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PRIME MINISTER

FINANCIAL RELATIONS WITH JAPAN

My officials have been reviewing relations with Japan in the financial area, together with officials from the DTI, FCO and the Bank. Their report, which I endorse, is attached.

The report outlines the progress the Japanese have been making towards opening up their markets in recent years, and analyses the strength and weaknesses of our current stance of "informal reciprocity". It concludes that we should consider our future strategy in three phases.

- (i) In phase 1, until an acceptable timetable is announced for admission of BZW and James Capel to the Tokyo Stock Exchange, we should continue to impose significant delays on the progress of Japanese firms in London. This policy must be applied firmly but with sufficient flexibility to keep the risks of successful legal challenge to a minimum.
- (ii) In phase 2, once the TSE issue is resolved, we should adjust the balance of our approach, continuing to press hard for UK interests in Japan, applying general sustained pressure where appropriate on Japanese interests in financial services in the UK. However we would wish to avoid linkages between specific authorisations here and in Japan without very convincing special reasons. This approach has been described as "stickiness without sticking points".

CONFIDENTIAL

Prime Minister

This sets out a strategy for keeping up pressure on the Japanese to open their financial markets. It is relevant to your meeting in Paris with Mr. Uno. Are you content? I have also attached

a short paper which the Japanese Ambassador has given me. CDD 7/7



- (iii) Phase 3, will begin when the Second Banking Directive comes into force in 1993 and formal reciprocity powers are adopted by the European Community. Our scope for pursuing independent bilateral negotiations will be reduced.

As you know, the Japanese have so far refused to offer seats on the Tokyo Stock Exchange to two UK firms which we regard as well qualified, BZW and James Capel. You raised this issue with Mr Takeshita last year both at a meeting and in correspondence.

In order to put pressure on the Japanese on this issue, we have been holding up certain Japanese ambitions in London. In particular, we delayed for a time admitting Japanese firms as Gilt Edged Market Makers and are now delaying their admission as market makers in ECU Treasury Bills (EBMMs). The Bank has also discouraged applications for banking authorisation from a number of Japanese regional banks and prevented Japanese firms from lead managing sterling issues. However, there are potential disadvantages to the UK in impeding Japanese entry: a strong Japanese presence will help to ensure that London remains the leading financial centre.

In the last few days, and since the report was completed, there have been signs that the Japanese are beginning to move. A special committee has been established to develop a consensus on a further enlargement of the Tokyo Stock Exchange, aiming for a decision around the turn of the year. This is a welcome preliminary step which we expect Mr Uno to report to you in Paris. We shall wish to keep a close watch on the progress of the committee's work.

Also since completion of the report, the Japanese have made positive moves on two other UK priorities: a study group on investment trusts has reported and cleared the way for the entry



of foreign firms in this market; and Barclays has won a small slice of Japanese Government pension fund management business.

Provided that Mr Uno is fairly forthcoming, we shall be nearing the end of what the report defines as "phase 1", and we shall soon be in a position to rebalance our approach as we move into "phase 2" allowing us to take a more relaxed approach to Japanese interests in London. This will have the advantage of consolidating the position of the City as the leading European financial centre, at a time when competition within Europe is becoming more intense.

In line with this approach and given the favourable developments in Tokyo, I expect that the Bank will be in a position to approve admission of at least one Japanese EBMM after your meeting with Mr Uno.

I am sending copies of this letter to Geoffrey Howe, David Young and Robin Leigh-Pemberton.

[N.L.]

7 July 1989

[Approved by the Chancellor
and signed on his behalf]

Paper produced by
the Japanese Ambassador
esp.

JAPAN'S INCREASING IMPORTS OF MANUFACTURED GOODS : new forces and factors.

1. Introduction. When criticisms are made of the alleged inadequacy of Japan's imports of manufactured goods, despite the measures that have been taken to augment them, two specific reasons are often adduced as follows:

(1) The rate of domestic savings is particularly high and offsets pressures to buy more imported products. The reasons for this allegedly excessive rate of savings are -

a) the lack of development of the social security system in Japan compared with other advanced industrial nations and

b) the extremely high price of land.

- and on account of these factors, it is claimed, the majority of Japanese families are compelled to rein back spending and save at high levels to provide for themselves after retirement and to purchase dwellings.

(2) In Japan, it is often claimed, the distribution system for goods is neither open nor competitive enough, is very difficult to understand, with an excessive number of retail outlets, thereby strongly deterring entry to the market from overseas.

2. Changes in Japan

(1) The above is a dated and static picture of what is happening in the Japanese economy. In general, it has progressed from a growing, external-demand led economy to a growing, domestic-led economy. Japan's imports of manufactured goods have been rising at the maximum sustainable rate. Manufactured goods already make up half of all Japan's imports despite the country's great dependence on imports for food and energy supplies, and industrial raw materials. Japan is still pursuing vigorous programmes to sustain the high level of domestic demand and to further increase imports from abroad and the results have been encouraging. (See attached graph 1 & 2).

(2) The savings rate in Japan remains at high level, although it shows some decline from its level at the beginning of the 1980s. In this respect, a high rate of savings has not been an obstacle preventing the increase of imports. Furthermore, the rate of savings is also expected to decline as the percentage of people in the population in the over 65s group climbs higher. Generally the older the population the lower will be its saving rate. It should be also pointed out that the young generation of today in Japan has a propensity of consuming more than previous generations.

It is worth noting, however, that high rates of saving in Japan provide substantial capital resources which flow to stimulate the

world economy. (For example, Japan's high rate of saving is beneficial to the United States whose saving rate is very low in contrast to Japan. The communique of the OECD ministerial meeting issued on 1 June, 1989 mentions the necessity to reduce the savings-investment gap in the context of specific economic policy orientations required with respect to the United States).

(3) The social security system in Japan is in no manner to be regarded as inferior to that of other advanced nations. (According to studies carried out in Japan, based on Japanese and UK statistics, the ratio of the average amount of pension, for example, paid to eligible retired people, to the average wage paid to employees in work, was 43.3% in Japan in 1987, higher than the comparable figure in the UK in 1985). Therefore it is not relevant to say simply that the rate of savings in Japan is high because of the lack of development of the social security system. In Japan, admittedly, the ratio of total expenditure on social security to GNP is lower than in other advanced countries. But this is not because the level of social security is lower, but because the percentage of old people, who are eligible for pensions, among the total population is at present lower than in other countries. However, demographic trends show that in the year 2025, the percentage of persons in Japan of 65 years and over will be 23.4, the highest among advanced countries. (See attached graph 3). Therefore expenditure in Japan on social security, and the ratio thereof to GNP, are expected to increase rapidly. (According to a study by the IMF, total social spending in Japan would account for 25.86% of GDP, higher than in the UK, the US and Canada). It would work in the direction of decreasing the saving rate, probably accelerated by further improvement of social security system in Japan here after.

It may be noteworthy that this prospective change is a main background against which major reform of the tax system has recently been achieved earlier this year to cope with future problems of revenue and expenditure.

(4) The high price of land and its steep rise in Japan, particularly in metropolitan areas are acknowledged as serious problems by the Japanese Government. Most people who purchase high priced houses in Japan are paying lots of money by installments over a long period. Since this loan repayment is counted as saving, the high price of land and houses on it may be regarded as a factor of raising the saving rate in Japan. On the other hand, however, it can be also said that many people in Japan have given up buying houses, and are now engaged in "desperate consumption".

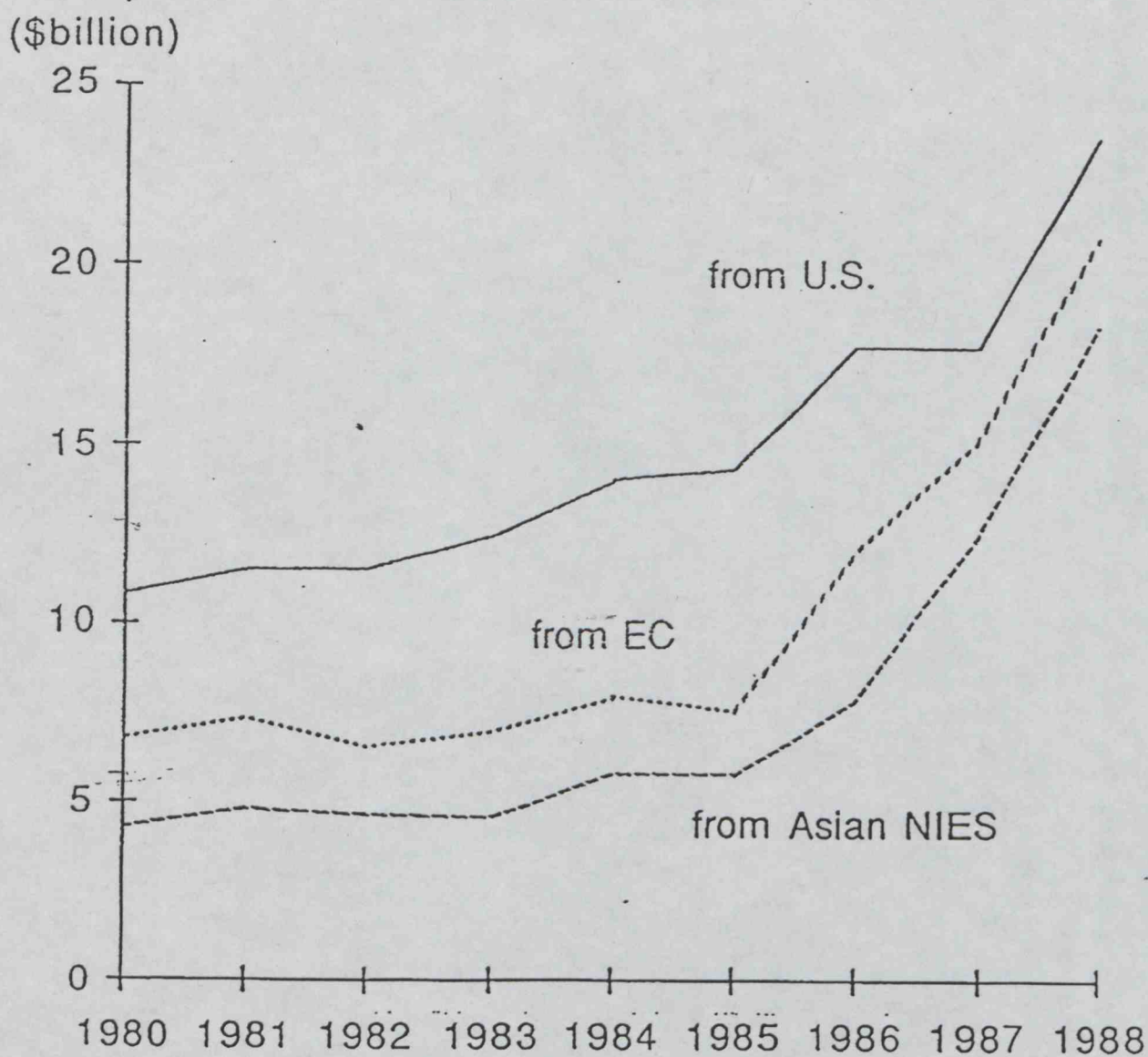
Land reform as in any country is of its nature slow and difficult. The Government of Japan has taken surveillance measures to check speculative land purchases, and as a result, the steep rise of land prices in Tokyo has abated. Further action is called for, and steps being taken by the Government include reviewing land taxation, enhancing land utilisation and dispersing organisations and functions, including governmental agencies, outside the capital, with a view to reducing the house price to a more reasonable level. These steps could bring about various kinds of effects upon the rate of savings in Japan.

(5) The distribution system in Japan is being steadily overhauled and reformed. It takes time to understand it, and other commercial systems in Japan, but recently more and more foreign enterprises are enjoying remarkable success in doing business in Japan. It is often said that companies which are successful in Japan can succeed anywhere. From the UK they include Glaxo, ICI, Wedgwood, Unilever and many others in widening areas of business. The Government is meanwhile taking steps to de-regulate and streamline the distribution system through, for example, relaxing the restrictions on large-scale stores and on the licensing of liquor stores. The Japanese Government started preliminary dialogue with the United States Government on mutual structural reforms which could contribute to improve the problem of external imbalance in the world economy. Following thorough and vigorous enquiries into de-regulation in Japan, the Government intends to implement the necessary measures for structural reforms including that of the distribution system. As a result of implementation of de-regulation, the distribution system in Japan is expected to become comparable to those of Western countries.

(6) In summing up, it would be fair to add that as the Japanese economy continues to expand, to the great benefit of the world economy generally, the Japanese Government is determined to continue to encourage growth in a balanced manner, and to avoid inflationary developments which would damage the world economy as well as Japan. Japan's efforts in managing balanced economic growth in an open trading system would, as a whole, contribute to the furtherance of harmonious development of the world economy.

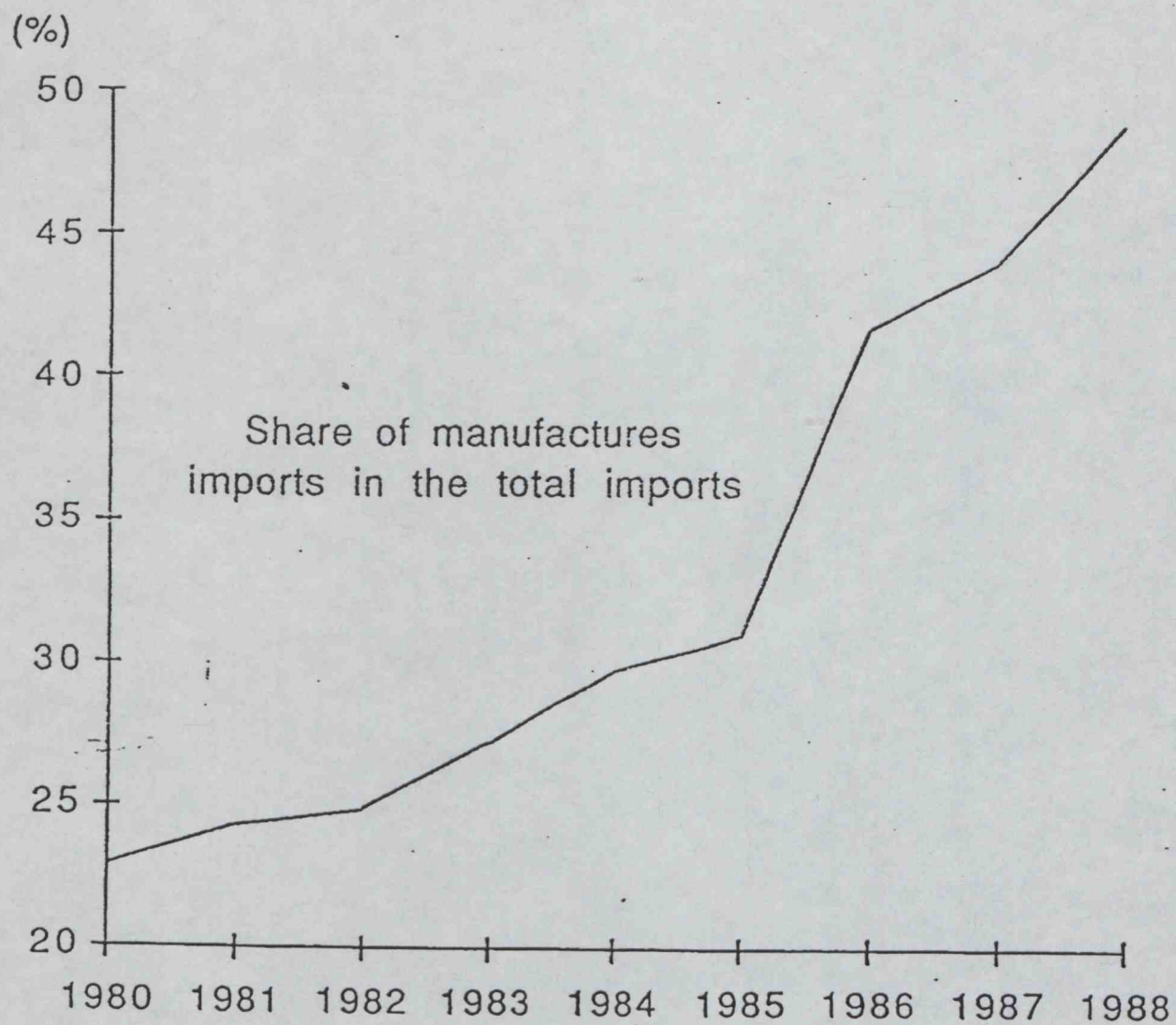
6th July 1989

Japanese manufactures imports
are increasing rapidly.



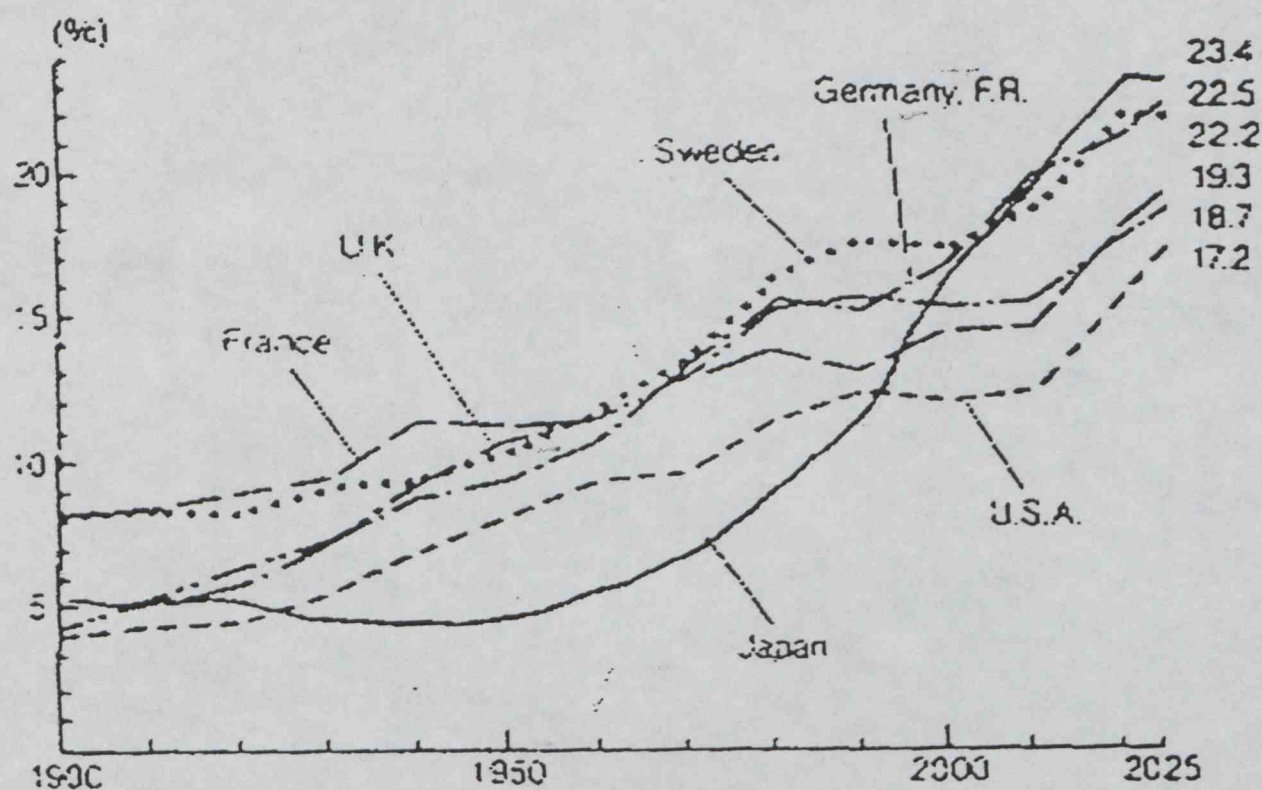
Source: Ministry of Finance

Share of manufactures imports
are also soaring.



Source: Ministry of Finance

Persons 65 Years Old and Over: Percent of Total Population (1900—2025)^{a)}



a) Based on U.N. World Population Prospects, Estimates and Projections as Assessed in 1984

Source: Economic Planning Agency, Japan, Japan in the Year 2000.