

BILATERAL WITH MR. NAKASONE

1. Thanks for receiving the 2000 Group.
2. Any points from Summit discussion.
3. Must remember that one country's surplus is another country's deficit. Up to those running large surpluses to do everything possible to remove restrictions and change attitudes to imports in their own markets.
4. They also have a particular responsibility not to stray from agreed practice on credits. Very surprised to find
/Japan

Japan linking up with Italy - which imposes severe limits on imports of Japanese cars - to offer excessively favourable credit terms on Bosphorus Bridge. Is the lesson that we should similarly restrict import of Japanese cars?

5. Japanese Government should also set an example on import policy in field of public purchasing.

PRIME MINISTER'S BILATERAL WITH MR NAKASONEOur Objectives

(a) To discuss Summit and other international issues, with particular emphasis on continuing need for Japan to reduce all her trade surpluses.

Arguments

(a) Pressing political need for Japan to take action to rectify trade imbalance if demands for protectionism in USA and Europe are to be resisted. Cannot wait for new GATT round: urgent action needed now to create favourable environment for negotiations. Must take account of EC as well as US concerns. (refer to PMV(85)1 + PMV(85)2).

(b) Welcome Mr Nakasone's 9 April statement and look for continuing liberalisation of financial markets and increased purchases of manufactured imports. But Japan will be judged by results. Japanese Government needs to lead by example in areas such as defence procurement and civil airline purchasing. (Harrier; Tornado; BA146 airbus and Shorts' 360 airliner).

Tactical Arguments

(a) Lack of success in Japan by industrial sectors with proven success elsewhere in the world shows that products and marketing are available to meet Japanese requirements.

(b) Appreciate that Japanese low propensity to import is in large part cultural factor. But in our interests (especially Japan's) to preserve and strengthen fully open trading system.

/ His Objectives

His Objectives

- (a) To secure the Prime Minister's understanding of Japan's trade policies and problems (and to enlist her support for an early launch for new GATT round).
- (b) To discuss East/West relations and US/Soviet arms control talks (refer to PMV(85)13 and PMV(85)11).

Your Response

See objectives above.

Background

- (a) Prime Minister last met Mr Nakasone at London Summit and afterwards for his short Guest-of-Government visit to the UK.

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- (b) Mr Tebbit met Mr Nakasone on 16 April during his visit to Japan. Record of the call is attached.

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PRIME MINISTER

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Prime Minister
Mr. Tebbit's account of his
visit to Japan.
understand that he intends
to give Cabinet a brief
summary tomorrow.

CDP 24/12.

VISIT TO JAPAN : 15-19 APRIL 1985

My visit, the first by a Secretary of State in the Trade or Industry field since January 1983, came at a significant time. In the light of their current preoccupation with their international trading position, it was regarded by them as an important event. Despite the pressure of Government and party business, and a simultaneous visit by the Dutch Prime Minister, Senior Japanese Ministers went out of their way to find time to see me, including the Prime Minister, (who sent his warm regards to you, which I hereby convey) the Foreign Minister and the Ministers for Trade and Industry and Finance. A list of meetings is annexed. Separate records of each meeting have been circulated.

2 Recent events in Japan made the emphasis of my visit necessarily upon trade issues. In response to rising criticism of Japan's increasing trade surpluses coupled with her low propensity to import, reflected most recently in US Congressional pressure for action against Japanese imports and the EC Foreign Affairs Council declaration of 19 March, Prime Minister Nakasone on 9 April announced a further market-opening package. Although this included many of the kinds of limited, though not unimportant, measures contained in its predecessors, such as the promise of tariff reductions and concessions on non-tariff barriers, it represented potentially a significant departure. First it implicitly recognised that the inaccessibility of Japan's market was due to structural or cultural factors as well as formal obstacles. And secondly, it addressed, even if tentatively,

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the key problem of how Japan's propensity to import might be changed. An Action Programme is to be worked out by July, under the personal supervision of the Prime Minister, to secure results over a 3 year period.

3 The immediate reactions to the package will not have reassured Mr Nakasone. There is scepticism both in Japan and elsewhere about the ability of the Government to manage a fundamental change in the attitude of consumers and industry towards imported goods. And there is concern in the Community that the main measures seem tailored principally to meet US objectives in a number of relatively limited and selected fields.

4 In my meetings, and notably with the Prime Minister, I laid stress on two aspects. First, I warned of the urgency of the situation and for the need for early action that would convince all Japan's trading partners that real and measurable results would be produced. I made no threats on the part of the UK; indeed I said that we perhaps had more understanding of Japan's problems than others. However, I did foresee that, if Japan's surpluses with the US and Community continued to rise and her level of imports remained unchanged, unilateral protectionist measures would be proposed which would not just harm Japan but would threaten the whole of the liberal international trading system upon which the UK, no less than Japan, depended. Secondly, I placed emphasis on the need for the Japanese Government to give a firm lead to industry and consumers in purchasing goods from abroad, for example through its procurement policies. Action could not simply be confined to exalting consumers to change their traditional preference for domestically produced goods. I did, however, show some appreciation of the proposal by MITI to call in 60 leading

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Japanese companies to "explain" the problem and the contribution which they could make - that, in Japanese terms, could represent a powerful instrument for change.

5 I placed most emphasis on the multilateral nature of the problem, although naturally referring to our £2.8 billion deficit with Japan. Nevertheless, I did take the opportunity to advance British interests, principally by illustrating ways beneficial to us in which the Japanese Government could show its determination to increase its ratio of imports and its commitment to the liberalisation of its internal markets. I was able to point to the possibility of advancing the purchase of civil aircraft and referred to the competitiveness of the BAe 146, the Shorts 360 and the Airbus. I cited defence equipment as another area where substantial contracts could be placed, mentioning Sea Harrier and Tornado. In the civil field, I confirmed that our firms were interested in supplying telecommunications equipment, particularly peripheral systems, since that is a sector where the US is clearly intent upon securing a preferential position. And, within the general framework of market liberalisation, I pressed for non-discriminatory treatment for our whisky and tobacco exports.

6 In addition to the need for direct action to change the import balance, I raised the issue of the Yen and the liberalisation of the internal financial market, pointing out that were the Yen free to reflect the underlying strength of the performance of the Japanese economy - and were action elsewhere to be taken to correct the over-valuation of the Dollar - it would be reasonable to expect that the problem of surpluses and deficits would, over time, be largely self-correcting. In Japan's case, what needs to be done is to allow interest rates to fluctuate more freely and to

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develop new financial instruments which would facilitate Yen holdings by overseas investors; ultimately, one would also wish to see the Yen becoming more readily used as the basis for international transactions. I believe that these points are understood by the more internationally and liberally-minded Ministers and officials and the Prime Minister's programme includes a reference to the internationalisation of the Yen. It remains to be seen, however, how far and how fast the Government will be prepared or able to go down this road.

7 A road which they are taking, somewhat more slowly than the Prime Minister professes to wish, is the liberalisation of the financial market; an area in which the City naturally has an especially keen interest. Some progress has been made. Two UK institutions have been granted security dealers' licences and Barclays have applied for a licence to carry out cost banking - I was able to give positive support to their ambitions. But we need to maintain strong and persistent pressure, particularly in view of the risk that the US will persuade Japan to afford her institutions favoured treatment.

8 On the question of a new GATT round, I resisted the idea that action to deal with the "Japan problem" could be left for negotiations in that framework; that would be a further excuse for delay. Nevertheless, I emphasised that all participants, including Japan, would have to come to the table prepared to make significant concessions if the round was to be a success. I confirmed our commitment to making early progress, laying particular stress on the importance of thorough preparation.

9 My assessment, in relation to the question of Japan's

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international trading position and the associated issues of market opening and trade surpluses, is that the Nakasone package was conceived originally as part of a strategy to buy more time and to carry Japan through the period of preparation before a new round. The strength of feeling in the US, and to a lesser degree in the Community, was not foreseen and the Prime Minister has been shocked by the expressions of dissatisfaction at, for example, the OECD Ministerial meeting. (He has still to convince all his colleagues of the seriousness of the position and the need for concrete action but there is a growing realisation that promises and token market-opening gestures will not be enough. The difficulty which the Government faces is what to do. I think that the Action Programme will now contain more specific steps than would otherwise have been the case and that the Government may make, perhaps through public purchasing, a demonstration of their intention to buy more from abroad. (But it will be hard to make a real impact in the short term, and it is the short term that will count.

10 Our approach must be to maintain the pressure for change but to avoid, so far as we can bring influence to bear, either the US or the Community resorting to precipitate protectionist measures against Japan. That would be immensely damaging to the international trading system; it would end any hope of a new GATT round and would represent yet a further threat to the survival of that institution. These are considerations which will need to be heeded carefully at the Bonn Summit.

11 I will also be raising the question of the US and Community's attitude to Japan during my visit to Washington in two weeks time. I shall explore the possibility of a concerted effort by the US and the Community to speed the

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process of Japan's integration into the international trading and financial system. But I shall equally stress the need for the Administration to resist Congressional pressures for damaging protectionist measures - against any of the US's trading partners.

12 Although trade issues took up the greater time in my discussions, I was able also to impress upon Ministers and senior industrialists the importance which we attach to increasing industrial collaboration between Japanese and UK companies and to attracting investment of a kind that contributes positively to the UK economy through jobs, the transfer of skills and technology, and import substitution. The message was well received, partly because there is, I believe, a real appreciation of the progress which we have made in strengthening the economy, improving the operation of the market and enhancing the profitability of companies. We already account for a high proportion of Japanese (and US) investment in Europe and I believe that we can maintain our rate of success. I took every opportunity to promote interest in the "Britain Means Business" campaign which I launched earlier this month.

Not many jobs worth

13 In addition to a general exchange of views with the Keidanrein on trade investment, I met individually the Presidents of Nissan and Honda. With Nissan, I emphasised the importance which we attached to their making maximum use of UK component suppliers both for UK and Japan-built cars and resisted any suggestion that we would be prepared to relax our requirements on imported content. (In the case of Honda, I explained why we were not able to come to an immediate decision but assured Mr Kume that we would consider carefully and quickly the recent propositions, within the framework of a revised BL Corporate Plan. Both he, the Prime

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Minister and the Minister for Trade and Industry went out of their way to assure me of their enthusiasm of further collaboration between the companies and showed themselves sensitive to our concern that this should take a form which strengthened BL's future competitiveness and created a positive flow of trade in both directions.

14 I believe that my visit will prove useful. Its timing lent force to the message delivered and I hope that I have done something to counteract the tendency of Japan to place rather too much weight on her relations with the US to the exclusion of the Community's interests.

15 I was left in no doubt of our current standing. We are regarded as a friend but a firm and critical one. That is a position which we must maintain.

16 Finally, I would record my thanks to Sir Sydney Giffard and his staff both for the careful preparation for my visit and for the expert support given during my stay. Our interests in Japan, not least in the trade and commercial field, are very efficiently and effectively served.

17 I am sending copies of this minute to Geoffrey Howe, Nigel Lawson, Peter Walker, Michael Heseltine, George Younger, Nicholas Edwards, Nicholas Ridley, David Young, and to Sir Robert Armstrong, Sir Michael Butler and our Ambassadors in Washington, Tokyo and Bonn.

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April 1985

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Department of Trade and Industry



VISIT OF SECRETARY OF STATE FOR TRADE AND INDUSTRY
TO JAPAN : 15-19 APRIL 1985

LIST OF MEETINGS:

Mr Nakasone,	Prime Minister
Mr Abe,	Foreign Minister
Mr Takeshina,	Minister of Finance
Mr Murata,	Minister of International Trade and Industry
Mr Komoto	Minister for Market-Opening Measures
Mr Kaneko	Director, Economic Planning Agency
Mr Sato	Minister for Posts and Telecommunications
Keidanren	(Some Thirty or so Leading Industrialists)
Mr Ishihara	Nissan
Mr Kume	Honda

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Lunch with Mr Esaki and other Members of The Special Research
Council on External Economic Affairs of The Liberal
Democratic Party

Lunch with Leading Representatives of Japanese Financial
Institutions.

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SECOND BOSPHORUS BRIDGE: ATP: CLEVELAND BRIDGE

BACKGROUND NOTE

The Project

Cleveland Bridge Ltd led an international consortium in a bid for this project which involves a contract for the building of the second Bosphorus Bridge, and immediate approach roads packaged together with three other contracts for some 160 kilometres of related motorway. The main competition was from a Japanese led consortium including the Italians. Cleveland Bridge's particular interest was in the bridge itself. The company applied for ATP support and ECGD cover for the minimum necessary UK content for the bridge only. They recognised that it would be impossible to secure agreement to any further ECGD cover sufficient to have allowed greater UK involvement in either the bridge or the roads.

The Bids

2. Ministers decided at EX that the ECGD cover limit for Turkey should be increased which allowed Cleveland Bridge to bid with an offer of £10 million ATP support and export credit cover of £40 million for the UK content of the bridge. But the Cleveland consortium (including US, West German and Turkish firms) had to put in a bid for the whole project. They did this with commercial finance which included \$300 million officially supported US credit for the 90% plus balance of the project.

3. The Japanese competitor's bid for the bridge itself was slightly higher (\$114 million against Cleveland's \$111 million), but their offer which involved \$206 million yen loan at 5% over twenty five years represented a mixed credit subsidy of some 37%. It was therefore agreed to increase ATP for Cleveland's bid to almost £15 million. This matches the subsidy level of the Japanese offer but not of course the overall amount which remained some four times greater.

4. It has to be emphasised that the Japanese led consortium's bid for the whole project, including the road (\$550 million) was, irrespective of aid, some 20% cheaper than the Cleveland consortium at \$675 million. This pricing together with the inability of Cleveland Bridge to secure US or German government aid support put the Japanese in an unassailable position.

5. In the context of the Japanese offer the Italian official support was largely marginal but added to the attractiveness of the Japanese/Italian bid.

Japanese Methods

6. The Japanese might very well have won the project on price even without an injection of aid. The OECF aid money that was put in was offered on their usual supposedly 'untied' basis. The Japanese often claim their aid is untied because contractors from LDCs as well as Japanese companies are eligible to compete for it. In practice this results in effectively tying the aid to Japanese companies. However we cannot really complain about more than the pretence of Japanese "untied aid" practices. Their offer is not counter to international rules and indeed our own aid offer was also tied.

7. It is also understood that in making their aid offer the Japanese government made it conditional upon the Japanese consortium winning the whole project thus ensuring that they beat Cleveland on the bridge. But there is ^{no} absolute evidence of this, and in any case it is difficult to argue that it is illegitimate as a commercial tactic.

ECON. POL: Bonn Summit: Pt 18

From: JOHN WILKINSON, M.P.
(Ruislip - Northwood)



HOUSE OF COMMONS
LONDON SW1A 0AA

26 April 1985

Dear Michael,

I have sent the enclosed note to the Prime Minister for the forthcoming Bonn Summit. It is of the greatest importance that she should very briefly promote the merits of Tornado to the Japanese Prime Minister, Mr. Nakasone.

There is a definite potential military requirement for the aeroplane in Japan and it would help reduce the huge trade imbalance in Japan's favour between Japan and Western Europe.

Yours ever
John
JOHN WILKINSON

The Rt. Hon. Michael Alison, M.P.

From: JOHN WILKINSON, M.P.
(Ruislip - Northwood)



HOUSE OF COMMONS
LONDON SW1A 0AA

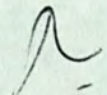
26 April 1985

I am writing to you as a matter of urgency to ask that you raise the possibility of Japan's buying the Tornado aircraft to meet the requirements of the Japanese Air Self-Defence Force and to redress the serious trade imbalance between Japan and Europe.

There is definite interest in the aircraft in Japan and Norman Tebbit did his best to promote the aeroplane during his recent visit to Tokyo.

The Japanese Government has shown an appreciation recently of the problems caused by its huge trade surplus and I am sure that if you could very briefly promote the merits of Tornado to Prime Minister Nakasone at the Bonn Summit, it would be very worthwhile.

As you know, it is necessary to demonstrate political support at the highest level and I hope that Chancellor Kohl and Signor Craxi may be able to do likewise. Nevertheless I am sure that it is your support for the aeroplane that would carry most weight with the Japanese.



JOHN WILKINSON

The Rt. Hon. Margaret Thatcher, M.P.,
Prime Minister,
10 Downing Street.

**BRIEFING PAPER FOR THE PRIME MINISTER OF GREAT
BRITAIN FOR HER FORTHCOMING MEETING
WITH PRIME MINISTER NAKASONE AT THE SUMMIT
CONFERENCE IN BONN**

TORNADO FOR JAPAN

The Japanese Defence Agency (JDA) is now studying how best to replace its ageing fleet of Mitsubishi F-1 ground attack aircraft which will need to be phased-out in the early 1990's. For this FSX project there are three basic options open to the government:

- a) To modify and extend the life of existing aircraft.
- b) To design and build an aircraft in-house.
- c) To select a suitable foreign aircraft either off-the-shelf or for license-manufacture.

To replace completely the Mitsubishi F-1 fleet, the Japanese Air Self Defence Force (JASDF) final order could be around 100 units. At 1984 prices 100 aircraft, including spares for two years and ground support equipment, would amount to approximately US\$ 2.6 Billion. With the trade deficit between Japan and the EC running at over US\$ 10 Billion and between Japan and the TORNADO nations at over US\$ 5 Billion a TORNADO purchase would be a significant step towards re-dressing the trade imbalance. Over 500 companies and 70,000 people are involved in the TORNADO programme and, therefore, a TORNADO purchase would have a wide ranging impact on the economies of Britain, West Germany and Italy.

For the last 5 years, PANAIA has covertly maintained close contact with the key decision-makers in Japan. The JDA and JASDF have been regularly updated on TORNADO and possess technical information, logistics support plans, aircraft performance information and a budgetary proposal, and this will be followed by a license build and in service support proposal.

At present PANAIA continues to stimulate discussion of TORNADO in Japan with the military and political leaders. Since the issue of a new 5 year defence plan is imminent, the FSX decision-making process is reaching a critical point and it is now necessary for the TORNADO topic to be brought into the open. It is therefore important that, during the meeting in Bonn, TORNADO's economic and military benefits for Japan are brought to the attention of Prime Minister Nakasone and his accompanying ministers. This is an essential move if TORNADO is to remain in the competition.

Although there is considerable enthusiasm for the development of an in-house aircraft within Japanese Industry, this option has several drawbacks:

1. It will be an expensive exercise in comparison with the off-the-shelf or license manufacture option.
2. Japanese Industry does not possess the necessary technological know-how to develop and build an aircraft capable of meeting the Soviet threat.
3. An in-house aircraft will take in excess of 10 years to develop thus committing the JASDF to obsolescent equipment well into the 1990s.

On the other hand, a TORNADO purchase would:

1. Give Japan access to the latest European technology.
2. Be a firm base from which to tackle later aircraft replacement requirements.
3. Bring Japan closer to Europe and NATO, diversify its source of weapons and become less dependent on the United States and,
4. Be a no risk solution to a tough military requirement.

Conclusion

It is vital that TORNADO is mentioned at the Bonn Summit. Prime Minister Nakasone is unlikely to make any immediate commitments but he will alert his staff to the issue and set in motion the necessary high level debate. It is hoped that Chancellor Kohl and Prime Minister Craxi will also raise this issue but it is the comments of Prime Minister Thatcher that carry the greatest weight. Prime Minister Nakasone is expecting all three leaders to declare their full support for the sale of TORNADO to Japan.

15.4.1985

Prof. Dr. Riccius
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