

PRIME MINISTER

10 June 1985

E(A) DISCUSSION: COMMERCIAL POLICY TOWARDS JAPAN

Further deregulation of the Japanese financial market looks the most promising route towards reducing Japan's trade surplus.

The Yen is undervalued. The deregulation which has so far been achieved - notably the removal of exchange controls in 1980 and the establishment of a Euroyen market - has encouraged an outflow of funds (\$50 billion last year) in search of higher interest rates. This weakened the Yen, making Japanese products more competitive and the Japanese market more difficult to penetrate. If deregulation can be pursued further, eg less regulation of interest rates on bank deposits and Post Office savings accounts, new financial instruments, such as Treasury Bills, freer access to the market by foreign banks - Tokyo would compete better for savings, Japanese interest rates would probably rise, and so would the Yen.

We want better access to this market. The 75 foreign banks in Tokyo account for only 1% of all the Yen deposits, whereas 30 or so Japanese banks in London take 2½% of all sterling deposits. Our merchant banks are finding it hard work obtaining securities dealing licences in Japan (2 have done so recently; several more are still waiting).

Tactics

We should try two approaches:

1. Try to persuade the Community to put the "internationalisation of the Yen" as a main priority. Our partners will have less interest than we have in access to the Japanese market for financial services, but they ought to share our concern that the Yen should be higher.

2. Adopt a robust bilateral negotiating stance with the Japanese on access. There is a queue of Japanese seeking access to the London market. We should use what powers we have, and bluff where we do not, to secure an open policy on the part of the Japanese. The Banking Act, 1979 provides us with useful leverage, which the Chancellor is much keener to use than the Bank of England. The Act does not specifically refer to reciprocity, but it provides a means of exerting pressure by administrative delays. The Act refers to "fit and proper persons", "proper banking bodies", and it enables us to satisfy ourselves that the supervisory régime in Tokyo is as we would wish to see.

Imports

We should go along with setting the Japanese a target level on manufactured imports, as a percentage of GDP, with the threat that failure to achieve this would trigger GATT action. We should be aware of the limitations in this approach:

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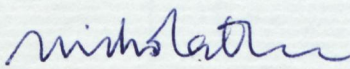
1. If Japan imports more manufactures, her import-competing industries will do something else; quite possibly, they will export more. In other words, this measure will not reduce the trade surplus by as much as we might hope.

2. Any target will be arbitrary. There is no reason at all why, for example, the OECD average propensity to import manufactures would be appropriate, since Japan's economic structure reflects her heavy dependence on imports of oil and raw materials, and her outstanding manufacturing capabilities. Large economies also tend to import proportionately less than small ones. The target ought to be set sensitively, so as to avoid placing the Japanese under an unreasonable obligation, which, sooner or later, will make them sullen and less co-operative than Mr Nakasone is proving.

Recommendations

1. Go for financial liberalisation with a two-pronged attack. Ask Nigel Lawson to explain what sanctions we can impose on Japanese banks to secure reciprocal access to the Tokyo market.

2. Support the import target concept, provided that it is set at a realistic level.


NICHOLAS OWEN

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MR FLESHER

MINISTERIAL STEERING COMMITTEE ON ECONOMIC STRATEGY
SUB-COMMITTEE ON ECONOMIC AFFAIRS, 11 JUNE, 10.15 am

--- I attach a brief for the Prime Minister on commercial
policy towards Japan (E(A)(85) 33).

I am sending copies to Sir Robert Armstrong and Mr Wiggins.

DF Williamson
D F WILLIAMSON

7 June 1985

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cc to
B/SP.

MINISTERIAL SUB-COMMITTEE ON ECONOMIC AFFAIRS, 11 JUNE AT 10.15 am

Chairman's Brief

UK AND COMMUNITY COMMERCIAL POLICY TOWARDS JAPAN
(E(A)(85)33)

PURPOSE OF MEETING

1. To decide the United Kingdom line in the review, expected to begin later this month, of Community policy towards Japan.

BACKGROUND

2. Ministers agreed at ES(84)1st Meeting that the United Kingdom's best interests continued to lie in combatting protectionism; that we should therefore take a generally positive attitude to further rollback; and that, in particular in any new GATT round, it should be one of our objectives to open up the Japanese economy. This objective has been consistently pursued in subsequent contacts with the Japanese. Success so far has been almost negligible. The Japanese trade surplus with the rest of the world is expected to be over \$50,000 million in 1985.

3. The Secretary of State for Trade and Industry's Note, therefore, draws attention to the lack of progress made by Japan in liberalising its economy. The details of Prime Minister Nakasone's Action Programme, which are expected to be unveiled in September, will be a test of Japanese good faith. Something may then be achieved. The discussions, however, at the Trade Expansion Committee on 30-31 May and the Community-Japan high level talks on 3-5 June were not good, with the Japanese appearing more interested in defending their own

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system and the status quo than in finding ways of meeting European problems and complaints. At these meetings the Commission identified some specific Community interests and stressed to the Japanese that it will not be enough to concentrate on satisfying United States requests.

MAIN ISSUES

4. In E(A)(85)33, the Secretary of State for Trade and Industry argues that the Community needs to take a tougher and more concerted line towards the Japanese. We should seek to persuade our Community partners that the prime objectives now should be - to secure an increase in Japan's imports of manufactured goods to reach a target level which should be set in line with that for OECD countries, and - the internationalisation of the yen through the more rapid liberalisation of financial markets.

5. Recent soundings by posts in other Community capitals suggest there is widespread dissatisfaction about the rate of progress, and pessimism - particularly in Paris - about the Japanese intention to deliver.

6. The memorandum (E(A)(85)33) refers to a risk that foreign criticism - and in particular the threatened introduction of United States discriminatory measures against Japanese imports this autumn - could drive the Japanese into a more isolationist and nationalistic mood. It is, however, evident that open international trading is in their own best interest. This risk, therefore, by no means precludes taking a tougher line in further discussions with the Japanese.

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Import Target

7. An import target for manufactured goods would provide a means of testing the effectiveness of market opening measures. It is likely to be more effective than the recent level of general discussions in which the Japanese have always stalled. The Japanese are likely to argue that because of their dependence on imported raw materials, it is unreasonable to expect them to reach the same import propensity level as the Community. It might therefore be more effective to set import targets for several major sectors rather than a single global figure. The United States did not support earlier the concept of an import target, but we understand that they may be prepared to reconsider this position.

Sectoral Approach

8. The United States has put substantial resources into the Market Opening Sector-Selective (MOSS) scheme, which has identified four priority sectors (telecommunications; electronics; forestry products; and pharmaceuticals and medical equipment) for detailed joint study to identify the effective barriers to Japanese imports. Neither the United Kingdom nor the Community are likely to have adequate resources to mount an initiative on a similar scale. There could also be some difficulty in getting Community agreement on priority sectors. We have seen the Trade Expansion Committee as a possible vehicle for getting action on specific sectoral requests, but the lack of progress at last month's Trade Expansion Committee means that the Community will need to think about how it can be made more effective. We should not decide lightly to abandon the Trade Expansion Committee altogether however, in the absence of other fora in which to put detailed and specific pressure on the Japanese.

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Financial Markets and Role of the Yen

9. Liberalisation of Japanese financial markets and promotion of an international role for the yen are key objectives. The Japanese themselves wish to see Tokyo as a major financial centre and among Community countries the United Kingdom has a particularly strong interest in seeing improved access to Japanese financial markets. For competence reasons, we would prefer to continue to pursue this topic primarily on a bilateral basis rather than in a Community framework but the Treasury's series of discussions with Japanese officials has so far made disappointing progress.

10. Treasury officials and the Bank of England have identified means by which existing instruments for obstructing Japanese participation in United Kingdom financial markets could be used if significant progress is not made. These are not, however, by themselves likely to provide sufficient leverage to secure the opening of Japanese markets.

GATT Article XXIII

11. The threat of reactivating the GATT Article XXIII action may carry some weight with the Japanese, but probably only if the United States give support. Some member states - including the Germans - would be reluctant to agree to reactivation but may be prepared to agree to it as a reserve threat. It should be kept in reserve but not too much importance should be attached to it.

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Contact with the United States

12. The United Kingdom and the Community need to keep in close contact with the Americans on policy towards Japan, particularly since work on market opening is likely to continue well into the proposed new GATT round. The Americans are however reluctant to be seen to be acting in open concert with the Community, and have tended to believe that they can make satisfactory progress on their own with the Japanese. This attitude may change, depending on the success of the sectoral exercise and the shape of the detailed Action Programme.

Voluntary Restraint Arrangements

13. The Community's voluntary restraint arrangements with Japan expire at the end of 1985. A Community review of the desirability of renewing or revising these would not prejudice the outcome of the review which United Kingdom Ministers have already requested of our own national voluntary restraint arrangements with Japan and other third countries. Even if it were concluded that it would not be desirable to continue the Community agreements, their dismantlement could be used as a bargaining counter in multilateral trade negotiations.

HANDLING

14. The Secretary of State for Trade and Industry will introduce the paper. The Foreign and Commonwealth Secretary may want to comment on the likely amount of support within the Community for a tougher line on Japan, and on the scope for closer concertation with the United States. The Chancellor of the Exchequer may wish to comment on the financial services and yen internationalisation aspects of the paper.

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CONCLUSIONS

15. You may be able to conclude that:

i. the United Kingdom should make quite clear to the Japanese, both through the Community and in bilateral contacts, its mounting concern about the slow rate of progress on trade liberalisation;

ii. the Community must maintain pressure on Japan to take practical steps to liberalise her internal markets; to promote a wider international role for the yen; and to raise manufactured imports to a target level (which could be set by sectors) in line with that for OECD countries;

iii. the role of the Trade Expansion Committee should be reviewed in order to ensure that the Community's specific requests are pursued as vigorously as possible;

iv. the United Kingdom should argue for the possibility of reactivation of the Community's action under GATT Article XXIII to be kept open, and for the Japanese to be made aware that this option could be pursued if substantial progress is not made within a reasonable timescale;

v. the United Kingdom should support vigorous action by the Community against unfair trade practices such as dumping, and a full review of the Community's existing voluntary restraint arrangements with Japan before their expiry at the end of 1985;

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vi. there should be closer contact between the Community and the United States about their policy towards Japan (while maintaining our own bilateral consultations with the United States), and support from the United States and other trading partners in seeking significant concessions from Japan in any new GATT round;

vii. the United Kingdom should continue bilateral discussions with the Japanese on financial services and the role of the yen;

viii. if Prime Minister Nakasone's Action Programme proves to be a damp squib and other progress is unsatisfactory, Ministers should review the situation again in the autumn.

Cabinet Office

7 June 1985

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