

JAPAN

Background

1. The Japanese are nationalist and instinctively protectionist. Their society remains relatively closed. A strong sense of nationalism runs through industrial policy: uneconomic industries (eg aluminium) are retained - on a small scale - if the government believes that security of supply or keeping up with technological developments is of strategic importance. Industrial policy works in Japan because:

- industrial leaders cooperate with each other and with government;
- the labour force is ruthless at the sub-contractor level (Japan has among the highest rates of bankruptcy in the world);

And agriculture is ruthlessly protected, for domestic political reasons and in the name of "food security". These are all attributes of a close knit corporatist state.

2. In the 1950s and 1960s the Japanese market for manufactured goods was heavily protected; they also did their best to keep out investment which might threaten national industries. For long periods the yen was badly under-valued. But this has changed. The Japanese have responded to international pressures for market opening, and more recently, for measures to reduce their surplus.

The Present

3. This emerges from the figures as follows: between 1986 and 1987 Japan's current account surplus fell from 4.4% of GNP to 3.8%. First quarter figures for 1988 are consistent with the OECD's forecast that this proportion will decline to 2.9% for 1988 as a whole. If non-monetary gold is excluded the fall in the surplus is steeper (imports of non-monetary gold were worth \$7 bn in 1986 and \$3.5 bn in 1987).

4. Much of this has been brought about by the change in the value in the yen and the stimulus to domestic demand. Growth in the Japanese economy in 1987/88 has been generated by domestic demand not, as in the recent past, by exports. In calendar 1987 domestic demand contributed about 5% of growth, offsetting a fall of 0.7% in the external sector's contribution. This is a dramatic change.

5. In volume terms Japanese exports have fallen from the 1985 peak levels, though this fall appears now to have come to an end. Imports have increased by some 20%. The increases are most striking for imports of manufactured goods (see attached chart). This is important because the large share of raw materials in Japanese imports has meant that hitherto increases in Japan's imports were of little benefit to developed countries. UK exports to Japan were up 26% in sterling terms in 1987 and by 31% over the latest 12 month period to April.

6. The second and third charts attached show the way in which tariff and quota barriers have been removed. Our own exporters report from direct experience that the regulatory environment for our exports is now greatly improved, though marketing and distribution are still difficult. Concern about their international image has also prevented the Japanese from introducing new protectionist measures: MITI has rejected strong pressure from a textile industry potentially ruined by the rising yen to introduce MFA quotas (contrast the US which unlike Japan has a free trade ideology but which has applied a number of protectionist measures in textiles - against free-trading Hong Kong amongst others).

The Future

7. Japan may have built up its industry by unfair practices, but its continued success is a result of efficiency. More is spent on private sector research and development in Japan than in any other country including the USA. Japanese firms have also demonstrated an astonishing ability to cut costs in response to the appreciation of the yen. Macroeconomic measures will help reduce Japan's surplus, but it will not be eliminated altogether for the foreseeable future.

as long as their domestic savings ratio remains so high.

8. The result will be that Japan will accumulate assets abroad (as we did at the beginning of this century). These will include financial assets but will increasingly be real estate, equity and direct investment. This can be beneficial. Japanese investment has brought jobs to the UK; it has also brought single union/no strike deals, and quality standards that have transformed some UK component suppliers. But, like it or not, the Japanese are bound to increase their investment abroad, not least because of the failure of others such as the US to save and invest at the same rate they do.

How to handle Japan

9. We have not done badly so far. We have applied persistent pressure on selected individual issues. We got our way on Cable and Wireless; we got more than we expected on whisky; we got more than the Japanese thought we were asking for on the Tokyo Stock Market (we told them initially that we wanted three seats: we got four, though this is still not an adequate share of the world's largest stock market); and we are now moving into investment management, which is what our firms have had their eyes on. For specific problems this should still be our approach. Persistent pressure, but applied in such a way that the Japanese believe that they can work with us.

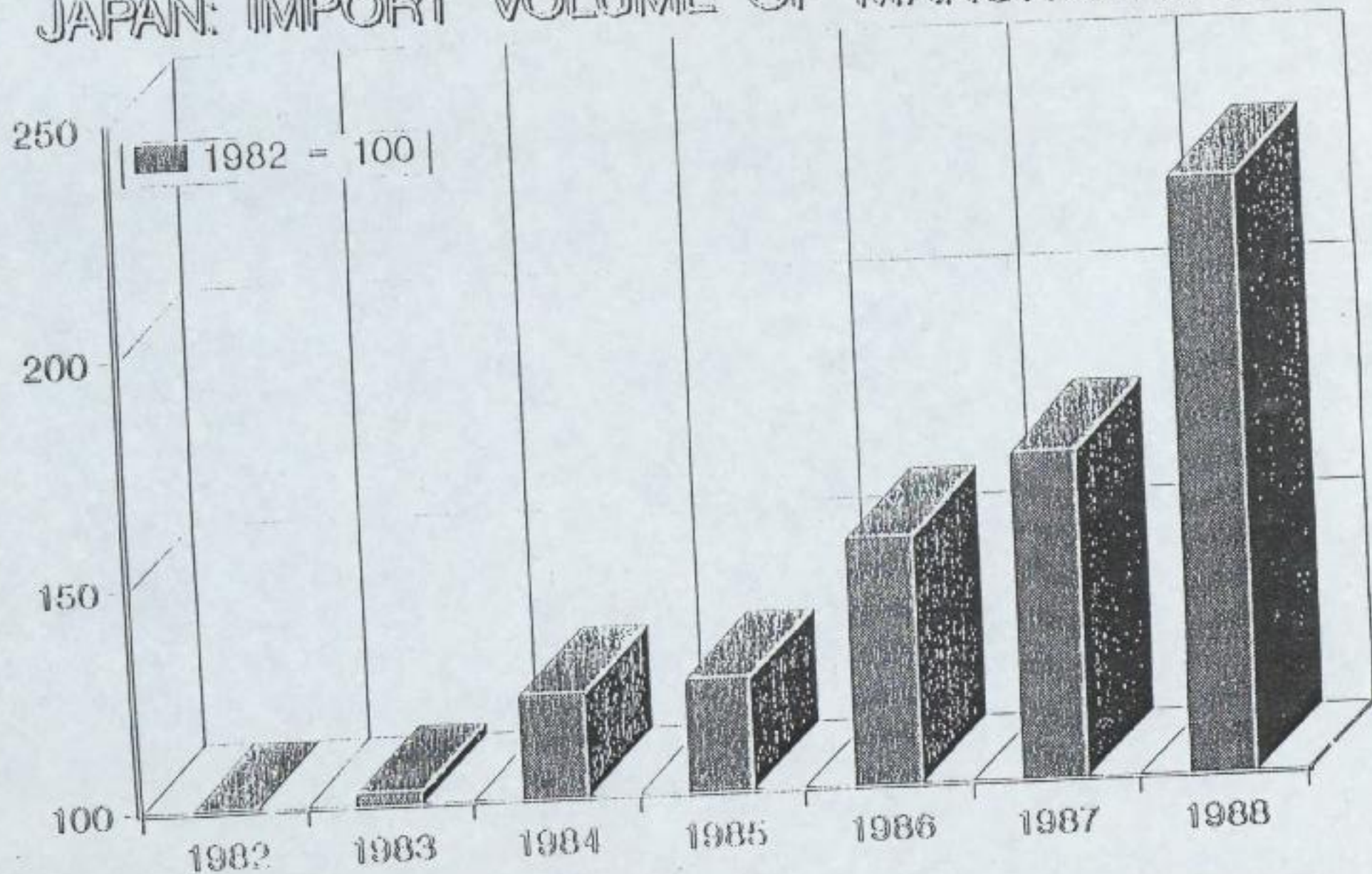
10. Economic Summits provide a good opportunity to work on the Japanese. Unlike others (the FRG, US, France) Japan has taken action in connection with Summit discussions. Some of the action has been a smoke screen. But nevertheless real change is occurring (see above). The most effective way of getting at the Japanese is through collective, multilateral pressure to which the collectivist mentality responds. Our results on whisky, for example, were obtained through action in the GATT. But on Cable and Wireless, we got our way because of the Prime Minister's personal intervention. The Summits also provide an opportunity to sustain this direct pressure, eg on financial services. Mr Takeshita's recent undertakings to the Prime Minister still need to be followed through.

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11. The Japanese can be difficult to deal with. But they respond more than is commonly believed. Their influence and wealth will grow and will extend into political as well as economic spheres (see for example their Afghanistan initiative). They are an important asset for the West, but we need to integrate them better into the Western political as well as economic system. The signs are that they are looking again at their over-exclusive relationship with the US and that they wish to diversify by expanding their political as well as their economic links with Europe. We ourselves already have 50% of Japanese investment in Europe, English is the second language in Japan, and the Japanese recognise the influence of the present British Government in Europe and with the Americans. These are assets we can exploit for our own political and commercial ends.

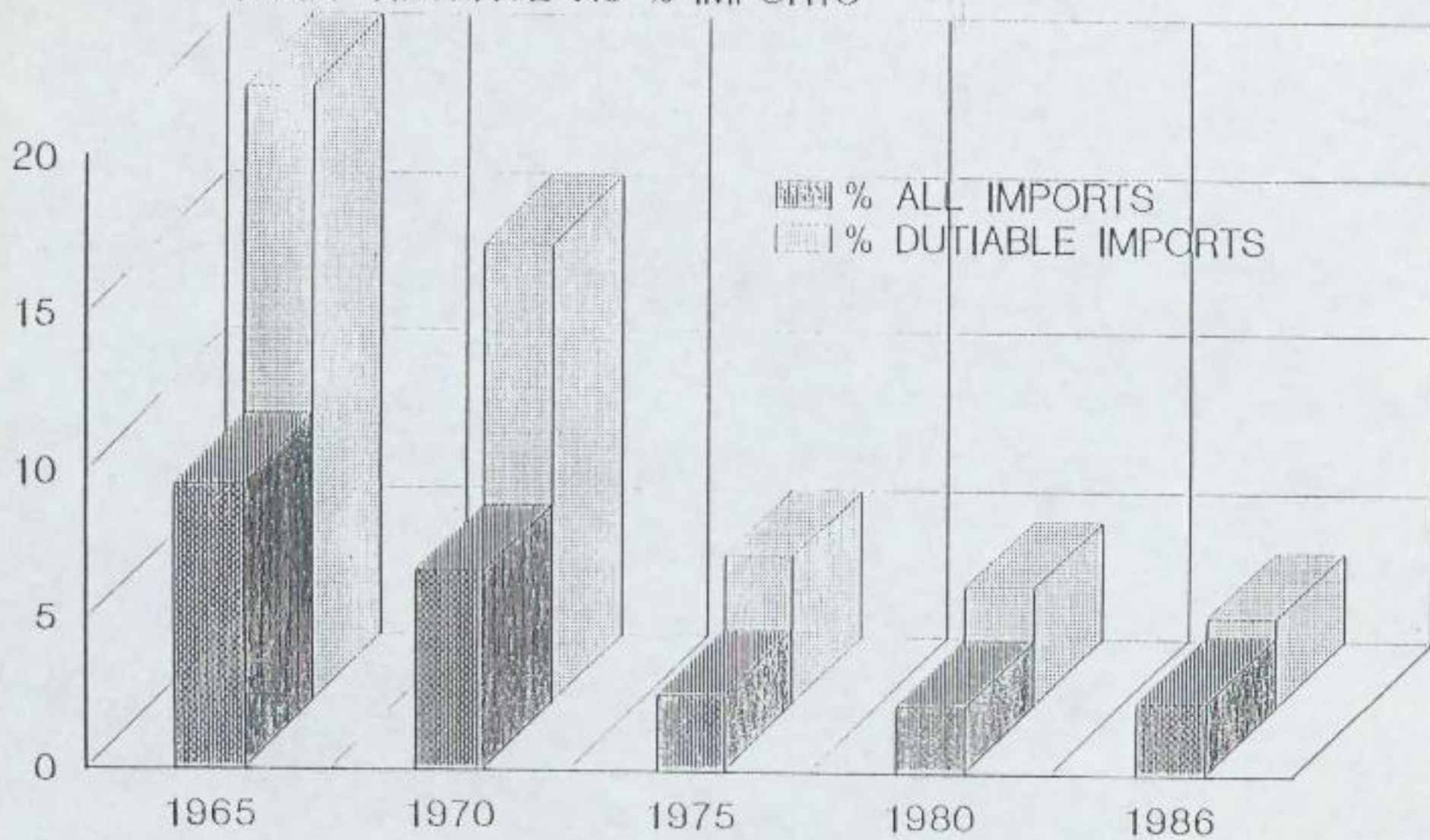
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JAPAN: IMPORT VOLUME OF MANUFACTURES



JAPAN: AVERAGE TARIFF RATES

TARIFF REVENUE AS % IMPORTS



JAPAN: NO. OF ITEMS UNDER IMPORT QUOTAS

