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CABINET

OPENING THE JAPANESE MARKET

Memorandum by the Secretary of State for Trade and Industry

Following Cabinet on 26 March, I am reporting on three aspects of trade policy towards Japan:

- a. how to secure greater access for our financial institutions;
- b. how to obtain a fair deal for Cable and Wireless (C&W);
- c. and, more generally, how to achieve faster progress in opening the Japanese market.

2. On the first two issues we have considerable freedom to decide our own line of action. We have to pursue the last issue through the Economic Community (EC) because under the Treaty of Rome trade policy is a matter of Community competence. We also have to have regard to our General Agreement on Tariffs and Trade (GATT) obligations.

FINANCIAL SERVICES

3. A large number of Japanese securities dealers and banks have established themselves in London, helping to build up London as a major international financial centre. On the other hand, United Kingdom firms who have applied for permission to set up in Tokyo have met with obstacles. Our response has been to demand reciprocity. In order to strengthen our leverage we took powers in the Financial Services Act enabling the Government to override decisions by the United Kingdom regulatory authorities if reciprocal access to foreign markets was denied to United Kingdom financial service firms (see Annex A). As the powers were specifically taken for these financial market opening purposes they can only be used in that context.

4. I have told the Chancellor of the Exchequer that I propose to make forthwith the Commencement Orders to bring into effect the Act's powers in relation to the banking and insurance sectors. The insurance powers are for me to exercise; the banking powers are for the Chancellor. This will be a strong signal to the Japanese but does not commit us yet to revoking the authorisations given to any Japanese banks or insurance companies operating in the United Kingdom.

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5. Once the new system of authorisation of investment businesses under the Financial Services Act is in place, I can then bring into effect the reciprocity powers for those activities. That should be at the end of this year.

6. Our strategy has produced some results (see Annex A). But we are now meeting Japanese resistance to better access to the Tokyo Stock Exchange. The Minister of Consumer and Corporate Affairs is visiting Tokyo next week and will press the Japanese for a firm timetable for the enlargement of the membership of the Exchange with unrestricted access for United Kingdom firms. If no satisfactory timetable is forthcoming we shall have to decide on the most effective way to use our new powers.

CABLE AND WIRELESS

7. The Japanese assure us that no decision has been taken but there is very heavy pressure from the Ministry of Posts and Telecommunications to allow C&W only a advisory share in the winning consortium (see Annex B). C&W are asking for 20 per cent but realistically they may have to settle for something less. We are pressing the Japanese Government to permit adequate foreign participation, as allowed in Japanese law and should continue to do so backed by threats of unspecified retaliatory action. I am calling in the Japanese Ambassador and will take this line with him. I shall also ask him why there has been no reply to the Prime Minister's letter to Mr Nakasone.

8. United States support is very important in resisting Japanese pressure to reduce foreign shareholdings to an insignificant level. However, it is quite possible that United States interests could be met by bringing in other United States companies such as American Telephone and Telegraph in a way that would still restrict C&W to an unsatisfactory level.

9. It is possible that the Japanese may ask C&W to sell them a similar shareholding in their United Kingdom subsidiary Mercury. The Government's agreement would be required if the Japanese acquired more than 15 per cent of the shares.

10. If we judge that the eventual outcome is unacceptable we should have to respond. The EC are most unlikely to agree trade sanctions over a bilateral United Kingdom-Japan dispute in the services field, and as noted above the Financial Services Act powers cannot be used in this context. The available options are limited. It is often suggested that we should take administrative action to delay or inconvenience imports, eg Customs procedures and discrimination in applying safety and other regulations. The objection to such devices is that they would be subject to legal challenge in our Courts, and expose us to the risk of damage and investigation by the Parliamentary Commission. Some other options are:

- a. Telecommunications: I could announce that I intend to take reciprocity considerations into account in deciding whether to grant telecommunications licences to foreign companies, and in the telecommunications apparatus approvals procedure. But the former

would have no immediate impact since there are no proposals from Japanese companies, and none seem to be in prospect. The latter could be challenged in the Courts.

b. Intellectual Property: Discriminate against Japanese patent applications; but this would be contrary to the Paris Convention and patents valid in the United Kingdom could be obtained from the European Patent Office.

c. Air Services: Move Japanese Airlines from Heathrow; retaliation against British Airways and British Caledonian Airways would be likely.

d. Work Permits: Make it more difficult for the Japanese to obtain permits; this would have a severely discouraging effect upon Japanese inward investment from which the United Kingdom economy benefits substantially.

e. Share Purchases: Deny the Japanese the opportunity to buy shares in privatisation and in the British Petroleum plc sale but we would need to be clear that the flotations would not thereby be harmed.

So that we are able to respond quickly, should the need arise, I propose that the pros and cons of these and any other options should be studied by officials, bearing in mind the need for the measures to fit the circumstances of the C&W case.

#### MARKET OPENING

11. United Kingdom/EC strategy has been to:

- press for monetary and macro-economic measures, eg a stronger yen and expanded domestic demand;
- seek to remove barriers, by action in the GATT eg on alcoholic drinks;
- promote exports, by offering exceptional levels of support to British exporters to Japan.

12. These policies have been reflected in successive Community declarations - most recently at the March Foreign Affairs Council. This called for the implementation of the Maekawa Report on structural economic reform and for market opening against a quantified import target. The Council agreed to consider further action at its July meeting.

13. Despite lack of market opening it has been difficult to persuade the other EC countries to take decisive action. We have been forced to adopt a lead role throughout. The growing United States resentment against Japan, reflecting their trade deficit and dissatisfaction over the working

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of the United States-Japan agreement on semi-conductors, may be helpful in stimulating the EC to take a more robust line. Even so it will be an uphill task to get EC agreement on new and tougher measures.

14. The options (see Annex C) for further action, in increasing order of difficulty, are as follows:

a. Tougher measures against the dumping of components, on which the Commission has recently tabled a proposal.

b. Unbinding the EC's tariffs against a range of Japanese electronic consumer goods to balance the industrial benefits which Japan derives from Spain and Portugal's accession to the EC.

c. If the United States acts against Japanese exports eg as it threatened over semi-conductors, for the EC to follow suit to avoid trade diversion.

d. Press the EC to relaunch its general GATT Article 23 acting against Japan under which we would effectively accuse Japan of "nullifying" the rights of GATT partners. If successful, Japan would be required to offer remedies under threat of retaliation.

There is reasonable prospect of getting EC agreement on a. to c. The chances of achieving d. would be poor without substantial non-EC and especially United States support.

15. There is one further option: to press the EC to agree that Japan's persistent refusal to take effective action to integrate its economy into the multilateral trading system can no longer be tolerated; that Japanese breach of GATT Article 23 is self-evident; and that discriminatory trade action against Japan, including penal import duties on a selected range of goods, should therefore be taken. The very act of raising this option in the EC would send a shock-wave through the Japanese administration, but such a course could bring down the GATT and would meet strong opposition from within the EC, led by the Germans. And if rejected it would undermine our credibility both within the Community and in the eyes of the Japanese.

16. United States resentment against Japan should make it easier to get EC agreement to taking stronger measures. The next step could be for the Foreign Secretary to sound out other EC views at the European Political Co-operation meeting this weekend. Subject to the outcome, we should then ask for detailed Community consideration. We want to lobby the other EC countries hard and take up the recent French offer of bilateral talks. Thereafter we could use the Venice Summit in June to promote a declaration critical of Japan. Japan could also be high on the agenda for the European Council meeting later that month.

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CONCLUSIONS

17. I invite colleagues' agreement to the following courses of action:

a. Financial Services: The reciprocity powers of the Financial Services Act should be brought into effect as soon as possible: the Minister for Consumer and Corporate Affairs when in Tokyo should press hard for a firm timetable for access of United Kingdom firms to the Stock Exchange.

b. Cable and Wireless: Maintain pressure for fair treatment: officials should examine the full range of options for retaliation.

c. Market Opening: Press the EC to act quickly on items a. to c. in paragraph 14: use the European Political Co-operation meeting to press EC countries to agree to a GATT Article 23 challenge and test reactions to the further option in paragraph 15; seek United States co-operation to a general GATT challenge; use other opportunities such as the Venice Summit to maintain pressure on Japan.

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Department of Trade and Industry

31 March 1987

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## FINANCIAL SERVICES

The Financial Services Act contains a reciprocity provision, which enables the Secretary of State to refuse or revoke the authorisation to do banking, insurance or investment business, of financial services companies from countries which do not offer reciprocal access for UK firms in their financial markets. The Banking Bill was amended in February, to extend these powers to takeovers of UK banks by foreign institutions: the Bank of England will be empowered to block voting rights or require divestment. It is proposed to bring the Financial Services Act powers into force for banking and insurance now and for investment business later this year when investment businesses are authorised by either the Securities and Investments Board or recognised self regulating organisations (assuming that the SIB becomes the designated agency).

The Minister for Consumer and Corporate Affairs is to visit Japan from 5-8 April for discussions on access to the Japanese financial markets. His principal target will be access for British firms to the Tokyo Stock Exchange (TSE). Six foreign firms have seats on the TSE, following a 10 seat enlargement in September 85, out of a total membership of 93. Three are US owned, one is wholly British owned (Warburgs) and two are UK-connected: Vickers da Costa (US owned) and Jardine Fleming (half Hong Kong owned). Two British firms, Schroders and Kleinwort Benson would like seats at once and others will want them in due course. Four Japanese firms are members of the London Stock Exchange, but following the Exchange's merger with ISRO, 40 others are qualified to become members of the new International Stock Exchange in London.

A new Japanese law, brought into force last November, provides for the registration of investment advisers, who may apply for licensing as discretionary investment managers. Registration has been straightforward; we are waiting to see if problems arise with licensing: the first licences are due to be issued in May. UK firms have particular expertise in this area.

Since October 1984, we have secured 12 Securities Branch Licences (SBLs). UK-owned or UK-connected houses now hold 14 out of around 30 foreign SBLs (compared with 2 out of 9 then). We have been broadly satisfied with recent progress in this area, but 6 British firms including Barclays and Lloyds are still seeking SBLs now and during the next 12-18 months. Japanese and other foreign firms have been freely authorised by DTI to "deal in securities in Great Britain". There are now some 58 authorised subsidiaries of Japanese houses in London.

As regards banks there are in London 29 Japanese banks. In addition there are 15 Japanese representative offices. Their business has grown remarkably. In Tokyo all 5 UK clearers have commercial banking offices but they have found business difficult.

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ANNEX B

## CABLE & WIRELESS

Japanese law allows 33 1/3% foreign participation in any company operating telecommunications services. Two consortia ITJ and IDC, have been formed to offer international services in competition to KDD, the existing Japanese monopoly. ITJ is entirely Japanese. IDC includes foreign members; C&W (20%), Pacific Telesis (US) 10%, and Merrill Lynch (SU) 3%). The proposals they have put forward are different. ITJ, at least initially, would rely on KDD facilities. IDC propose the use of a new privately financed Trans-Pacific cable. The Ministry of Posts and Telecommunications (MPT) has made it clear that significant foreign participation is unwelcome, and it would not welcome separate applications from IDC and ITJ. It has, therefore, encouraged the two groups to merge, and at present only wants to allow C&W a 3% share. Many Japanese companies are in both consortia, and most are content to merge. C&W are fighting the merger proposal, with some Japanese support. MITI and Foreign Ministry are sympathetic to UK and US demands that foreign participation should be allowed to the extent permitted by Japanese law.

The outcome on this issue, and what Cable and Wireless will accept, are far from clear. Similarly we cannot be certain that C&W will continue to receive support from their Japanese partners or from the American interests who are involved in this consortium.

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OPTIONS FOR FURTHER ACTION IN THE TRADE FIELD

(i) Dumping of Components - The Commission want to extend EC anti-dumping rules to allow action not only against imports of completed products but also against such products assembled in the Community from imported parts. We have expressed strongly sympathy with the Commission's objective but want to achieve it in a way that does not discourage inward investment in the UK.

(ii) Unbinding EC Tariffs - Spain and Portugal are considerably reducing their import duties on manufactures as part of the process of accession to the Community. Japan will benefit from this. The Commission recommend that consistent with GATT the EC should unbind (ie free from increase but not raise) its tariff on various consumer electronic goods. We have supported unbinding since it clears the way for rapid action to raise tariffs (or threats to do so) in the future. Precise proposals to raise tariffs would require careful study: in some cases UK has no industry to protect but considerable interest in low prices for consumers.

(iii) US Retaliation - The US has threatened to impose prohibitive tariffs on \$300 million worth of imports from Japan in retaliation both for Japan's failure to implement the US/Japan agreement on semiconductors and to balance the lack of market access in Japan. If denied access to US markets a proportion of the goods affected would probably be diverted to the Community. The EC could therefore arguably match the US action in order to avoid such diversion, claiming under GATT Article XIX that this threatened "serious injury" to EC industries.

(iv) General Article XXIII Action - In 1982 the EC opened a GATT case against Japan's entire trade regime. They argued that the clear imbalance of trade benefits between Japan and the EC constituted, effectively, "nullification of their GATT rights". The EC suspended the case in 1984 because Japan offered a programme of market opening measures and because the Commission doubted the likelihood of further success. The Community could now relaunch the case, but the prospects of a clear victory remain unpromising.