

(Appendix 2)

Regional Revitalization Program

(1) Development of regional industrial bases

We will develop regional industrial bases such as facilities for technological development and training, based on "the Industry Relocation Promotion Law".

(2) We will additionally designate specific areas to be covered by "the Temporary measures Law for Facilitating Industrial Structural Adjustment".

(3) To revitalize regional economies through the efficient use of land, we will promote further utilization of the land trust system.

(4) We will promote the development of village areas based on "the Village Area Development Law", in accordance with the Village Zoning Schemes and the Regional Development Schemes for Village Agriculture Promotion. We anticipate early approval of Basic Policies on Development of Village Areas.

(5) We will promote development of public airfields for helicoptor and visit to different local areas.

(6) Through public investment and investment of public nature in agriculture, forestry and fishery, we will strengthen these industries and promote revitalization of local economies.

(Appendix 3)

Utilization of Private-Sector Vitality and Other Measures

(1) Vitalization of Regional Economies by the Utilization of Sales Gains of NTT Shares.

We will promote infra-structure development of the economy and society, and vitalize regional economies through the expansion of assistance to enterprises covered by the Private-Sector Vitality Law and others, making use of sales gains of NTT shares.

(2) Promotion of Urban Redevelopment

1) Promotion of Urban Redevelopment by the Private-Sector Urban Development Promotion Organization.

To promote high-potential projects utilizing private-sector vitality such as urban redevelopment in local cities and redevelopment of ports, supportive measures such as supplying long-term and low-interest-rate funds will be implemented through the Private-sector Urban Development Promotion Organization based on the Law on Special Measures to Promote Private-Sector Urban Redevelopment.

2) Relaxation of Regulations

Appropriate review will be conducted on designated areas in view of land use, improvement of public facilities and progress in high-potential projects, as

well as measures will be taken to ensure the notification advising improvement of the total floor area/ground area ratios in specially designated areas, and comprehensive urban planning areas, thoroughly known to those concerned.

Efforts will also be made to ensure well known the notification on the flexible application of rezoning in local cities.

In accordance with the revision of the Building Standard Law, measures will be taken for the relaxation of various restrictions such as rationalization of restrictions on the total floor area/grand area ratio in view of road width and on height of building in Category 1 Exclusive Residential District as well as on wooden buildings.

3) Promotion of Urban Railways Construction

Based on the Urban Railways Construction Law, approval for construction projects will be given and by utilizing Urban Railways Construction Fund System, measures will be taken to promote quadruple tracking railways and large-scale improvement construction of railways in major cities.

(3) Promotion of Improvements at Designated Facilities by the Private-Sector Vitality Law

In accordance with the revision of the Law for Provisional Measures Relating to the Promotion of Improvements at Designated Facilities Utilizing

the Ability of Private-Sector Operator, basic policies will be formulated immediately on international-information-related local development facilities and international business exchange facilities.

(4) Promotion of Development of Comprehensive Resort Areas

Based on the Comprehensive Resort Area Development Law, basic policies will be formulated immediately to promote actively the development of comprehensive resort areas. At this juncture, effective use of state-owned forests and fields is to be promoted.

(5) Promotion of Large-Scale Projects

1) Promotion of Redevelopment of Coastal Areas in Tokyo

As for redevelopment of coastal areas in Tokyo, basic policies on development of the whole region as well as on the construction of the basic facilities for wide area will soon be formulated in the Council for the Promotion of Development of Coastal Areas in Tokyo which consist of the relevant ministries and the Tokyo metropolitan government and other organizations concerned.

2) Promotion of Construction of the Kansai Cultural and Academic Research City

Based on the Law for Promotion of Construction of the Kansai Cultural and Academic Research City, basic policies will be formulated and approval for the construction plan given immediately to promote actively the construction of the Kansai Cultural and Academic Research City.

3) Promotion of Construction of the Kansai International Airport, etc.

The Construction will be steadily promoted of the Kansai International Airport, the Tokyo Bay Bridge and Tunnel and the Akashi Straits Bridge. For the Ise Bay Road, the construction will be commenced as soon as possible.

(5) Efficient Utilization of National and Public Land

For the efficient utilization of national and public land through the mobilization of private-sector vitality, steady implementation of measures such as land sales including utilization of the Land Trust System will be promoted. With regard to the sale of JNR land (the land owned by JNR Settlement Corporation), the sale of the land will be promoted considering the opinion of the Assets Dealing Council.

(Appendix 4) Policy on Small and Medium Enterprises, etc.

(1) Policy in specified areas

1) Additional local areas will be designated as "specified areas" under the Temporary Law on Measures for Small and Medium Enterprises in Specified Areas.

2) Special loan program for small and medium enterprises in specified areas will be in effect for an extended period with increased total fund.

3) The credit guarantee provided in relation to the specified areas under the Temporary Law on Measures for Small and Medium Enterprises in Specified Areas will be in effect for an extended period with increased total fund.

(2) Measures to facilitate business conversion

1) The Small and Medium Enterprises International Economic Adjustment Special Loan will be in effect for an extended period with increased total fund.

2) The credit guarantee and others, provided in relation to the international economic problems under the Temporary Law on Business Conversion and Adjustment Measures for Small and Medium Enterprises will be in effect for an extended period.

(3) General financial measures

1) The Trust Fund Bureau depository rate and interest rates of Government-related financial institutions will be reduced.

2) Measures for reduction of repayment burden on outstanding loans provided by Government-related financial institutions for small and medium enterprises ("Emergency Loan Program for Repayment on Outstanding Principal and Interest to Small and Medium Enterprises in Depressed industries") will be expanded and extended.

3) Credit guarantee measures by credit guarantee associations will be further promoted in order to enhance creditworthiness of small and medium enterprises and to facilitate their efforts to raise funds.

(4) Measures for subcontracting small and medium enterprises

1) To prevent contracting companies from unfairly shifting the burden on small or medium subcontracting enterprises, we will continue to strictly implement the Law to Prevent Subcontractor's Payment Delays.

2) To secure business for subcontracting small and medium enterprises, we will promote subcontracting arrangements through the

Subcontractors Enterprises Promotion Association with more flexibility and a wider regional scope, by such measures as the inauguration of "The Project to Explore Business Information for 100,000 Enterprises".

(5) Measures for the metal mining industry

Loans under the Metal Mining Management Stabilization Financing Program will be provided to a wider range of enterprises.

(Appendix 5) Strengthening of Employment Policy, etc.

(1) We will implement the Employment Development Program for 300,000 People in a flexible and steadfast manner. In particular, we will actively promote employment development in local areas through comprehensive regional employment measures based on the Regional Employment Promotion Law. We will aim at smooth reallocation of labor force without creation of unemployment in industries including those specified as depressed through the utilization of vocational retraining and assistance to the activities of the Industrial Employment Stability Centers.

(2) We will designate specified depressed industries and industries to be awarded Employment Adjustment Grant in a flexible manner. Necessary measures will be taken to improve the Employment Adjustment Grant System, the Designated Job-Seeker Employment Development Grant System, etc. We will pursue policies more vigorously than ever to prevent unemployment, and to secure employment and reemployment opportunities for the aged workers and displaced workers from industries including those specified as depressed.

(3) Development of vocational abilities will be promoted in an appropriate and flexible manner. The vocational training system for information-processing-related technicians and other occupations will be improved, and

measures will be taken to facilitate smooth labor force movement across distant regions.

(4) To shorten work hours, we will pursue greater use of the 5-day work-week system, and early passage of the bill to amend the Labor Standard Law. Simultaneously, guidance and assistance will be given to facilitate voluntary efforts by labor and management in this direction. 5-day workweek for government employees will continue to be actively pursued by such means as smooth transition to the system of six holidays for four weeks and the "closed Office" method now under consideration.

(Appendix 6) Expansion of Consumer Finance and Other Related Measures

(1) Private-sector financial institutions are being called upon to be more active in consumer finance, including developing and offering new merchandises and new services commensurate with the diversification of consumer requirements and improving the terms of lending. From the same perspective, efforts will be made to enhance usefulness of the banks' cash cards and to improve branch services and locations.

(2) In the field of sales credit, efforts will be continued for the promotion of countermeasures against accumulative debtors for the development of the basis of credit industry and a request will be made to the credit business participants to develop new merchandises reflecting recent changes of consumers' needs. Also efforts will be made to lift standard condition of installment sale of air conditioners.

(3) Efforts will be made to contribute to the expansion of personal consumption through raising welfare level by promoting fund lending of three government-affiliated financial institutions for small and medium enterprises to enterprisers used for the welfare of employees.

REMARKS BY CHIEF CABINET SECRETARY

(PROVISIONAL TRANSLATION)

MAY 29. 1987

TODAY THE GOVERNMENT DECIDED UPON THE EMERGENCY ECONOMIC MEASURES. BASED ON THE RECOGNITION THAT POLICY COORDINATION AMONG MAJOR INDUSTRIALIZED COUNTRIES IS INDISPENSABLE UNDER THE DIFFICULT DOMESTIC AND INTERNATIONAL ECONOMIC SITUATIONS. JAPAN HAS EXPRESSED ITS RESOLUTION TO CONTRIBUTE TO THE WORLD ECONOMY ON SUCH OCCASIONS AS G-7 MEETINGS IN LOUVRE AND WASHINGTON. JAPAN-U. S. SUMMIT MEETING AND THE OECD MINISTERIAL COUNCIL. THE MEASURES ARE INTENDED TO PUT THIS RESOLUTION INTO PRACTICE.

BY THESE MEASURES. WE INTEND TO VIGOROUSLY EXPAND THE ECONOMY CENTERING ON DOMESTIC DEMAND. AND TO RECTIFY ITS EXTERNAL IMBALANCES. AND THUS TO FORMULATE MORE HARMONIOUS EXTERNAL ECONOMIC RELATIONS THESE EFFORTS WILL

CONTRIBUTE TO FACILITATING TRANSFORMATION OF OUR ECONOMIC STRUCTURE INTO ONE LED BY DOMESTIC DEMAND. AS WELL AS IMPROVING QUALITY OF JAPANESE LIFE.

AN EMPHASIS WAS GIVEN. FIRST AND FOREMOST. TO THE MEASURES FOR THE EXPANSION OF DOMESTIC DEMAND. ACCOMPANIED BY THE LARGE-SCALE FISCAL MEASURES AMOUNTING TO MORE THAN 6 TRILLION YEN. THE GOVERNMENT WILL IMPLEMENT LARGE-SCALE ADDITIONAL PUBLIC WORKS. INCOME TAX REDUCTION AND OTHER MEASURES. INJECTING AS MUCH GOVERNMENT SPENDINGS AS POSSIBLE. TO THIS END. THE GOVERNMENT WILL IMMEDIATELY START THE FORMULATION OF SUPPLEMENTARY BUDGET.

THE SECOND PILLAR OF THE PACKAGE IS FURTHER EXPANSION OF IMPORTS AND IMPROVEMENT OF MARKET ACCESS. UNDER THIS HEADING. MEASURES WILL BE TAKEN TO PROMOTE IMPORTS OF FOREIGN MANUFACTURED GOODS FOR GOVERNMENT PROCUREMENT IN THE ORDER OF DOLLAR1 BILLION. THE THIRD PILLAR IS POSITIVE CONTRIBUTION TO THE INTERNATIONAL SOCIETY. TO THIS END. WE DECIDED TO TAKE SUCH MEASURES AS THE ACCELERATED IMPLEMENTATION OF THE THIRD MEDIUM-TERM TARGET OF DOUBLING ODA BY TWO YEARS. RECYCLING OF MORE THAN DOLLAR20 BILLION NEW AND COMPLETELY UNTIED FUNDS TO THE DEVELOPING COUNTRIES AND EXTENTION OF NON-PROJECT GRANT ASSISTANCE TO SUB-SAHARA AFRICAN AND OTHER LEAST DEVELOPED COUNTRIES.

WE EXPECT THAT THESE LARGE-SCALE MEASURES. CORRESPONDING TO 1.8PARCENT OF THE JAPANESE GNP. WILL BRING ABOUT DRASTIC EXPANSION OF THE NATION'S DOMESTIC DEMAND. WE ALSO BELIEVE THAT THE MEASURES WILL CONTRIBUTE TO THE STEADY CORRECTION OF INTERNATIONAL IMBALANCES.

STRENGTHENED ECONOMIC GROWTH AND THE STABLE DEVELOPMENT OF THE WORLD ECONOMY WHEN THEY ARE COMBINED WITH THE COOPERATIVE POLICY EFFORTS OF OTHER MAJOR INDUSTRIALIZED COUNTRIES. (END)

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TELNO 949
OF 301900Z APRIL 87
INFO IMMEDIATE TOKYO, UKREP BRUSSELS
INFO ROUTINE UKMIS GENEVA
INFO SAVING BONN, PARIS, ROME, OTTAWA

NEUTRAL.

OUR TELNO 906: US/JAPAN: VISIT BY NAKASONE

SUMMARY

1. NAKASONE PROMISES CUT IN JAPANESE INTEREST RATES. LITTLE NEW DETAIL YET ON THE PACKAGE OF JAPANESE MEASURES. UP-BEAT PRESENTATION OF FIRST DAY'S TALKS BY THE WHITE HOUSE.

DETAIL

2. ON THE FIRST FULL DAY OF HIS VISIT, NAKASONE HAD AN HOUR'S MEETING WITH PRESIDENT REAGAN FOLLOWED BY LUNCH WITH SHULTZ AND CALLS ON THE HILL. THERE IS AN OFFICIAL DINNER AT THE WHITE HOUSE THIS EVENING. ON 1 MAY, THE NAKASONES WILL BREAKFAST WITH THE REAGANS. THERE WILL THEN BE A FURTHER ROUND OF TALKS AT THE WHITE HOUSE, AFTER WHICH NAKASONE WILL MAKE A SPEECH AT THE NATIONAL PRESS CLUB AND HAVE FURTHER SESSIONS ON THE HILL. HE LEAVES ON 2 MAY.

3. AS EXPECTED, BOTH SIDES HAVE PRESENTED THIS VISIT IN THE CONTEXT OF CLOSE US/JAPANESE COOPERATION ON A WIDE RANGE OF ISSUES. BUT IN HIS WELCOMING REMARKS AT THE WHITE HOUSE, THE PRESIDENT STRUCK A SLIGHTLY QUALIFIED NOTE: QUOTE I HAVE HEARD OUTLINES OF NEW MEASURES THAT YOU ARE CONSIDERING, AND I AM MOST ENCOURAGED BY WHAT APPEARS TO BE A COMMITMENT TO POLICIES OF DOMESTIC GROWTH AND THE EXPANSION OF CONSUMER DEMAND IN JAPAN, SOMETHING WE STRONGLY BELIEVE WILL HAVE A POSITIVE EFFECT ON THE TRADE BALANCE UNQUOTE.

4. ACCORDING TO ADMINISTRATION SPOKESMEN, THE ONLY SURPRISE AT THE FIRST ROUND OF TALKS WAS AN UNDERTAKING BY NAKASONE TO CUT JAPANESE INTEREST RATES.
THE WHITE HOUSE HAVE WELCOMED THIS AS A STEP WHICH SHOULD STIMULATE JAPANESE GROWTH AND CREATE OPPORTUNITIES TO INCREASE US EXPORTS TO JAPAN.

5. FOR THE REST, NAKASONE SEEMS TO HAVE STUCK TO THE FOUR POINT PACKAGE UNVEILED BY ABE HERE LAST WEEK. LITTLE NEW DETAIL HAS EMERGED AS YET, AND THE WHITE HOUSE SAY THAT SPECIFIC POINTS WILL BE DISCUSSED FURTHER AT THE MEETING ON 1 MAY. BUT THE FOLLOWING APPEAR TO BE THE MAIN POINTS FROM THE FIRST ROUND, ON THE BASIS OF US BACKGROUND BRIEFING:

I) SEMICONDUCTORS: NAKASONE DENIED THAT THE JAPANESE HAD BEEN VIOLATING THE AGREEMENT, AND ASKED THAT THE RETALIATORY MEASURES BE LIFTED. THE PRESIDENT TOOK THE STANDARD LINE THAT HE WANTED TO LIFT THEM AS SOON AS POSSIBLE, BUT THAT THE US NEEDED EVIDENCE

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THAT

THAT THE EARLIER AGREEMENT WAS BEING COMPLIED WITH. ADMINISTRATION SPOKESMEN HAVE ADDED THAT THE DATA FOR APRIL WOULD BE AVAILABLE BY MID-MAY: AND HAVE NOT RULED OUT THAT IT MIGHT BE POSSIBLE TO LIFT THE RETALIATION BEFORE THE VENICE SUMMIT.

II) ON THE RE-CYCLING OF FINANCIAL SURPLUSES TO THE LDCS: NAKASONE APPARENTLY MADE PLAIN THAT THE FUNDS WOULD BE UNTIED, AND WOULD BE CHANNELLED MAINLY THROUGH THE INTERNATIONAL FINANCIAL INSTITUTIONS. SOME 20 BILLION WOULD BE NEW FUNDS, AND 10 BILLION EXISTING MONEY.

III) ON THE TRADE BILL (OUR TELNO 929), THE PRESIDENT IS REPORTED TO HAVE CONFIRMED THAT HE WOULD VETO A BILL WHICH INCLUDED THE GEPHARDT AMENDMENT.

COMMENT

6. IT IS NO SURPRISE THAT THE ADMINISTRATION ARE DOING ALL THEY CAN TO PORTRAY THIS VISIT AS A SUCCESS. BUT THE ACID TEST WILL BE WHETHER NAKASONE MAKES ANY PROGRESS IN CONVINCING CONGRESSMEN OF HIS DETERMINATION TO TAKE EFFECTIVE STEPS ON THE TRADE SURPLUS. WE SHALL REPORT FURTHER EARLY NEXT WEEK.

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TELNO 906
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CDP 27/4.

MY TELNO 855 AND TOKYO TELNO 335: US/JAPAN

SUMMARY

1. ABE VISITS WASHINGTON TO PREPARE THE PATH FOR NAKASONE. SOME INFORMATION EMERGES ON PACKAGE OF MEASURES DESIGNED TO BLUNT CRITICISM OF JAPANESE TRADE AND ECONOMIC POLICIES. US PRESS FOCUS IN PARTICULAR ON PROPOSALS FOR THE RECYCLING OF SURPLUS JAPANESE FUNDS TO DEVELOPING COUNTRIES AND THE GROWING VOLATILITY IN THE FINANCIAL MARKETS.

2. THE ADMINISTRATION ARE KEEN TO USE NAKASONE'S VISIT TO EMPHASISE THE POSITIVE ASPECTS OF US/JAPAN RELATIONS: BUT IT WILL COINCIDE WITH PASSAGE OF THE TRADE BILL IN THE HOUSE, ALMOST CERTAINLY INCLUDING THE GEPHARDT AMENDMENT, AND COMMITTEE MARK-UP OF THE SENATE TRADE BILL, WHICH MAY WELL BE AMENDED TO INCLUDE JAPAN-SPECIFIC LANGUAGE.

DETAIL

3. THE PAST WEEK HAS SEEN INTENSE BILATERAL US/JAPAN ACTIVITY FOLLOWING THE ANNOUNCEMENT OF US RETALIATION AGAINST JAPANESE BREACHES OF THE BILATERAL SEMICONDUCTOR AGREEMENT AND IN PREPARATION FOR PRIME MINISTER NAKASONE'S VISIT TO WASHINGTON ON 29 APRIL TO 2 MAY. US TRADE REPRESENTATIVE YEUTTER AND AGRICULTURE SECRETARY LYNG HAVE BEEN IN TOKYO AND EX-FOREIGN MINISTER ABE HAS BEEN IN WASHINGTON FOR MEETINGS WITH THE PRESIDENT, BUSH, SHULTZ, TREASURY SECRETARY BAKER AND OTHERS IN THE ADMINISTRATION AND ON THE HILL.

4. WITH HIS ADMINISTRATION INTERLOCUTORS, ABE STRESSED THAT CURRENT TRADE DIFFERENCES SHOULD NOT UNDERMINE THE WIDER BILATERAL RELATIONSHIP. ECONOMIC RELATIONS WERE NOW AT THEIR MOST DIFFICULT POINT. THE NAKASONE VISIT SHOULD BE THE FIRST STEP TOWARDS A LASTING IMPROVEMENT. HE GAVE A PRELIMINARY INDICATION OF STEPS THE JAPANESE GOVERNMENT WERE PLANNING IN FOUR AREAS - DOMESTIC EXPANSION, AND INCREASED GOVERNMENT SPENDING ON IMPORTS (SEE TOKYO TUR): MARKET OPENING IN RESPONSE TO SPECIFIC TRADE PROBLEMS: AND MEASURES TO HELP LDCS. HE ALSO STRESSED THE NEED FOR THE US TO RESIST PROTECTIONISM, REDUCE ITS BUDGET DEFICIT, STRENGTHEN INDUSTRIAL COMPETITIVENESS AND APPROACH TRADE PROBLEMS IN A COOPERATIVE SPIRIT.

5. SHULTZ TOLD ABE THAT THE PROPOSED JAPANESE MEASURES LOOKED HOPEFUL, BUT IT WAS IMPOSSIBLE TO EVALUATE THEM PROPERLY WITHOUT MORE DETAIL. BAKER IS SAID TO HAVE UNDERLINED THE IMPORTANCE OF ENSURING THAT THE PROPOSED INCREASED EXPENDITURE WAS ACTUALLY NEW MONEY, AND TO HAVE PRESSED FOR EARLIER IMPLEMENTATION OF PROMISED TAX CUTS.

6. THE ELEMENT IN THE JAPANESE PACKAGE WHICH HAS RECEIVED THE GREATEST ATTENTION IN THE PRESS HERE SO FAR IS THAT RELATING TO THE RECYCLING OF JAPANS FINANCIAL SURPLUSES TO LDCS. ABE TOLD THE WASHINGTON POST THAT JAPAN WOULD BE MAKING AVAILABLE UP TO 30 BILLION DOLLARS OVER THREE YEARS, MAINLY IT SEEMS IN THE FORM OF GOVERNMENT GUARANTEES OF COMMERCIAL LOANS TO COUNTRIES IN SOUTH EAST ASIA AND LATIN AMERICA. HE PLACED THIS PROPOSAL FIRMLY IN THE CONTEXT OF THIRD WORLD DEBT PROBLEMS. STATE DEPARTMENT CONTACTS SAY THAT THE DETAILS OF THIS PACKAGE HAVE NOT YET BEEN WORKED OUT BY THE JAPANESE: AGAIN THE ADMINISTRATION WOULD BE LOOKING CAREFULLY AT THE EXTENT TO WHICH THEY INVOLVED GENUINELY NEW FUNDS, AND DID NOT EG INCLUDE EXISTING COMMITMENTS TO THE IMF AND THE WORLD BANK. PUBLICLY ADMINISTRATION SPOKESMEN HAVE WELCOMED ABE'S REMARKS, BUT STRESSED THAT ANY JAPANESE INITIATIVE ON DEBT OR AID MUST COMPLEMENT, AND NOT SUBSTITUTE FOR, ACTION TO EXPAND THE JAPANESE ECONOMY AND OPEN MARKETS. STATE SAY THAT ABE ALSO SPOKE OF AN EXPANSION OF JAPANESE GRANT AID TO AFRICA (400 MILLION DOLLARS IN WHAT APPEARS TO BE A ONE YEAR PROGRAMME). ABE CLAIMED THAT THE NEW ASSISTANCE WOULD NOT BE TIED.

7. ON SPECIFIC TRADE ISSUES, THE FOLLOWING APPEARS TO BE THE STATE OF PLAY AFTER ABE'S VISIT AND THE MEETINGS LYNG AND YEUTTER HAD IN TOKYO:

(I) SEMICONDUCTORS: THE PRESIDENT EXPRESSED REGRET THAT US RETALIATION HAD BEEN NECESSARY, AND ABE SAID HE HOPED THAT THE MEASURES WOULD BE LIFTED SOON. SEPARATELY IN TOKYO, YEUTTER AGREED THAT DISCUSSIONS SHOULD RESUME AT SENIOR OFFICIAL LEVEL WITHIN THE NEXT TWO WEEKS. BUT ADMINISTRATION SPOKESMEN CONTINUE TO EMPHASISE THAT NO NEW INFORMATION HAS EMERGED AND THAT THEY HAVE NO INTENTION OF REMOVING THE RETALIATORY TARIFFS IN THE IMMEDIATE FUTURE, THUS DASHING JAPANESE HOPES THAT THE NEW TARIFFS MIGHT HAVE BEEN LIFTED DURING NAKASONE'S VISIT.

(II) AGRICULTURE: ACCORDING TO USTR, THE MEETINGS BETWEEN LYNG AND HIS JAPANESE OPPOSITE NUMBER WENT VERY BADLY. KATO REFUSED TO CONSIDER LIFTING JAPAN'S BAN ON RICE IMPORTS, AND AT ONE POINT STATED THAT THE BAN WOULD NOT EVEN BE ON THE TABLE IN URUGUAY ROUND. HE SUBSEQUENTLY RETRACTED THAT STATEMENT, BUT SAID THAT AGREEMENT TO DISCUSS THE BAN DID NOT MEAN THAT IT COULD BE LIFTED. HE ALSO DECLINED TO REMOVE JAPANESE AGRICULTURAL QUOTAS, BUT PROMISED TO DISCUSS INCREASES IN BEEF AND CITRUS QUOTAS. USTR HAVE TOLD US THAT THE JAPANESE POSITION ON RICE IN PARTICULAR WAS SO HARD THAT THE POSSIBILITY OF AN S301 CASE BEING REFILED BY THE US INDUSTRY COULD NOT BE RULED OUT.

(III) KANSAI AIRPORT: ABE HAD PROMISED THAT MORE TRANSPARENT BIDDING PROCEDURES WOULD BE ANNOUNCED ON 27 OR 28 APRIL AND THAT US/JAPANESE JOINT VENTURE WORK ON THE PROJECT WOULD BE FACILITATED. SHULTZ PRESSED THE JAPANESE TO EXPAND THIS TO OTHER CONSTRUCTION PROJECTS. WE HAVE RECEIVED UNCONFIRMED REPORTS THAT DURING THE NAKASONE VISIT

A STUDY OF AIRPORT OPERATIONS BY THE PORT OF NEW YORK AUTHORITY AND A BECHTEL CONSTRUCTION CONTRACT WILL BE ANNOUNCED.

(IV) SUPERCOMPUTERS: ACCORDING TO THE STATE DEPARTMENT, AN AGREEMENT IS LIKELY TO BE CONCLUDED NEXT WEEK WHICH WILL MAKE EXPLICIT THE IMMEDIATE APPLICATION OF THE GATT GOVERNMENT PROCUREMENT CODE TO JAPANESE GOVERNMENT PURCHASES OF SUPERCOMPUTERS, EXTEND ITS APPLICATION TO THE LEASING OF SUPERCOMPUTERS AND IMPROVE JAPANESE GOVERNMENT PROCUREMENT PROCEDURES FOR SUPERCOMPUTERS TO THE BENEFIT OF US SUPPLIERS. OUR CONTACT HINTED THAT THE US WERE ALSO HOPEFUL THAT THE JAPANESE MIGHT MAKE PROMISES ON MARKET SHARING. THE JAPANESE EMBASSY ANTICIPATE FURTHER ANNOUNCEMENTS ON PURCHASES OF INDIVIDUAL US SUPERCOMPUTERS BY JAPANESE GOVERNMENT AGENCIES, POSSIBLY AS EARLY AS NEXT WEEK. MITI ARE SAID TO BE READY TO BUY TWO CRAY MACHINES.

(V) TARIFFS: ABE HAD SAID THAT THE JAPANESE WOULD REDUCE THEIR TARIFF ON CHOCOLATE AND CONFECTIONERY TO 10 PER CENT FROM 20 PER CENT.

(VI) FSX FIGHTER AIRCRAFT: THIS SEEMS NOT TO HAVE BEEN DISCUSSED IN ANY DETAIL, BUT THE STATE DEPARTMENT SAY IT WILL BE ON THE AGENDA FOR THE NAKASONE VISIT BECAUSE OF STRONG PRESSURE FROM THE SENATE AND THE US DEFENCE INDUSTRY.

8. AT NO POINT IN HIS VISIT WAS ABE PRESSED BY THE ADMINISTRATION ON 2-KDD, ALTHOUGH HE WAS GRILLED BY SENATOR MURKOWSKI (CF MY TELNO 865). ACCORDING TO CONGRESSIONAL STAFF AT ONE POINT HE IMPLIED THAT THE JAPANESE GOVERNMENT MIGHT COME UP WITH SOMETHING MORE ON 2-KDD AND AT ANOTHER THAT THERE WAS MORE ENTHUSIASM IN JAPAN FOR AN ADDITIONAL CABLE THAN THERE WAS FOR CABLE AND WIRELESS BUILDING IT. BUT HIS GENERAL LINE WAS THAT THE JAPANESE GOVERNMENT HAD DONE ALL THAT WAS NECESSARY TO ENSURE FAIRNESS BY PROMISING EQUAL TREATMENT TO THE CORE COMPANIES, INCLUDING CABLE AND WIRELESS AND PACIFIC TELESSIS, AND DECLARING THEMSELVES OPEN TO CONSTRUCTION OF A CABLE. ACCORDING TO USTR, YEUTTER DISCUSSED 2-KDD WITH KARASAWA AND WITH THE JAPANESE FOREIGN MINISTER DURING HIS VISIT, AS ONE OF TWO OR THREE BILATERAL TELECOMMUNICATIONS PROBLEMS (THE OTHER MAIN ONE BEING CELLULAR TELEPHONES WHERE SOME CONCESSIONS WERE OBTAINED FOR MOTOROLA). HE HAD PRESSED FOR A TWO CONSORTIUM SOLUTION, OR FAILING THAT A FIRM COMMITMENT ON A CABLE. THE JAPANESE HAD SAID NOTHING NEW. USTR SAY THAT 2-KDD WILL ALSO BE ON THE AGENDA FOR THE NAKASONE VISIT, BUT STATE HAVE WARNED US THAT IT WILL NOT BE A PRIORITY.

COMMENT.

9. US-JAPAN ECONOMIC RELATIONS ARE A DOMINANT CONCERN HERE AT THE MOMENT. TRADE TENSIONS, THE CONTINUED FALL IN THE DOLLAR, GROWING ANXIETY ABOUT JAPANESE WILLINGNESS TO KEEP ON BUYING DOLLAR SECURITIES AND ABOUT AMERICA'S UNDERLYING LOSS OF INDUSTRIAL COMPETITIVNESS VIS A VIS JAPAN FEATURE DAILY IN THE MEDIA. ACCORDING TO THE STATE DEPARTMENT THE PRESIDENT IS KEEN THAT NEXT WEEK'S VISIT SHOULD RISE ABOVE THE TRADE DEBATE AND DEMONSTRATE THE OVERALL STRENGTH AND IMPORTANCE OF THE US/JAPAN RELATIONSHIP.

RELATIONSHIP. AT THE PERSONAL LEVEL THERE IS SYMPATHY FOR NAKASONE'S DOMESTIC DIFFICULTIES (WHICH HAVE BEEN WIDELY REPORTED) AND A DESIRE TO GIVE HIM A SUCCESS. STATE DEPARTMENT AND TREASURY OFFICIALS TESTIFIED IN VERY UP-BEAT TERMS TO THE HOUSE FOREIGN AFFAIRS COMMITTEE ON 23 APRIL. ASSISTANT TREASURY SECRETARY MULFORD PREDICTED THAT JAPAN'S BILATERAL TRADE SURPLUS WITH THE US - 58 BILLION DOLLARS IN 1986 - WOULD DROP BY AROUND 7 BILLION DOLLARS THIS YEAR (CHANGES IN VOLUME HAVE STILL TO BE REFLECTED IN DOLLAR TERMS).

10. ADMINISTRATION CONTACTS EMPHASISE THAT THE VISIT'S ULTIMATE SUCCESS WILL DEPEND ON THE EXTENT TO WHICH THEY ARE GIVEN SOMETHING TANGIBLE TO WORK WITH BY NAKASONE AND THE JAPANESE. THERE IS DEEP SCEPTICISM ON THE HILL - AND IN SOME PARTS OF THE ADMINISTRATION - ABOUT IMPLEMENTATION OF JAPANESE EXPANSIONARY PACKAGES (EVEN ABE'S REMARKS ON LOAN GUARANTEES FOR LDCS ARE DISMISSED BY SOME CONGRESSIONAL CONTACTS AS A MEANS OF ASSISTING JAPANESE PENETRATION OF THESE MARKETS). THERE IS UNPRECEDENTED PROTECTIONIST LOBBYING ON THE HILL FROM THE UNIONS AND US INDUSTRIES OPPOSED TO JAPANESE COMPETITION.

11. IN ANY EVENT NO JAPANESE ANNOUNCEMENT BEFORE OR DURING NAKASONE'S VISIT WILL HAVE AN IMMEDIATE MODERATING EFFECT ON DEVELOPMENTS IN CONGRESS, WHICH SEEM CERTAIN TO CAST A CLOUD OVER THE VISIT. THE HOUSE RULES COMMITTEE IS NOW SET TO MEET ON THE TRADE BILL ON 27 APRIL, AND THE FLOOR DEBATE AND VOTE WILL BE ON 28 - 30 APRIL IE IN THE MIDDLE OF THE NAKASONE VISIT. THE SPEAKER HAS PREDICTABLY REJECTED SUGGESTIONS THAT HE DEPART FROM THIS TIMETABLE IN DEFERENCE TO THE VISIT, AND INDEED PROBABLY WELCOMES THE MEDIA ATTENTION THE COINCIDENCE WILL GIVE TO THE HOUSE BILL AND THE PRESIDENTIAL AMBITIONS OF CONGRESSMAN GEPHARDT. THE GENERAL ASSESSMENT NOW IS THAT THE GEPHARDT AMENDMENT REQUIRING AUTOMATIC ANNUAL REDUCTIONS IN BILATERAL TRADE SURPLUSES WITH THE US OF A NUMBER OF COUNTRIES, CERTAINLY INCLUDING JAPAN, WILL BE RESTORED TO THE BILL IN ITS ORIGINAL FORM IN THE FLOOR VOTE DESPITE STRONG LAST-MINUTE LOBBYING BY THE ADMINISTRATION.

12. NOT TO BE COMPLETELY OUTSHONE, THE SENATE FINANCE COMMITTEE BEGAN TO MARK UP ITS VERSION OF THE TRADE BILL ON 22 APRIL, A WEEK EARLIER THAN EXPECTED, AND THE MARK UP WILL CONTINUE DURING THE NAKASONE VISIT: AN ATTEMPT WILL PROBABLY BE MADE TO INSERT THE GEPHARDT AMENDMENT INTO THE SENATE BILL DURING THE MARK UP: BUT THIS IS LIKELY TO BE DEFEATED. IT IS HOWEVER QUITE LIKELY THAT ALTERNATIVE JAPAN SPECIFIC LANGUAGE WILL BE ADOPTED BY THE COMMITTEE, JUST POSSIBLY A PROVISION REQUIRING THE ADMINISTRATION TO INITIATE A GATT ARTICLE XXIII CASE AGAINST JAPAN (SUPPORT FOR THIS IDEA IS GROWING SLIGHTLY AMONG COMMITTEE MEMBERS: SENATOR BENTSEN IS SAID TO BE SYMPATHETIC, AND SENATOR BAUCUS, CO-CHAIRMAN OF THE CONGRESSIONAL COMPETITIVENESS CAUCUS, HAS PUBLICLY ESPOUSED THE CONCEPT).

13. THIS LEGISLATIVE ACTIVITY WILL ENSURE A HIGH DEGREE OF ANTI-JAPANESE RHETORIC THROUGHOUT THE NAKASONE VISIT. IT IS PROBABLY JUST AS WELL THAT EARLIER FEELERS FROM TOKYO SUGGESTING THAT NAKASONE MIGHT ADDRESS A JOINT SESSION OF CONGRESS DURING THE VISIT WERE POLITELY REJECTED.

14. FCO PLEASE PASS TO BRAITHWAITE, SHEPHERD (ECD(E)), MASEFIELD (FED), COOKE (OT2, DTI), JOHNSON (ITP, DTI), LOEHNIS (BANK OF ENGLAND), H P EVANS (HM TREASURY), HADLEY (MAFF), PRIDDLE (TP, DTI).

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Prime Minister
For paragraphs 4-6.

DRN 24/4.

JAPANESE ECONOMIC POLICY

1. IN ADVANCE OF MR NAKASONE'S VISIT TO THE US ON 29 APRIL, WATANABE, MFA, BRIEFED OTHER WESTERN EMBASSIES ON 22 APRIL ON PROGRESS BY THE LDP IN ELABORATING THE PACKAGE OF EMERGENCY ECONOMIC MEASURES TO BE TAKEN IMMEDIATELY AFTER THE PASSAGE OF THE FY 1987 BUDGET (MY TELNO 290) , AND HANDED OVER COPIES OF THE FINAL REPORT, PUBLISHED TODAY, OF THE STRUCTURAL ADJUSTMENT COMMITTEE OF THE ECONOMIC ADVISORY COUNCIL - THE COMMITTEE CHAIRED BY MAEKAWA WHICH HAS BEEN CHARGED WITH FLESHING OUT THE ORIGINAL MAEKAWA REPORT. SUMMARIES OF THESE TWO DOCUMENTS ARE IN MIFTS, FULL TEXTS BY BAG TO FED.

2. THE PURPOSE OF THE BRIEFING WAS TO GIVE AN INTERIM REPORT BEFORE NAKASONE'S VISIT TO THE US AND TO EXPLAIN THAT THESE MEASURES WERE NOT BEING PREPARED "WITH ONE LARGE COUNTRY IN MIND" BUT WERE GLOBAL IN APPLICATION. WATANABE ADMITTED THAT THERE WERE STILL MANY UNCERTAINTIES, AND SOME LACK OF DEFINITION IN THE PROPOSALS BECAUSE OF THE SITUATION IN THE DIET AND DOUBT ABOUT THE FUTURE OF THE SALES TAX BILL. MORE PRECISE DETAILS, AND ALLOCATION OF RESPONSIBILITY FOR THE IMPLEMENTATION OF THE PROPOSALS WOULD BE FOR THE GOVERNMENT TO WORK OUT LATER. THE POINTS HE WISHED TO EMPHASIZE WERE THAT:

A. BOTH THE ECONOMIC PACKAGE AND THE REPORT OF THE SUBCOMMITTEE ON STRUCTUAL REFORM WERE PART OF JAPAN'S RESPONSE TO WHAT IT PERCEIVED AS A SERIOUS WORLD ECONOMIC SITUATION.

B. THERE WAS A CLEAR RECOGNITION OF THE NEED TO RECTIFY THE EXTERNAL IMBALANCES.

C. THE SCALE OF THE SUPPLEMENTARY BUDGETARY MEASURES WOULD BE CATEGORICALLY DIFFERENT FROM THOSE IN 1986. THE TAG OF YEN 5 TRILLION IS PUT ON THE PACKAGE, BUT DEBATE CONTINUES WITHIN THE GOVERNMENT AS TO HOW MUCH OF THIS WILL BE NEW MONEY.

D. IT WAS RECOGNIZED THAT THE STRUCTURE OF THE ECONOMY WAS SUCH THAT DOMESTIC EXPANSION OF ITSELF WOULD NOT ACHEIVE DRAMATIC INCREASES IN IMPORTS. THEREFORE THE GOVERNMENT WAS CONTEMPLATING EXTENSIVE DIRECT MEASURES TO PROMOTE IMPORTS AS PART OF THE PACKAGE, PARTICULARLY FURTHER INITATIVES IN THE AREA OF GOVERNMENT PROCUREMENT.

E. THERE WAS A CONSENSUS NOW THAT THE MAEKAWA PRESCRIPTION WAS RIGHT WHICH HAD NOT EXISTED IN 1986.

3. IN A SEPARATE BRIEFING FOR THE PRESS ON HIS SUBCOMMITTEE'S PROPOSALS, MAEKAWA POINTED TO IMPORTANT CHANGES WHICH HAD ALREADY TAKEN PLACE IN THE LAST YEAR: THE MOVE TO OVERSEAS PRODUCTION BY JAPANESE COMPANIES, THE REDUCTIONS IMPLEMENTED IN BASIC INDUSTRIES SUCH AS COAL, THE RISE IN VOLUME OF IMPORTS AND FALL

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IN EXPORTS, AND THE SLOWING OF JAPAN'S GROWTH RATE. IN REPLY TO QUESTIONS HE HINTED, HOWEVER, THAT HE WAS NOT HAPPY WITH THE PACE OF GOVERNMENT ACTIONS TO BRING ABOUT CHANGE (HE WAS REPORTED EARLIER THIS WEEK, TOGETHER WITH OTHER MEMBERS OF THE ORIGINAL MAEKAWA COMMITTEE AS HAVING EXPRESSED THIS DISSATISFACTION AT A MEETING WITH NAKASONE). IN HIS BRIEFING MAEKAWA IDENTIFIED AS THE MAIN SHORT TERM PROBLEMS THE NEED TO STIMULATE DOMESTIC DEMAND, INTRODUCE MORE FOREIGN COMPETITION INSIDE JAPAN AND SEE THAT THE BENIFICIAL EFFECTS OF YEN APPRECIATION AND MORE COMPETITION WERE REFLECTED IN IMPROVED LIVING STANDARDS FOR JAPANESE PEOPLE. WHEREAS HIS ORIGINAL REPORT OF 1986 HAD SET OUT THE PHILOSOPHY BEHIND THE NEED FOR STRUCTURAL CHANGE, THE LATEST RECOMMENDATIONS WERE INTENDED AS POINTERS TO PRIORITY POLICY ACTION IN SPECIFIC SECTORS.

COMMENT

4. THE MEASURES IN PREPARATION AND THE LATEST MAEWAKA PROPOSALS ARE A RESPONSE PRIMARILY TO EXTERNAL PRESSURE, BUT ALSO TO DOMESTIC CRITICISM OF THE GOVERNMENT'S ECONOMIC POLICIES. IN THE LIGHT OF THE AMERICAN ACTION OVER SEMICONDUCTORS THE JAPANESE ARE NOW MUCH MORE APPREHENSIVE ABOUT THE WORLD ECONOMIC CLIMATE: THEY ARE AS USUAL LOOKING FOR SOME SHORT TERM PALIATIVES, BUT THEY HAVE ALSO BEEN FORCED TO THINK MORE URGENTLY ABOUT THE LONGER TERM CHANGES TO WHICH THEY HAVE SO FAR PAID ONLY LIP SERVICE. AT THE SAME TIME THEY ARE MORE OPENLY VOICING THEIR CONVICTION THAT THE RESPONSIBILITY FOR AMERICA'S TRADE DEFICITS LIES AS MUCH IN US INDUSTRY AND ECONOMIC POLICY AS IN THEIR OWN TRADE PRACTICES.

5. THE MOST POSITIVE ELEMENTS IN THESE PROPOSALS ARE
(A) A CLEAR SHIFT AWAY FROM THE OVER-RESTRICTIVE FISCAL POLICIES OF THE MINISTRY OF FINANCE AND ACCEPTANCE OF A NEED TO STIMULATE THE ECONOMY FOR INTERNATIONAL REASONS. IT IS NOW ASSUMED THERE WILL BE A STIMULATORY SUPPLEMENTARY BUDGET EVEN IF THE NEW REVENUE EXPECTED FROM THE TAX REFORM BILL IS NOT FORTHCOMING. (THE GOVERNMENT IS LOOKING AT CONSTRUCTION BONDS AND THE SALE OF NTT SHARES AS THE PRIMARY ALTERNATIVE SOURCE.) THE RECOMMENDATIONS OF THE SUBCOMMITTEE ON STRUCTURAL ADJUSTMENT MAKE A BOW IN THE DIRECTION OF NAKASONE'S FISCAL RECONSTRUCTION POLICY, BUT PUT MUCH STRONGER EMPHASIS ON ACHIEVING SHORT TERM GROWTH IN DOMESTIC DEMAND.
(B) THE INDENTIFICATION OF GOVERNMENT PROCUREMENT AS A MEANS OF INCREASING IMPORTS, EVEN THOUGH THE IMPETUS COMES FROM PROBLEMS WITH THE US OVER THE KANSAI AIRPORT AND SUPERCOMPUTERS. IT IS RELEVANT THAT EUROPEAN EXPORTS TO JAPAN HAVE INCREASED MORE RAPIDLY THATN US EXPORTS IN 1986.
(C) THE MAEKAWA PAPER CONTAINS RECOMMENDATIONS FOR CONCENTRATED POLICY ACTION WITHIN 2-3 YEARS, AND PUT A MORE ASTUTE PRESENTATIONAL EMPHASIS THAN HERETOFORE ON THE IMPROVEMENT OF THE QUALITY OF LIFE FOR JAPANESE PEOPLE. THEY REFLECT A CONSIDERABLE SHIFT IN THE GROUND ON AGRICULTURAL REFORM SINCE LAST YEAR, THOUGH MAEKAWA SPECIFICALLY SUPPORTS THE GOVERNMENT LINE ON NON-LIBERALISATION OF RICE.

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6. WATANABE ALLUDED NONETHELESS TO CONTINUING DIFFERENCES OF VIEW WITHIN THE GOVERNMENT BOTH ON THE SCALE OF THE NEW WORKS TO BE INCORPORATED IN THE SUPPLEMENTARY BUDGET, AND ON THE DEGREE TO WHICH GOVERNMENT SHOULD ITSELF TAKE THE LEAD IN PURCHASING IMPORTS. THE LATEST MAEKAWA RECOMMENDATIONS AGAIN CONTAIN NO SPECIFIEC TARGET FOR THE REDUCTION OF JAPAN'S SURPLUSES (A PROPOSAL WITHIN THE SUBCOMMITTEE TO INCORPORATE ONE WAS OVER-RULED), AND THOUGH THEY ARE MORE SPECIFIC AND MORE URGENTLY EXPRESSED THAN BEFORE, THERE CAN STILL BE NO GUARANTEE THAT THE GOVERNMENT WILL PURSUE THEM OVER THE RESISTANCE OF DOMESTIC LOBBIES.

7. THE VIRTUE OF THE MAEKAWA RECOMMENDATIONS, AS BEFORE, IS THAT THEY CONCENTRATE ATTENTION ON THE KEY ISSUES. THE DOMESTIC CHANGES NOW REQUIRED TO ACHIEVE A REAL SOLUTION OF THE TRADE IMBALANCE PROBLEM AND THE PROMOTION OF DOMESTIC-DEMAND ARE DIFFICULT ONES SUCH AS HOW TO HOLD DOWN LAND PRICES PROMTE NEW INDUSTRIES IN THE REGIONS WITH DECLINING INDUSTRIES, ENCOURAGE CONSUMPTION WHILE NOT INCREASING THE PUBLIC BURDEN OF WELFARE SCHEMES AND HOW TO CHANGE ATTITUDES ON THE PART OF BOTH CONSUMERS AND PRODUCERS TO GREATER ACCEPTANCE OF IMPORTS AND FOREIGN COMPETITION, WHILE REDUCING RELIANCE ON EXPORTS WHERE THE JAPANESE CORPORATIONS HAVE FORMIDABLE ORGANISATIONAL STRENGTHS. THESE RECOMMENDATIONS - APPARENTLY THE LAST TESTAMENT OF THE MAEKAWA COMMITTEE - SHOULD CONTRIBUTE OO THIS LONG TERM PROCESS. THESE ARE INDEED THE REFORMS WHICH WILL BRING MOST BENEFIT IN THE LONG TERM TO JAPAN'S TRADING PARTNERS AND WHERE WE SHOULD THEREFORE CONTINUE TO PRESS MOST INSISTENTLY FOR PROGRESS. BUT THE OUTSIDE WORLD IS UNLIKELY TO GIVE THE JAPANESE MUCH CREDITE FOR TACKLING THIS LONG TERM AGENDA UNLESS THE GOVERNMENT TAKES A STRONGER LEAD THAN HITHERTO IN PROMOTING CHANGE AND IN DEMONSTRATING ITS MARKET-OPENING INTENTIONS WHEN DEALING WITH SPECIFIC SHORT TERM ISSUES.

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JAPAN : POLITICAL AND ECONOMIC BACKGROUND

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JAPAN: POLITICAL PROSPECTS

SUMMARY

1. IN THE LOCAL ELECTIONS ON 12 APRIL THE LDP SUFFERED SOMETHING OF A REVERSE, INTERPRETED AS BEING ON ACCOUNT OF THE UNPOPULAR SALES TAX BILL. UNLESS THEY ARE PREPARED TO COMPROMISE ON THIS ISSUE, IT MAY BE DIFFICULT TO SECURE THE EARLY PASSAGE OF THE BUDGET. NAKASONE'S PERSONAL POSITION HAS TAKEN A FURTHER KNOCK.

DETAIL

2. YESTERDAY'S ELECTIONS WERE THE FIRST MAJOR TEST OF JAPANESE OPINION AT THE POLLS SINCE THE LDP'S LANDSLIDE VICTORY IN LAST SUMMER'S GENERAL ELECTION. ELECTIONS WERE HELD TO ELECT GOVERNORS IN 13 OF JAPAN'S 47 PREFECTURES. PREFECTURAL ASSEMBLY ELECTIONS WERE ALSO HELD IN 44 PREFECTURES. AT THE GUBERNATORIAL LEVEL, THE STATUS QUO HAS BEEN MAINTAINED, ALTHOUGH ON A LOW TURNOUT. LDP BACKED CANDIDATES ATTRACTED A SMALLER SHARE OF THE VOTE THAN IN 1983 WHEN SIMILAR ELECTIONS WERE LAST HELD. FINAL RESULTS FOR THE PREFECTURAL ASSEMBLIES ARE NOT YET KNOWN BUT OVERALL THE LDP APPEARS TO HAVE LOST ABOUT A HUNDRED SEATS (OUT OF 1,487).

3. THE ELECTION CAMPAIGN WAS DOMINATED BY THE SALES TAX ISSUE. TO MINIMISE THE LOCAL IMPACT OF THE UNPOPULARITY OF THIS TAX MOST LDP BACKED CANDIDATES DISTANCED THEMSELVES FROM THE GOVERNMENT'S PROPOSALS. PRIME MINISTER NAKASONE WAS NOT INVITED BY A SINGLE CANDIDATE TO COME AND SPEAK ON HIS BEHALF. THIS TACTIC APPEARS TO HAVE SUCCEEDED IN PREVENTING A MAJOR REVERSE FOR THE LDP. HOWEVER IN PREVIOUSLY MARGINAL HOKKAIDO THE JAPAN SOCIALIST PARTY BACKED INCUMBENT WON WITH A GREATLY INCREASED MAJORITY WHILE IN IWATE, WHERE THE OPPOSITION WON A BY-ELECTION IN FEBRUARY, THE LDP'S SHARE OF THE VOTE FELL BY 25 PER CENT. THE GREATEST DISAPPOINTMENT FOR THE LDP IS THEIR FAILURE TO REGAIN FUKUOKA LOST TO THE OPPOSITION IN 1983, DESPITE THE MASSIVE DEPLOYMENT OF SUPPORT FOR THE LDP BACKED CANDIDATE.

4. DURING THE CAMPAIGN NAKASONE'S HANDLING OF THE SALES TAX CAME UNDER INCREASING CRITICISM WITHIN THE LDP. THE OPPOSITION PARTIES, ECHOED BY THOSE NEWSPAPERS UNSYMPATHETIC TO THE GOVERNMENT, CLAIM THAT THE ELECTION RESULTS ARE A VERDICT AGAINST THE SALES TAX. REACTIONS BY LDP LEADERS INDICATE THAT THEY TOO RECOGNISE

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/THAT

THAT THE SALES TAX HAS INFLUENCED THE OUTCOME OF THE ELECTIONS. AND CALLS FOR THE AMENDMENT AND EVEN WITHDRAWAL OF THE SALES TAX BILL ARE SURFACING WITHIN PARTS OF THE LDP . WHEN THE DIET REASSEMBLES THIS WEEK AFTER THE ELECTION RECESS, THE GOVERNMENT'S PRIORITY WILL BE TO MAKE A RENEWED EFFORT TO SECURE THE ADOPTION BY THE LOWER HOUSE OF THE BUDGET FOR FISCAL 1987 BEFORE NAKASONE DEPARTS FOR WASHINGTON ON 29 APRIL. BUOYED BY THE ELECTION RESULTS, THE OPPOSITION PARTIES ARE UNLIKELY TO COOPERATE. UNLESS THE GOVERNMENT IS PREPARED TO USE THE GUILLOTINE, WHICH IT HAS SO FAR PREFERRED TO AVOID, THE PRICE OF PASSING THE BUDGET MAY BE THE ABANDONMENT OF THE SALES TAX BILL IN ITS PRESENT FORM.

5. NAKASONE MUST HAVE HOPED THAT THE LOCAL ELECTIONS WOULD REINFORCE THE GOVERNMENT'S STANDING. INSTEAD, THE RESULTS ARE LIKELY FURTHER TO SAP HIS AUTHORITY WITHIN HIS PARTY. THE CONTINUED APPRECIATION OF THE YEN AND NAKASONE'S INABILITY TO CARRY HIS FISCAL POLICIES THROUGH THE DIET ARE SHARPENING CRITICISM OF THE GOVERNMENT'S PERFORMANCE, EVEN AMONG ITS OWN SUPPORTERS. IMPATIENCE WITH NAKASONE IS GROWING, BUT IT IS UNLIKELY THAT A SERIOUS ATTEMPT TO UNSEAT HIM WILL BE MADE BEFORE HIS PLANNED VISIT TO THE UNITED STATES.

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Japan joins the quark hunt

PA

Particle physicists in Japan are now the proud users of a world-beating electron-positron collider. This could be their opportunity to beat Europe and the US to some new discoveries

Bob Johnstone

FIFTY YEARS ago, the Japanese had the world of particle physics at their fingertips. They numbered leading theorists among their ranks, and were in a position to embark on important experimental work. The Second World War changed all that; in the aftermath, the occupying forces destroyed the Japanese particle accelerators. But the opportunity has arisen for experimental particle physicists in Japan to regain their pride. Last November, beams of electrons and their antiparticles (positrons) collided head-on at higher energies than ever before in a machine called TRISTAN. Now it is up to the 400 or so scientists at Japan's National Laboratory for High Energy Physics (KEK) in Tsukuba, where TRISTAN is located, to prove that their machine is capable of doing something more significant than breaking records.

Their stated aim is to find new elementary particles, in particular, the top quark—a sixth variety of the fundamental quarks, which has so far eluded physicists elsewhere. If KEK's physicists can pull this off, they can expect newspaper headlines at home, plaudits from the physics community abroad—perhaps even a Nobel prize. Above all, they can expect continued large-scale funding from their government. But the Japanese know that they have to hurry, for in a few short months their "window of opportunity" will slam shut, as bigger and more powerful accelerators in Europe and the US come on line. Failure to find anything exciting in the new energy range will inevitably relegate Japanese scientists to their familiar, humiliating role of handmaiden in projects elsewhere.

This would be a bitter blow, for Japanese particle physics has come a long way since 1945, when the American forces of occupation confiscated the cyclotrons at Tokyo and Osaka and threw them into the sea. Though this was done to stop research on atomic weapons, it also put paid to Japanese aspirations to play a major role in particle physics.

Until that point, Japanese scientists had been among the leaders. They had managed to produce a line of distinguished theorists, stretching back to Hantaro Nagaoka. In 1904, Nagaoka proposed a "saturnian" model of the atom—that is, a massive positive nucleus surrounded by a ring of electrons—eight years before Rutherford proposed his atomic model. In 1917, Nagaoka founded the Institute of Physical and Chemical Research in Tokyo where, 20 years later, the first cyclotron outside the US was built.

Nagaoka also inspired Japan's best-known scientist, Hideki Yukawa. Yukawa's prediction in 1935 of the existence of a particle to carry the strong nuclear building force won him Japan's first Nobel prize. His schoolmate, Shin-ltiro Tomonaga, won a second Nobel for Japan for his work during the Second World War on quantum electrodynamics—the quantum theory of the electromagnetic force. Unlike Nagaoka, who had studied in Europe under Planck, Yukawa and Tomonaga were entirely educated at home, indicating how high the level of work in particle physics had become in Japan.

After the war, Japanese theorists continued to make a significant contribution to particle physics. Most notable was Kazuhito Nishijima's introduction of the "strangeness" quantum number, which helped to make sense of the relationship between new particles. But theory without the experimental hardware to test it on is rather like having only

KEK

Japan's National Laboratory for High Energy Physics, KEK, occupies a site of only 2 square kilometres not far from Mount Tsukuba. To fit on this site, the new machine, TRISTAN, is shaped like a square with rounded corners

e chopstick with which to eat. For many years, Japanese earchers who wanted to practise high-energy physics were ced to go abroad, principally to the US. Many did not urn.

Immediately after the war, the Japanese government nply did not have the funds to support the construction of particle accelerators. Such machines, as were built, were all and, owing to a shortage of decent materials, did not ork well. The physicists had to pool their scanty resources, ubbing together to form inter-university institutes. The first these was the Mount Norikawa Cosmic Ray Observatory, tablished in 1952. Next came the Institute for Nuclear udies, founded at Tokyo University in 1954; this became e first Japanese institute to have accelerators after the war. he most important of these was a 750-megaelectronvolt leV) electron synchrotron, which was completed at the end 1961. Experiments began the following year, effectively arking the birth of the modern high-energy physics com-unity in Japan.

This synchrotron served as a training machine for many ysicists. In 1965, it was upgraded to 1·3 gigaelectronvolts eV). But by then the Japanese were 20 years behind the est, where machines such as the proton synchrotrons at ERN, the European research centre in Geneva, and at the ookhaven National Laboratory in New York, could reach ergies of 30 GeV or more. Realising in 1959 that their achine would be inadequate, Japanese physicists formed a udy group to design a big accelerator. By 1962, they had rsuaded the Science Council of Japan—a representative dy of top Japanese scientists—to recommend that the vernment should establish a new institute to house the big achine.

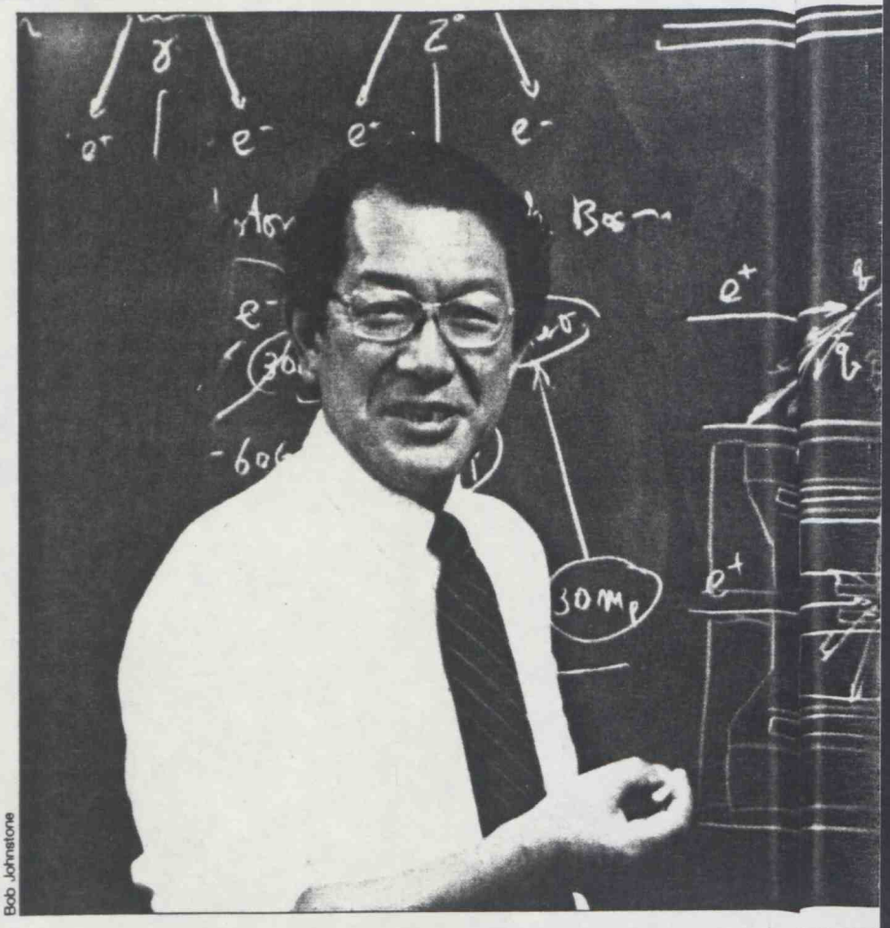
Reaching consensus on any new proposal takes time in pan, however, and it was not until 1971 that KEK (the tters stand for "Ko Enerugi butsurigaku Kenkyujo"—High nergy Physics Laboratory) was officially established. This is ow going, even by Japanese standards. One reason it took so ng was that the physicists could not make up their minds hat sort of machine they wanted. Another was that when ey had decided, they asked for far more money than the onsoring body, the Ministry of Education, Science and ulture, could possibly afford. At one stage in the discussions, ey proposed a proton synchrotron to operate at 40 GeV for institute that would have a staff of 900 and an annual udget of Y30 billion (£120 million). The most the ministry uld manage was a quarter of that. After much anguished iscussion, the scientists bit their lips and settled for a much maller machine.

Trimming down the dreams

This became KEK's first accelerator, a synchrotron that ccelerated protons to 12 GeV. It began experiments in 1976. he institute's second machine, an electron storage ring oper-ting at 2·5 GeV, started up in 1982. This is known as the hoton Factory because it is used exclusively to generate ynchrotron radiation.

The initial proposal for TRISTAN, KEK's third and major achine, dates back to 1973. The proposal was an ambitious ne, as the original reading of the accelerator's acronym—Tri-Ring Intersecting Storage Accelerators in Nippon"—ndicates. The plan called for three rings in the same tunnel, conventional electron–positron collider, plus two rings with uperconducting magnets to guide the particles, one for olliding protons and antiprotons, the other for electrons and rotons.

This turned out to be overambitious. The first part to be ropped was the proton–antiproton ring, swamped by more owerful proposals from CERN and the US. Then, after onstruction of TRISTAN's tunnel had started, the West Germans decided to build an electron–proton collider HERA), thereby pre-empting the Japanese proposal. Now, nless something remarkable happens, the likelihood is



Bob Johnstone

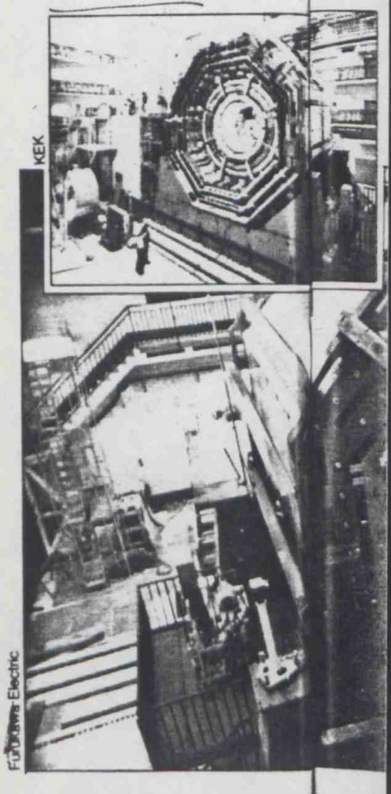
Why Japanese industry likes particle physics

THE LIST of companies participating in the TRISTAN project reads like a "Who's who" of Japanese heavy industry: Hitachi, Mitsubishi, Ishikawajima-Harima and Toshiba have all played important roles in building the accelerator and its detectors. So what exactly is the attraction of high-energy physics for such companies? "That's a very difficult question to answer," confesses Hiroyuki Akimoto, a senior engineer at Hitachi. "I can give you a lot of pretty reasons, but when it comes down to it, our ultimate purpose is to make money."

Is particle physics a profitable business, then? "Well, no," admits Noboru Yamaguchi, manager of accelerator products at Mitsubishi Heavy Industries, adding that he has no confidence that it will ever be one, either. "But so long as it is not unprofitable, we don't mind." Do companies actually manage to break even? According to Akimoto, the answer is, no: "It's a bad practice," he says, "but the fact of the matter is that we can't make a profit from government projects." Other Hitachi employees reportedly claim that, far from making a profit, the company actually pays for 30 per cent of R&D on magnets itself.

Making up for this lack of profitability are several compensations. One is the prestige that attaches to participation in national projects. Image-conscious Japanese companies believe that it is good to have their names associated with research at the frontiers of science. Participation also presents a challenge to their young engineers.

The TOPAZ detector features what is reputedly the largest superconducting magnet in the world —the shiny inner cylinder visible in the main picture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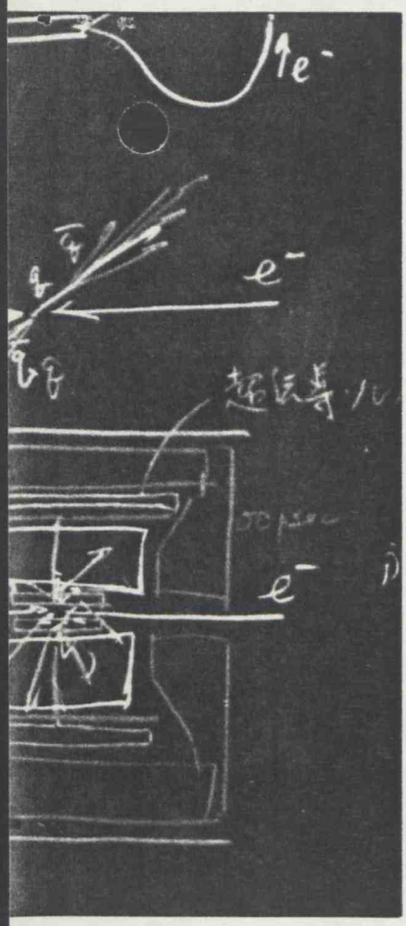


Satoshi Ozaki is chief director of the TRISTAN project. Once a group leader at the Brookhaven National Laboratory in the US, he returned to Japan in 1981

that TRISTAN will remain an electron-positron collider, and the first initial in its acronym has accordingly been modified to read "transposable". Two legacies from the original plan remain, however. One is that TRISTAN's tunnel is large enough to accommodate several rings; the other is that KEK has continued research on superconducting technology, a field in which Japan now claims to lead the world.

The construction of TRISTAN began on 19 November 1981. In total, the accelerator has cost Y87 billion to build, a little more than £350 million at the current exchange rate. That such an expensive machine has come into being in Japan at all is a tribute to the extraordinary powers of persuasion of Tetsuji Nishikawa, KEK's charismatic second director. Well-connected academically (his father was a professor at Tokyo University) and politically (through his mother's family), Nishikawa was TRISTAN's original proposer.

Nishikawa also talked top expatriate Japanese physicists into returning to work at KEK. This was a significant achievement for, at an educated guess, returnees account for anything up to 20 per cent of the institute's staff. Their chief is Satoshi Ozaki, formerly a group leader at the Brookhaven National Laboratory in the US, who returned to Japan in 1981 to take over direction of the TRISTAN project.

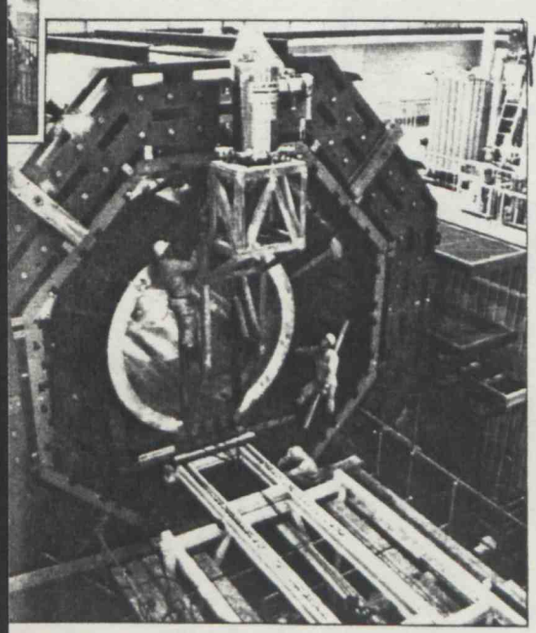
KEK had a limited amount of land on which to build TRISTAN—the site is only about 1 kilometre wide by 2 kilometres long. In Japan, property rights extend in principle to the centre of the Earth. Rather than try to get permission from the neighbouring farmers to dig under their land, TRISTAN's designers decided to keep the ring within KEK's boundaries. "Our design philosophy," explains Ozaki, "is, given the land, how to get the highest energy." The result is not a circle, but a square with the corners rounded off.

TRISTAN consists of four linear accelerators, each 194 metres in length, connected by arcs. The total length is about 3 kilometres. The long linear sections give the electrons as much energy as possible.

One difference between TRISTAN and accelerators elsewhere lies in the people who built it. According to Ozaki, "In Japan we use industrial technology extensively." KEK's scientists design and write specifications for components which are then built by industry, rather than by technical support staff within the project. And KEK has no workshops for building equipment for TRISTAN. When R&D is necessary, the scientists do it jointly with industry. "In this ▸

More practically, however, the companies reckon that participation can raise the level of their technology. Yamaguchi cites welding technology as an area where Mitsubishi has learnt something. "Before we participated in the TRISTAN project, our welding was merely strong. Now we can also make it very tightly vacuum-proof as well, using such techniques as electron-beam and tungsten-gas welding."

Huge companies like Mitsubishi and Hitachi may scratch their heads and ask themselves why they bother with such an unprofitable business; other, smaller companies, however, have fewer doubts. A good, if not the best, example of such a company is Furukawa Electric, a specialist cable-maker whose involvement with KEK has turned it into one of the world's leading suppliers of superconducting materials. Tsutomu Isobe, its director of R&D, lists three ways in which his company benefits from joint research with KEK.

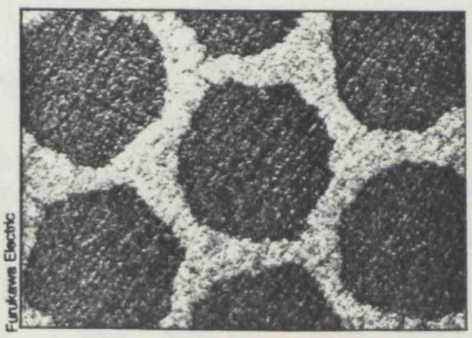


The first is the challenge that such research presents: "KEK demands the highest technology that industry is capable of," he says. "The conventional is not good enough—the scientists there want the best possible equipment for their experiments. Our hope is that helping them produce it will advance our technology."

In Isobe's view, KEK's physicists represent the best Japanese brain power in a variety of different fields. Access to such people can allow you to learn a great deal. Ordinarily, when a company contracts to make something for a client, the client presents a set of technical specifications to fulfil, leaving it little leeway for its own initiative. By contrast, at KEK, Furukawa's engineers get to work hand-in-glove with the laboratory's scientists.

Isobe claims that this contact provides his company with the added benefit of a two-way flow of information. KEK is an international institute, whose members have close links with other institutes, such as CERN and Fermilab, in different parts of the world. Through these links, Furukawa can obtain information about developments elsewhere of potential value to its business. "Conversely," he points out, "if we develop something, then KEK's scientists will disseminate information about it all over the world." Blowing its own trumpet could never have the same effect for the company.

The intimate relationship between KEK and industry also has its disadvantages. For example, what happens when industry learns all it wants to know from high-energy physics? Companies do not mind building one of something, because they stand to learn from the experience. But they are much less willing to make a second one, especially if there is no profit in it. Another, more serious, disadvantage of having industry make everything is that it prevents KEK from developing its own high level of technical expertise. This is unfortunate, because it is just this sort of expertise that can ultimately lead to breakthroughs in such crucial areas as the design of detectors. Both CERN and Fermilab have made crucial technical advances in-house. □



A close-up of superconducting wire shows the fine filaments of superconductor embedded in normal metal

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JAPAN: ECONOMIC REPORT: FEBRUARY 1987

- The Government's draft budget for the fiscal year 1987 is having a difficult passage through the Diet, mainly because of opposition (from both the main opposition parties and from some sections of the ruling Liberal Democratic Party) to the proposed new sales tax. It is now almost certain that the draft budget will not be passed before the beginning of the new fiscal year on 1 April, and some form of provisional budget will be necessary. Commentators are now speculating whether the Government will be able to pass the sales tax as planned, or whether it will be obliged to modify or delay its proposals.

- Further measures to stimulate the domestic economy may be introduced quite early in the new fiscal year. It is possible, however, that an early package would have little budgetary impact, with a more substantive programme for additional public spending being reserved for a supplementary budget later in the year.

- The yen remained very stable throughout the month, both before and after the G5/G6 meetings in Paris on 21 and 22 February. It closed at Y153.30 on 26 February. No significant intervention by the Bank of Japan was reported during the month.

- In a move co-ordinated with the G5/G6 meetings, the Bank of Japan cut its official discount rate, for the fifth time since September 1985, to a new record low of 2.5%.

- Industrial production fell by 0.7% (seasonally-adjusted) in January, in marked contrast to the increase of 3.6% seen in December.

- The unemployment rate rose to 3.0% in February. Although widely anticipated, the breaking of the 3% barrier provoked widespread press comment and calls for measures to stimulate the economy.

- The current account surplus in January was $8.8 billion after seasonal adjustment, $0.9 billion higher than in December. After three months of decline the year-on-year export volume index rose by 1.1%, prompting concern that the trade surplus is once again showing signs of expanding.

GNP DATA (TABLE I)

1. GNP figures for the fourth quarter of 1986 are due to be published shortly. A new comparison of GNP per capita, published by the OECD, estimates that in 1986 Japan ranked third after the United States and Norway in nominal GNP per capita, with $16,200 against $17,200 for the US. When expressed in terms of purchasing power parity, however, Japan ranked eighth, with a real GNP per capita of $12,200 against $17,200 for the US.

TABLE I: GROSS NATIONAL EXPENDITURE

(Real, seasonally-adjusted, base year = CY 1980)

Percentage change over the preceding period

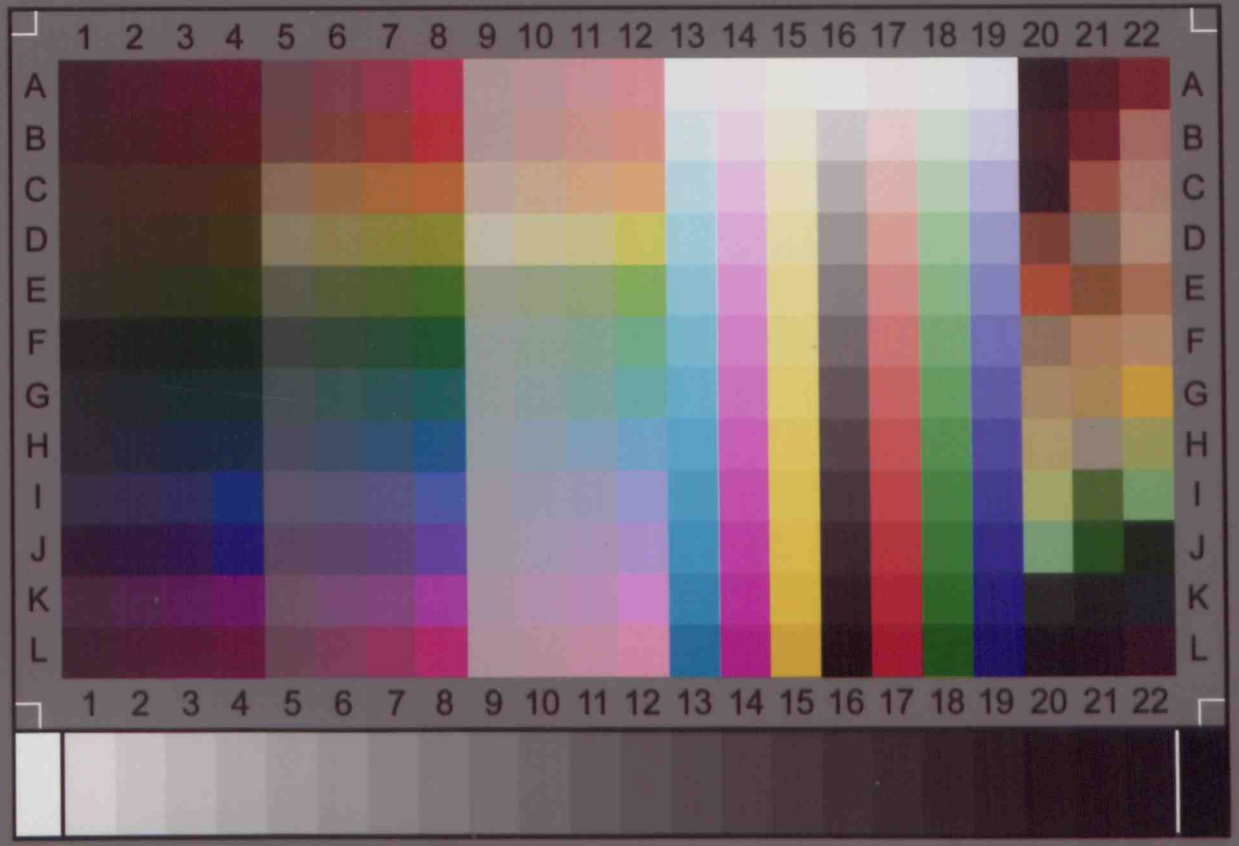
	FISCAL YEAR			QUARTER ENDING			
				1985	1986		
	1983/4	1984/5	1985/6	DEC	MARCH	JUNE	SEPT
Consumers' Expenditure	3.0	2.6	2.6	0.5	0.4	1.2	1.3
Private Housing	-8.9	0.5	2.9	1.7	1.5	3.3	7.1
Private Investment	4.9	11.4	12.9	2.6	0.3	0.4	0.5
Private Inventories	-20.2	95.4	8.7	15.3	-20.5	-63.0	26.6
Government Current Expenditure	3.5	2.6	1.9	1.0	0.9	0.4	1.1
Government Capital Expenditure	- 2.2	-2.9	-6.4	1.7	0.3	3.6	1.6
Government Inventories	na	na	79.1	41.4	-93.5	8119.9	-44.8
External (Net)	135.7	48.8	19.9	-1.2	-13.0	-27.8	-11.7
Exports	8.7	15.5	1.8	-1.8	-3.3	1.6	-1.0
Imports	-0.5	9.8	-2.4	-2.0	-0.4	9.1	0.8
GNE (Percentage change)	3.7	5.1	4.3	1.2	-0.4	0.9	0.6
GNE (Y Billion)	267699.7	281256.2	293332.7	295760.3	294483.4	297230.1	299128.5
Memo item: Nominal GNE	4.3	6.7	5.9	1.7	- 0.1	1.9	0.9
(Y Billion)	284058.3	303019.8	320774.8	324425.7	324076.8	330161.7	333046.1

PART 1 ends:-

Tokyo Saving Tel No 8 1.10.86

PART 2 begins:-

Tokyo Saving Tel No 2 5.3.87



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