



H M Treasury
Parliament Street London SW1P 3AG

Switchboard 01-270 3000
Direct Dialling 01-270 4369

com 12/

ccp

Sir Geoffrey Littler KCB
Second Permanent Secretary

13 June 1988

Dear Charles,

at flat

MR NAKAHARA

Thank you for sending me the copy of your letter to Rod Braithwaite of 31 May with a sheaf of papers from Mr Nakahara. This gentleman wrote also to the Chancellor recently, with a slightly different presentation of some of the same ideas.

I find his ideas something of a mish-mash. There is no doubt of the truth of some of the points he makes: much more doubtful are his assertions of causal connections.

I shall get my people to look at the papers more closely, but perhaps I could give you a few immediate comments.

First, the theme which he emphasised to the Chancellor was that Japanese industrial firms had managed to absorb and adjust to the shock of a dramatic appreciation of the Yen by exploiting property values. He used a Japanese word (I think coined fairly recently) to describe this: 'zai-teka'. My understanding from Japanese friends is that 'zai-teka' or 'zai-tech' goes well beyond associations with property, although that may play a part. It identifies the practice adopted increasingly in recent years by managements of cash-rich Japanese manufacturing companies, the practice of actively seeking profitable deployment of their cash surpluses, instead of simply leaving them on deposit or deploying them in some other relatively passive and unremunerative way.

The first point to note is that many Japanese companies do seem to have built up enormous reserves over the years - and of course many of them did particularly well during the period when the dollar was very high and the Japanese external surplus grew dramatically. Also, I don't have comprehensive figures to hand but I have seen some examples of what by British standards would be extraordinarily low dividend payments in relation to profits, associated with high cash retentions.

/The second point..

C.D.Powell Esq
10 Downing Street
LONDON SW1.

The second point is that the active management of reserves does indeed seem to have provided a profits cushion over the last year or so which has helped the overall position of companies whose trading out-turn has been damaged by the Yen appreciation. You will, I am sure, have seen references to Japanese companies in the United States - and elsewhere - having huge profit margins when the dollar was at Yen 250, accepting cuts in margins until around Yen 180 or so, and even then not raising their prices, but accepting losses in the hope of retaining markets, until the dollar value of the Yen dropped to 150 or less. They could only do this on the basis of strong financial positions.

It is probably true in a sense that the largely domestic financial investment of Japanese corporate reserves has helped to build up over the years and maintain the high values of stocks on the Tokyo Exchange. But this is really only a partial statement of the point that the very high Japanese savings ratio must have been a strong factor in keeping Japanese interest rates and yields at relatively low levels.

The third point relating to these phenomena is that I am sceptical about blaming, as Nakahara seems to, the machinations of Japanese institutions and regulations. Curiously he does not focus on the one point which we (and the United States) have seen as a major issue here: the deliberate tax and other measures to provide cheap finance for industry - arrangements which are now gradually being dismantled. Some of the Spanish practices he alludes to may well be correctly identified, and reprehensible from several points of view, but I doubt whether they have the macro-economic impact he seems to claim.

My last comment in this quick series of reactions relates to property. Prices in Japan are indeed astronomical. But this is not a result of financial juggling so much as of supply/demand. (It is as if one were to blame London house prices on mortgage tax relief and bank loans to employees, when these are contributory factors on the demand side but by no means the heart of the problem). In Japan, more important factors are:

- the rapid growth of a wealthy population has outstripped any normal rate of increase of supply of housing;
- land is very wastefully used in terms of dwellings per acre (perhaps partly a legacy of types of building used before engineering had met the earthquake threats);
- subsidised small agriculture is a major impediment to sensible land use and redevelopment;
- regulation of land use is exercised ungenerously as far as encouraging new housing is concerned.

I am copying this letter to Rod Braithwaite.

Yours,

Geoffrey

(Geoffrey Littler)

pa (15)

RESTRICTED

131603
MDHOAN 8057

FET 091/1

14 JUN 1988

RESTRICTED
FM FCO
TO IMMEDIATE TOKYO
TELNO 487
OF 131800Z JUNE 88

ARK 4/6

TORONTO SUMMIT: JAPANESE IDEAS ON DEBT

1. CHANCELLOR HAS ASKED WHETHER REUTERS REPORT DATED 8 JUNE OF JAPANESE INTENT TO UNVEIL PLANS TO HELP DEBTORS AT THE SUMMIT ARE ACCURATE AND FOR A BRIEF BY CLOSE ON 14 JUNE.
2. REUTERS REPORT THAT JAPANESE PLAN IS AIMED TO REDUCE DEBT OF MIDDLE INCOME COUNTRIES. THE IMF WOULD SET UP A SPECIAL TRUSTEE FUND WITH MONEY FROM JAPAN AND DEBTOR COUNTRIES. THIS WOULD BE USED AS COLLATERAL TO BACK BONDS ISSUED BY DEBTORS AND SWAPPED FOR DEBT OWED TO COMMERCIAL BANKS AT A DISCOUNT. THIS IS SIMILAR TO THE MEXICO DEBT CONVERSION SCHEME ANNOUNCED IN DECEMBER 1987.
3. PLEASE ADVISE BY RETURN WHETHER REPORT IS ACCURATE, AND PROVIDE ANY FURTHER DETAILS AND COMMENTS.

HOWE

YYYY

DISTRIBUTION

153

MAIN 152

.MONETARY
ERD (-)

FED

ADDITIONAL 1

MR WICKS NO 10 DOWNING ST

NNNN