



Ref: B06508

PRIME MINISTER

c Sir Robert Armstrong

Policy Towards Japan
(OD(82) 43)

BACKGROUND

1. In discussion of policy towards Japan at a meeting of Permanent Secretaries last January, it was agreed that we needed to work out a more coherent strategy for handling our economic and political relations with Japan. As a result, MISC 68 was set up to prepare a report for Ministers which would define as clearly as possible what should be our long-term relationship with Japan. This is the report before OD, circulated under cover of a note by the Secretary of the Cabinet.

2. You may recall that last February, E Committee invited the Secretary of State for Trade to circulate a memorandum on the problems arising from Japanese trade policies (E(82) 6th Meeting, Item 4). The Secretary of State for Trade is writing this afternoon to say that he regards the trade problem as adequately dealt with in OD(82) 43 and that no memorandum is necessary.

FLAG A
FLAG B

3. The Chancellor of the Exchequer has circulated a speaking note on Japanese macro-economic policy for your use at Versailles, based on paragraph 8 of the note by the Secretary of the Cabinet (OD(82) 43).

FLAG C

4. The purpose of the discussion in OD is to enable Ministers collectively to comment on the work that has been done, on the line that you might take at the Versailles Economic Summit next week, and to consider whether further work needs to be set in hand thereafter.

5. The Secretary of State for Industry has been invited to attend.



HANDLING

6. There is no lead Department on this broad subject. You may wish to introduce the discussion, drawing on the note by the Secretary of the Cabinet. You may wish to stress the following points.

(a) The elaboration of a general British policy towards Japan is an exceptionally complex and difficult matter: we cannot act in isolation from our partners and allies. In the key area of trade policy, our European Community membership means that we are not free agents.

(b) The report by officials poses the main questions about our relations with Japan which need to be considered.

(c) The key question is whether the West collectively can afford to be tough with the Japanese in the knowledge that at the end of the day they have no real alternative to maintaining their close links with the West.

(d) It would be tactically unwise for the United Kingdom to get out ahead in taking a tough line with Japan and so finding ourselves isolated. At Versailles we should aim to get a serious discussion going about the Japanese problem without ourselves making all the running. In the light of that discussion, we should consider what scope there is for a tougher approach.

7. You might then invite the Foreign and Commonwealth Secretary, the Chancellor of the Exchequer, the Secretary of State for Trade and the Secretary of State for Industry to comment on the paper as it affects their particular responsibilities.

CONCLUSIONS

8. Subject to the discussion, the aim should be to secure agreement to the conclusions in paragraph 10 of the note by the Secretary of the Cabinet (OD(82) 43).

ADS Goodall

26th May 1982

A D S GOODALL



B

Japan

PRIME MINISTER

We are due to discuss in OD(E) later this week the report of the group of officials on Policy Towards Japan, which has now been circulated by Sir Robert Armstrong under his note OD(82)43. At a meeting of E Committee on 25 February my predecessor was invited to circulate a memorandum on the problems arising from the trading policies of Japan, which could be discussed at the same time as the Official Group's report. The trade problem seems to me to be dealt with quite adequately in the paper which we shall have before us, and although there are of course a number of points I shall want to make at the meeting, I do not think there is any need for me to prepare a separate note for this occasion.

Copies go to our E colleagues and Sir Robert Armstrong.

LORD COCKFIELD

*(Approved by Secretary of State,
and signed in his absence)*

Department of Trade

26 May 1982



Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

POLICY TOWARDS JAPAN

Paragraph 8 of Sir Robert Armstrongs note OD(82)43 mentioned that the Treasury were working out a speaking note about Japan on which you could draw at the Versailles Summit. It may be helpful to have this before us at OD tomorrow, and I attach the draft which officials have prepared.

2. I think it is important that we should not pull our punches with the Japanese and should impress on them the risks to which their policies expose them. I believe we also have to urge this line in the Community, and the analysis in the speaking note is intended to attract wide support.

3. The Japanese would be reassured if others failed to support us: indeed they might form the impression that substantial pressure comes from the UK alone. That makes the effort of persuasion with Community partners, and also with the Americans, all the more important.

4. Copies of this minute go to our OD colleagues, and to Sir Robert Armstrong.

A handwritten signature in black ink, appearing to be 'G.H.'.

(G.H.)

26 May 1982

SPEAKING NOTE ON JAPAN AND THE OPEN WORLD ECONOMIC SYSTEM

1. Welcome steps which Japan has been taking to open up its domestic markets rather more to imports. But must say there is a long way to go before Japanese economy is same kind of open economy, in trade, investment and finance, as other major free economies. Very important because Japan now second largest free economy.

2. Open market economy can only work if openness is reciprocal between us in all the major areas of trade, investment, finance. Free flow of capital goes with free flow of trade. Have mutual responsibility here. If a major partner takes from the system without contributing to it to a corresponding extent, that promotes resentment, protectionism.

3. Worry that strong, successful Japanese economy which has benefitted greatly from open trading system is still itself much less open than other Summit economies. Some facts:
 - i. excess of growth of exports over growth of imports has contributed almost 1½ per cent a year to growth of Japan since 1973. More than offset extra cost of oil. In other Summit countries net external expansion contributed on average about ¼ per cent a year to growth over same period.

 - ii. imports of manufactures about 10 per cent of GDP in other Summit countries, 3 per cent in Japan. Share in Japan fallen sharply over last 20 years.

 - iii. Japanese exports concentrated. If look at top 5 categories of exports in Japan, Germany, UK - they account for 60 per cent of all Japanese exports, 45 per cent of all German exports, 38 per cent of UK exports. Nature and direction of Japanese exports such that official export credit covers 8 per cent of them - more than any other Summit country. Four per cent average for OECD countries generally.

- iv. direct investment in Japan difficult. In 1980 direct investment in US \$11 billion; UK \$5 billion; France \$3 billion; Japan only \$300 million.
- v. very high Japanese savings. But Japanese direct investment overseas modest. 1980 - US \$18 billion; UK \$6 billion; Germany \$4½ billion; Japan \$2½ billion.
- vi. role of yen small in international trade and finance compared with Japanese strength. World trade invoiced: 55 per cent dollars; 14 per cent deutschemarks; 8 per cent sterling; 6 per cent French francs; yen 2 per cent. And in official reserves dollar 70 per cent; DM 14 per cent; yen 3 per cent.

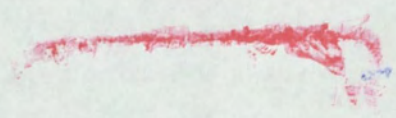
4. Cumulatively, suggests situation which puts strain on system, which is important to all of us and particularly important to Japan. Urgent need to move fast to more open economy as regards imports and movement of capital. But also to less dependence on exports for growth while this major adjustment is underway.

5. Risk that Japan so dependent on exports for growth that if export demand falters, eg because of recession in US, powerful Japanese economy stops growing. Seems to have happened recently.

6. Immediate problem worse if effect of Japanese policies is to produce not only heavy dependence on exports but low valuation of yen. Not just US interest rates. Japanese policies also enter into this. Yen now over 6 per cent lower than early in 1981.

7. Urge Japanese colleagues to devote similar resolution to this problem of lack of openness of Japanese economy as they successfully applied to oil shock. In their interests and ours to honour the basic principles of the free and open economic system. If not - grave risks of protectionism.

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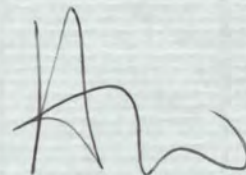
cc Mr. Mount
Mr. Vereker
Mr. Scholar

MR. COLES

OD(82)43: POLICY TOWARDS JAPAN

1. Although I agree with much of what is said in Robert Armstrong's covering letter and the report by the official group, it seems to me there is a very important omission in the analysis and consequently in the policy proposals. It fails to recognise the dominant reason for the superiority of Japanese industry, both in productivity and quality, especially in the manufacturing sectors. The main reason is simply the overwhelming efficiency of Japanese management. The fact that Japanese-managed firms in the UK, with unionised labour, produce at least twice as much per head, with the same technology, as UK-managed firms in Britain, is well-known, particularly in the consumer electronics business. And it's not just a matter of productivity, but the quality of products under Japanese management, even with British labour, is far higher than under British management.
2. These conclusions have been highlighted by a study carried out by the International Centre for Economics and Related Disciplines at the LSE - financed I believe largely by Japanese money and controlled by Michio Morishima.
3. I should have thought then that the central problem is to get Japanese management methods in Britain. These methods are spreading rapidly and with enormous success in the Far East in countries such as Taiwan, South Korea and Singapore. I suspect they will begin to spread in South Asia extensively over the next decade. I believe that Britain should be well in the van of encouraging Japanese management in this country.

Agreement among rest of us.



26 May 1982

ALAN WALTERS

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