

*Minutes of Japan-US Forum
Second Study Group Meeting in Tokyo*

**“Bi-national Study on the Impact of the rise of China and India, and
the U.S. - Japan Economic Relationship”**

Friday, July 7, 2006

Venue: ANA Hotel Tokyo, Japan

09:00-12:30 Morning Session - Session 1 (on Banquet room GLORY on B1F)

**Key topic 1: Policies designed to facilitate sustained growth and development in
India and China (including structural/market reforms, investments, infrastructure
development, stable property rights, etc.)**

Co-Chairs:

Noboru Hatakeyama, Chairman and CEO, Japan Economic Foundation
Kenneth Dam, Max Pam Professor Emeritus of American and Foreign Law,
University of Chicago Law School

Speaker (10 minutes):

Taizo Nishimuro, President and CEO, Tokyo Stock Exchange, Inc, Adviser to
the Board, Toshiba Corporation

Participants:

Japanese study group members
US study group members

Discussants:

James Jin Du, Professor of economics, Faculty of Asian-Pacific Studies, Department
of International Development, Takushoku University
Hideki Esho, Dean and Professor, Faculty of Economics, Hosei University

Hatakeyama

Thanked everyone for coming to the meeting. Impressed by responsiveness of American team concerning Japanese proposals. Have developed final reports regarding rise of China and India. Have asked for speakers to speak today and tomorrow regarding sustainable economic growth, trade and investment.

The views will be reflected in the final report. Introduced the first speaker, Taizo Nishimuro, President and CEO, Tokyo Stock Exchange, Inc, Adviser to the Board, Toshiba Corporation

Also asked James Jin Du and Hideki Esho to participate as discussants.

Nishimuro

Expressed appreciation for opportunity to participate. Became president of Tokyo Stock Exchange after series of problems.

Talked about sustainable growth in China and India, and how US and Japan can sustain prosperity. Japanese capital market should be used for development of China and India. Everybody is aware of

growth in China and India. There is rapid expansion of existing and new operations. In 2004, amount of capital wired was 150 billion yuan. Indian corporations acquired 40 billion US dollars at home and abroad.

Both China and India have historically been major world powers. India was pioneer in establishing Bombay Stock Exchange. Shanghai Stock Exchange amounts to 6% of Tokyo Stock Exchange. The Bombay Stock Exchange is 4% of Tokyo. Authorities in China are implementing a number of reforms. There remains a strong feeling of uncertainty.

A large percentage of capital is obtained on the overseas market. China and India Stock Exchanges are inadequate to supply capital requirements.

These businesses can use Tokyo Stock Exchange, which is currently number 2, behind NY Stock Exchange.

It is the number one Stock Exchange in Asia in scale.

China and Japan are already trading partners of the highest level, any many Chinese companies have strong ties to Japanese companies. They will secure capital in Japan in the future.

Believe that companies should procure capital in Japan. Hope to support these activities on Tokyo Stock Exchange.

If foreign companies are listed on Tokyo Stock Exchange, subsequent trading can be done much more smoothly.

The same ideas apply to companies in India. Steel company from Korea was listed in Japan recently in order to establish a plant in India. Having Chinese and Indian companies listed in Japan facilitates investment in emerging markets. With declining birthrate in Japan, it is important to utilize capital to take advantage of opportunities in China and India. The government of Japan is implementing a variety of measures to enable diversification of investment.

The Tokyo Stock Exchange will work to facilitate continued development of China, India and other Asian economies.

Du

State owned banks have started to be listed in Hong Kong. Why is the Tokyo Stock Exchange not promoting more Chinese banks and other companies being listed on the Tokyo Stock Exchange.

Nishimuro

One reason the Tokyo Stock Exchange is not promoting large-scale Chinese banks, is the difficulty of disclosure and due diligence. We require full disclosure of operations for the benefit of investors, and believe it is better to be careful for the benefit of investors.

Hatakeyama

Why are they able to invest in New York?

Nishimuro

This is not full-scale listing. They use diversified measures to get listed there. We have just started an effort to get more Chinese companies listed.

Esho

How about Indian companies. Not any Indian companies are listed on the Tokyo Stock Exchange. In New York and London, a lot of Indians are working in the financial sector, but not any in Tokyo.

Nishimuro

Shinsei Bank has decided that vice president and other employees will be from India. At Toshiba, 200 to 300 people from India are working. Toshiba has also started a training program for engineers to stay 3 to 6 months.

Dam

Recent disclosure documents in Hong Kong were interesting. Risks are described in section written by lawyers. To what extent have Asian companies used the Japanese market to raise money?

Nishimuro

The problem in the Japanese market is Japanese investors are not willing to take large risks, even if it is disclosed prior to listing. The Japanese market is more cautious than others. We are trying to educate the investors and the general public.

Madsen

Would like to challenge that. All private equity companies in Japan are oversubscribed by investors. Institutional investors are more risk aggressive. It is no longer fair to describe investors as risk averse.

Nishimuro

Attitudes have changed. Smaller investors are still very careful. Larger investors have to take larger risks.

Garrett

Would like to ask about assessment of impact of China and India on leading-edge Japanese companies in electronic sector. Large American IT firms view China and India as large potential markets. They are moving a lot of R&D activity to China and India. Please reflect on strategy of Toshiba and other large Japanese firms in China.

Nishimuro

Japanese electronics and IT companies have inherent language problem, making it difficult to fully utilize potential in China and India. IBM employs the largest number of engineers in India. Japanese companies employ a limited number. Some Japanese companies are using capacity of Chinese engineers. Fully utilizing capacity for manufacturing. Toshiba has a small number of engineers employed in China. Toshiba is substantial shareholder in Chinese software company. Japan is slower in understanding how to utilize potential in China.

Esho

Huge difference between US companies concerning auto related FDI. Japanese companies in China use Japanese, but in India they must use English.

Nishimuro

There are large software companies in India. Development of electronic translation is helping things. Toshiba would like to use English as the standard language.

Du

Recent business survey shows that for FDI in China, ROI is relatively low. Some people say reason is lack of localization strategy. Use less local materials, hesitate to employ local people. What do you think are the reasons?

Nishimuro

Most Japanese companies concentrate on labor-intensive manufacturing. US companies geared towards value added, i.e. software, such as IBM. These are higher value added. But this is changing. Cannot stay in labor-intensive operations in China. Need to use ability in value-added operations.

A. Kojima

Language barrier issue. What languages are disclosure accepted in. What about cross share holding.

Nishimuro

Recent changes have been made at Tokyo Stock Exchange, and now most financial data is accepted in English. We require a few pages translated into Japanese. Used to be full translation of thousands of pages. The burden much less now.

Some companies wish to go back to cross share holding. But it will be 1 to 2 percent. It used to be 30 to 40 percent. On paper it is evident, but in reality it is much lower. Prefer to have lower percentage for liquidity of market.

Bouton

There are great social differences between India and Japan. Business leaders have expressed in private great frustration about difficulty of doing business in India. Other factor is corruption. Indian corruption is typically in smaller amounts, but more of them. In India, many transactions. Third is geopolitics. Poor state of Japanese and India relations has been disincentive for Japanese investment, most recently after Indian nuclear test, Japan imposed its own sanctions.

Nishimuro

Will start with Toshiba's experience. After WWII, Japan and India's relationship was very good. First investment was in 1950. Started to produce small consumer items. Labor disputes and bureaucratic problems led to decision to closing of operation 30 years ago. But this is still in court. Suzuki Motor is the most successful Japanese company in India. The relationship is improving. Japan has a tendency to observe its international commitments.

Kokubun

Japanese FDI in China not so active. Wondering about recent relations influencing business activities in both countries. Japanese companies trying to enter Chinese market, but are losing in many cases. Japan has a bad political image in China. Big steel mill in Beijing is going to be transferred, and decided not to work with Japanese companies. Chinese asking about buying nuclear plants from Westinghouse, but this was stopped because Westinghouse became Toshiba, which is a Japanese company.

Nishimuro

Hesitant to answer this question. Toshiba's business in China is still growing. Political influence has been felt. Japan failed to get any orders for Three Gorges Dam project. But it really should not be blamed on political issues. There are many opportunities in China that we wish to pursue. High authorities in Chinese government do have certain policies. The current situation is not favorable for nuclear power generation around the world. It is difficult to satisfy the requirement that after five units, we have to assure that China can build the same type of unit itself. The manufacturer has the obligation to educate and give all information. Second, China wishes to have a full license to export nuclear plants around the world. Their third request is to give all future development information. All manufacturers are reconsidering whether or not this is feasible.

Tanino

There are cases, because of Japan, the shrine visit, quite a few cases bad influence. China will be very selective when introducing foreign investment. There is increasing popular sentiment against foreign investment, since it depends too heavily on this. Germany is becoming a target because they are very cautious about transferring technology.

Toshiba sent 100 engineers to India on a four-month project of how to develop an IT software program. They reported that they learned how to develop applicable software programs, and were very excited.

Suzuki enjoyed almost a 70 percent market share in India, because the president delegated all the power to an Indian vice minister.

The battlegrounds are China and India, so power must be given to local people.

Dam

Have a question about the focus of group. Spend a lot of time talking about manufacturing, and little about services. But higher percentage of business is in services. Financial services are the most important of all. Admire manufacturing in Japan for two reasons. At IBM, when flat panel displays became possibility, we chose Toshiba. Learned that there are manufacturing qualities in Japan not

found in the US. All of the R&D activity was in the US, and it was astounding to US engineers that the quality was always higher in Japan. In the present world, what are your reflections about the importance of services? Are a lot of issues in China related to manufacturing?

Nishimuro

Manufacturing is a tradition with Japanese workers, they are more attentive to what they are doing. IBM employs 45,000 people in India, and will shift focus to India. As far as the services industry, this is an area that Japan needs to work on. Japan has announced a program of financial restructuring to reduce government spending, and new economic growth policies. Can expect to have GDP growth of 2.2 or 2.3 percent. Main emphasis is on how to utilize and cooperate with Asian countries, and how to improve service sector in Japan. Asia experiencing the most growth, Japan is in the right geopolitical position to take advantage of this.

Moskow

Service sector in Japan. There is a difference in the manufacturing sector and service sector which has very low productivity. Could you mention some reasons for low productivity growth of the service sector?

Nishimuro

Short answer is existence of competition. Because there are many electronics and automotive companies, there is severe competition. But there are many restrictions and red tape in the service sector. In my new position, I spend a lot of time with bureaucrats in non-productive negotiations. The fact that there is less competition and restrictions are the main factors. Another area is agriculture, where there has been practically no improvement in productivity. After WWII, there was a transfer of ownership to local individuals. This is maintained by law, and is a serious problem for the future of agriculture.

Hatekeyama

Ten minute coffee break.

Hatekeyama

Let's resume the Q&A session. After session, will discuss final outline of policies.

M. Kojima

Two questions. Acute shortage of IT engineers in Japan. One report says shortage is 75,000. How serious is shortage in your opinion? Second is limited outsourcing. Japan accounts for only 3% of outsourcing in India. One problem is language, but another is Japan is not good at making complete specifications. I look to your for suggestions.

Nishimuro

Embedded software can be developed anywhere. The shortage of 75,000 engineers is an exaggeration. The shortage is not nearly this large. Embedded software can be outsourced to China or India. Some Japanese companies are doing this. Second area is very serious for Japanese companies. It is true they are not equipped to make final specifications, and this is a problem for the software industry. In Japan, software is improved on the spot, but this is very inefficient, compared with other countries. For outsourcing, you have to create precise specifications that will not be modified. Creating precise specifications is the start of software creation.

A. Kojima

Technology development is important for the future of Japan. There are tax policy differences between Japan, the US and Europe. How serious is the difference in depreciation tax policy?

Nishimuro

Japanese tax policy does not allow 100% depreciation. Five percent must be carried over. Am

advocating law must be changed. The Japanese government changed the expense allowance and IT introduction allowance four years ago.

Madsen

There is political conflict between Japan and China. But China needs huge inputs of capital goods. The only sources are Korea and Japan. Beijing will never interrupt trade with Japan that is essential. Rather than the efficiency of the manufacturing vs. services sector, the distinction is really between international and domestic companies. About one tenth of economy is globally exposed, and they set the standard. The other nine tenths operates at two thirds this level. Why don't more companies participate.

Nishimuro

Regarding investment restrictions, Chinese has gradually opening up the percentage of investment. Only 50% is allowed in the auto and electrical sectors. For some others, 100% is allowed. Toshiba was the last company to go to China for the production of copy machines. It asked for permission to sell copiers in China. Toshiba was the first company allowed to manufacture and sell. Toshiba is now number one in copier sales in China.

Your assessment is right. It is true that Japanese manufacturing companies are faced with international and domestic competition. Japan is the most difficult place to make a profit. The main reason is an antiquated distribution system. The financial area has been domestically protected, but this is changing and improvement will be seen.

Du

Many political scientists in China are concerned that tension between China and Japan will have a negative impact on economic ties. But this is not supported by statistics. The growth rate of FDI is negative, but this is not the case for Japan; FDI is increasing. Economic nationalism is emerging in China. This is different from first wave in the 1990s. It is the private sectors that are expressing dissatisfaction with government policy. China is welcoming foreign investment in the most profitable sectors, but does not allow investment in banking or communication. Income tax for foreign companies is 15%, with preferential treatment, but for Chinese domestic sector, the tax rate is 33%, and companies are saying this is unfair.

Nishimuro

Investment decisions have been based on decisions by the government. Regarding economic nationalism, we have experienced this with DVD video. Negotiated with Chinese authorities, and they wish to create their own specifications.

Hatakeyama

In newspaper report, read about an exodus of foreign investors from the Indian stock market. Will this continue in the future?

India's policy make it very difficult to invite foreign investment because of the difficulty to close plants, known as exit policy. Do you have similar experience in China?

Nishimuro

There was a forty percent decline in market prices, and some investors have gotten out. But now is the time for foreign capital to come back to India. There was unreasonable exuberance of the market, and this is being normalized.

Regarding exit policy in China, we have never experienced problems with this. Employment policy is much looser compared to India. We have 75 companies in China. We have closed five or six operations because of profit or other concerns and have had no problems fortunately.

Hatakeyama

Would like to discuss final outline.

Dam

No specific order. Please bring up points and discuss informally.
Start with topic 1B.

Overholt

There may be a serious setback to globalization. The French and Dutch votes set back globalization, and a failure at Doha will set back globalization. The mood in US congress is such that something bad could happen quickly. The developments between Latin America and the US have set back the prospects for globalization. I hope that this will not happen, and do not predict it will, but we must not be complacent. Globalization is more at risk than it has been since 1945. Strong efforts are required by the Japanese, US and EU governments to avert those risks and keep things moving forward.

Dam

See a lot of agreement.

Bouton

Will add couple of data points. Last year, there was an increase in public attitudes of internationalism vs. isolationism, and it is moving in the wrong direction. The other issue is the immigration debate in the US. There are enormous parallels between the period between 1910 and 1930 and the current time. The Governor of Colorado come out in favor of eliminating all social benefits for illegal immigrants and their children. This is a radical departure from policy to date. The first immigration limitation took place in 1908 and then in 1915.

Dam

Would like to hear from Japanese side.

Garrett

Have some bullish points in reaction. The studies comparing the late 19th century and today's do not point out the differences in the power of multinational companies. In the US, agree with assessment of public opinion, but as far as retaliatory legislation regarding China, the decision was made not to do this. Italy, France and Germany, have done terribly for more than 20 years, and this can be blamed on a lack of globalization. The public populations are more opposed. Japan's economic future is tightly tied to Asian integration.

Moskow

Agree with thrust of what was said. Globalization in the government sector, and in private sector are separate issues. In the private sector, the genie cannot be put back into the bottle. Concerned about this in the government sector. The Dubai situation got out of control. Globalization does have an adverse impact on a small number of people, but a positive impact on many more.

Tanino

I am cautious about introducing unskilled labor immigration. The Keidanren thinks Japan should introduce unskilled labor. In the 1990s, during the high point of bubble economy, policy in Japan allowed many workers from Brazil and Peru. But there are not schools for their children. We must be careful preparation in advance to prevent them from suffering.

Nishimuro

Have to wear the Keidanren hat now. The Keidanren used to have an open immigration policy. It was written clearly in the policy statement, but never advocated because of fear and opposition. This has changed because of experience in the Tokai area around Nagoya, with workers from Brazil and Peru, and a new Keidanren policy is being formulated. Immigration policy now only calls for qualified high-level talented people from around the world to be welcomed to Japan.

Dam

Have both issues on the floor.

Whitman

International economists have strongly argued about benefits of liberalizing international trade and investment, but have ignored distributional aspects. Something important is happening because of the rise of China and India. We are getting a significant shift of the effective labor-capital ratio. We are getting a bigger influx of labor into the global system than capital. There is an explosion of profits and stagnation of wages. Is this same shift happening in Japan?

Kokubun

In Japan, in the model for development, business, political and economic sectors worked closely together in the past. This is no longer the case. Businessmen go abroad, but politicians and economists do not.

In China, prof. Du mentioned the stakeholder discussion. What is meant by the international system? China must buy US bonds and other products from the US. China is learning lessons from US – Japan relationship.

Nishimuro

The labor compensation share went up during the bubble years, but it has come down gradually, and very steadily. Even though sales went up, compensation stayed level. But recently it is going up. Now Japan is in line with other competitive economies. Companies did maintain the R&D ratio during the years after the bubble.

Dam

Hourly workers have not done so well.

Whitman

A substantial amount of human capital is embodied. This is always a cyclical phenomenon. There is a rise during an expansion and a decrease during a contraction.

Garrett

If integration of China and India increases the skill level at low labor costs, this will be a shock to Western consensus about globalization. China is becoming the world's manufacturer. I am concerned about the innovation shock at a lower price. We may become unemployable because this is being done in China and India.

Tanino

How can you stop it?

Yellen

What has happened, you have a rise in wage inequality. The share of labor vs. capital, The gap between wages of skilled and unskilled labor. Europe has done more to implement protections for workers. This is a political and economic problem. Globalization is good for some groups and bad for others. There is the potential for everyone to be made better off. Looking at real wages, it can be said for workers with high school or less education, real compensation has either fallen or risen very little.

A. Kojima

The growth ratio is determined by the increase in capital, the increase in labor, and the increase in productivity. Demography policy is very important. Japan has 20,000 companies operating in China, employing almost 10 million people. Nishimuro's paper stresses the importance of integrating the Japanese economy. People over 65 years old currently account for 21% of the population. It will be as high as 36%. China's population is still young, but will not be so in 20 or 30 years. Japan must

think about long-term immigration policy.

Hatakeyama

I support A. Kojima's comments about immigration. Globalization results from differences in products, interest rates and wage rates. There are only 15,000 Indians living in Japan, but there are 1.7 million Indians living in the US. This is too small a number.

Madsen

A healthier welfare system is needed in China. I am concerned about this because currently China has nothing. The government uses growth as a social safety net. China needs a better welfare system to implement reforms, and this is related to the imbalance of trade. This will increase the quality of life, and benefit the trade imbalance.

Moskow

There is more inequality of real compensation in the US. But I would not attribute this 100% to globalization. Fifteen percent can be attributed to globalization. Some sectors were protected in the past, such as transportation and communication. Enormous technological change has taken place, leading to more competition. Jobs for high school graduates are shrinking. Higher education is needed.

Overholt

India and China produce 10 times more engineers than the US, but many of these do not qualify for jobs for international corporations. In India, there is a shortage of qualified engineers.

Dam

Globalization 1.0 and 2.0 has great journalistic appeal, but are we getting to the point?

Schoppa

The Japanese side first said, what do you mean by 1.0 and 2.0? What does Japanese side feel about it now? Does this help, or should it be altered?

Du

Agree that China must increase expenditures on social welfare. Global rebalancing is a hot topic in China. The growth pattern of the Chinese economy is not sustainable. Growth is export driven. The government is seriously considering how to adjust the imbalance. The external imbalance is related to the macro economic imbalance. The savings rate is too high, but it is not easy to increase consumption. Need five years to eliminate surplus in the international balance of payments.

Dam

Question about savings rate. Lot of this is individuals and government making investments.

Du

The household sector savings rate is about 25%.

Madsen

Government budget deficit is 5 or 6% of GDP. Tax rates will rise, but savings will rise faster by corporations and households. China saves so much because there is no welfare system and due to problems with the banking system.

Gottlieb

In March, Chinese put out its 11th five year plan. They talk about a lot of social issues and other things.

M. Kojima

Talking about rise of China and India. We are familiar with the China threat, but there is no perceived Indian threat.

Kokubun

People talk about the China threat in Japan. We must analyze the essence of the China situation. There were 87,000 demonstrations in China last year. There are three issues: The unemployment rate, young people cannot get jobs. Second, the private ownership issues, particularly land. The third issue is politics – Corruption and the lack of policy.

Hatakeyama

Expressed appreciation to Mr. Nishimuro. Meeting was adjourned for lunch.

14:00-17:00 Afternoon Session - Session 2 (in Banquet room GLORY on B1F)

Key topic 2: Technology sharing and its relationship to innovation

For the past half century, Japan and the US have led the world in innovation, benefiting not only their own economies and societies but those of China and India as well. Innovation has allowed multinational enterprises in Japan and the US to “divide up the value chain” with value-added R&D and production at home and lower value-added production in lower cost offshore locations, including China and India.

Yet today China and India are both producing many more scientists & engineers than the United States and Japan, and are beginning to produce innovations of their own in certain sectors. How should Japan and the US respond to the evolution of China and India from low cost economies toward innovation economies? Should they attempt to combine forces in some way to ramp up innovation to stay ahead of China and India, or should they shift gears and build partnerships with these two nations at the cutting edge of the global innovation economy? Are there win-win scenarios that will benefit all four countries? (Maybe address IP issues as well here?)

Co-Chairs:

Noboru Hatakeyama, Chairman and CEO, Japan Economic Foundation
Kenneth Dam, Max Pam Professor Emeritus of American and Foreign Law,
University of Chicago Law School

Speaker (10 minutes):

Fujio Cho, Chairman, Toyota Motor Corporation

Participants:

Japanese study group members
US study group members

Discussants:

Tomoo Marukawa, Associate Professor, Institute of Social Science,
University of Tokyo
Hiroyuki Oba, Professor, International Economics Department,
Reitaku University

Hatakeyama

Opened afternoon session. Introduced Mr. Fujio Cho, Chairman, Toyota Motor Corporation, graduated from University of Tokyo. Sent to Kentucky in 1987. Returned to Japan in 1994, became managing director. From 1999 to 2005, was president. Now Chairman, vice chairman of Keidanren, and chairman of Japan Auto Manufacturer's Association. Prof. Marukawa and Prof. Oba also participating in this session.

Cho

Thanked audience for opportunity to talk about economic growth in China and India, from standpoint of economic activity in both nations. There has been impressive growth in auto industry in India. This is presenting new challenges for global energy management and environmental protection. Toyota and other auto makers are now competing globally to find sustainable solutions, and looking for alternative energies. Toyota is a pioneer in hybrid technology, and the Prius has been very popular, reaching 500,000 unit mark. Intellectual property is a vital asset for corporations, and we need to protect this with patents and other safeguards. But we also must share technology. Toyota is sharing with other manufacturers in win-win relationships. The Toyota Production System, or TPS, is a key to this. Problems are identified and waste eliminated. This is being done in China and India. Auto manufacturing relies on parts and materials in a broad number of industries. We work with suppliers in Thailand, which has become a center of manufacturing. It is becoming the Detroit of Southeast Asia. Thais who have learned TPS can teach this system to other Thais, and this will provide lasting growth in Thailand. Japan has an international partnership with Malaysia, taking effect on July 13th, and this will strengthen ties with Japan. We have a five-year assistance program using TPS.

Toyota is also sharing TPS know-how with industrialized nations. It is sharing TPS with numerous suppliers in the US. I took part in setting up the Toyota plant in the US in 1980s. In 1992, we set up Toyota supplier's support center in the US. This center works with companies beyond the automotive field, such as food and financial sectors.

We welcome the growing presence of China and India on global scene, and see huge opportunities rather than a threat. Toyota will do its part to promote sustainability.

Hatakeyama

Any comments on speech?

Garrett

Is Thailand largest auto parts producer in Asia outside Japan.

Oba

Yes.

Marukawa

The topic here is technological innovation in China and India, and how the US and Japan should respond. My first response "Is China really catching up?". China is working hard to make China an innovator. In the last Five Year Plan, it states China will become a self reliant innovator. I have found that China is not really doing something that is really innovative. They are trying to buy cheaply existing technology, and make goods cheaply suited to the local population. Demand-pulled innovation is what is taking place. China has a comparative advantage in labor-intensive industries. They mainly select this type of technology. More and more multinational companies are setting up facilities in China. However, I must point out that there are some efforts to catch up to the latest technology. Recent cases include third generation mobile phone technology. China has created TDSCDMA. There are other cases, including DVD. Most are related to the electronics industry. Many people think that these activities will not be commercially successful. Mobile technology is not inferior, but China is not cooperating with Japanese or European companies. And users require ability to use same mobile phone around the world. Isolated self-reliant efforts will not bear fruit.

Dam

Think US and technology press assume China can require CDMA standard for China, and that is all they need to do, for prestige and to develop confidence.

Marukawa

China will require some of its mobile carriers to adopt the domestic standard. The Chinese will adopt two other standards also. In the end, there will be competition among the three standards. This is why many believe the Chinese standard will fail. The same thing will happen for many other technological standards. China is self confident because it has a huge market, and hopes that its own standard will succeed outside of China. These attempts will continue for 5 or 10 years, but there will be opposition from multinationals, and most attempts will not succeed.

A. Kojima

A couple of years before the Asia crisis, it was said East Asia has a limit, and there was very little development of technology.

Marukawa

There are many estimations inside and outside of China. Technological progress explains at least one third of China's growth, but much of it relies on input of labor. Technology is introduced from advanced nations, and then you have innovation. In Japan, factories already have state-of-the-art equipment, and it is getting more and more difficult to achieve innovation. But in China, simply the introduction of state-of-the-art technology will result in innovation. I am optimistic about the future of growth in China.

Garrett

If this is true, why are American firms doing R&D in China? Large concern about large numbers of engineers and scientists being produced in China and India. Do you not think that innovation will take place at all in China. Most large firms have moved R&D to China.

Marukawa

I am aware that many multinationals, including Japanese, are setting up R&D in China. These activities are taking place in a global setting. The facilities in China constitute a part of a global system, and they are arranging original technology to something to cater to the Chinese market. In many cases, such as with software development, there is a similar supply chain between China and the U.S. or China and Japan. China does the labor-intensive part, and Japan does the customer relationship and core technology.

Hatakeyama

Prof. Oba asked to intervene concerning India and China.

Oba

Lived in India in 1970s, therefore more qualified to talk about India. With multinationals, there is little chance of isolated or self-reliant growth. Must rely on foreign technologies.

Tanino

Japanese business, including Toyota, is sometimes still criticized for not transferring technology. Would like to say that this is not the case anymore. How does Toyota compare with General Motors in Shanghai or Volkswagen. Is Toyota stingy, or generous?

Kimura

In the future, China wishes to export vehicles. Mr. Cho asked to emphasize that there are two aspects that need to be protected and cannot be shared, and there are portions that need to be shared. The Chinese policy in the automotive sector is focusing on how to save energy. It needs advanced

environmental technology such as hybrids and bio-diesel. We will do our best to cooperate with the Chinese government. It wants Toyota to conduct R&D in China. We need to talk with the government about what type of R&D is needed at this stage.

Prof. Kojima

There are parts manufacturers in Thailand and auto manufacturers in India. India has formalized FTA with Singapore and Thailand. What impact will India-Thailand FTA have? Also, some Japanese companies outsource embedded software development to Indian companies. What is the future of this?

Kimura

The FTA has some impact on our business. We are now exporting transmissions from India to Thailand, but the volume is still low. Overall operations are very efficient. We are currently focusing on ASEAN wide integrations of operations. When India is ready to make more serious production, it will make more sense.

Regarding outsourcing of software, this is core technology for Japan, and I personally believe this should be done in Japan.

Overholt

I have studied the Chinese car industry for a couple of years, and feel optimistic about their ability to develop their own technology and brands. The Chinese succeeded in getting technology, first from General Motors. Other companies had to follow after that. It also succeeded in endowing research institutes at major universities. One university in Beijing has an engine institute, and another an institute devoted to drive trains. Third level is tremendous competition. There are 128 car companies, and three have been favored. The three have become captive of foreign companies, but the others are competing under unfavorable circumstances, and have begun moving quickly. Fourthly, they are very international in their outlook. It takes a long time to build homegrown technologies and brands. The Chinese think, "If the Koreans can do it, we can do it." I think the Chinese will succeed over a couple of decades.

Dam

Think it would be a mistake to say R&D facilities are of one pattern. Went to GE Lab in Bangalore. GE started at sales of 0, and is up to one billion, and it expects to be at five billion in five or six years. The GE Lab in Bangalore is doing R&D, but primary product line is health care industry. It is developing low-end MRI machines there, and it is taking off. That is a different model from China. There may be a number of different models. Would like some comments on this.

Gottlieb

Comments from Japanese side on how Japan auto industry or TV industry developed.

Dam

In Japanese car market, understand Honda became big exporter because it was not favored.

Hatakeyama

Honda and Sony were not liked by Japanese government, because they were new, as with Cherry in China. Now the situation has changed, and in addition to this, Japanese government has nothing to do with the fate of Toyota, Nissan or Honda, except for some minor tax issues.

Dam

Infosys started so rapidly because exports were going over telephone lines, and government could not tax it. There are many different patterns.

Madsen

Easy to overstate technological threat in short and medium term. Ultimately technology will

transform the country. China is currently assembling parts from other countries. Essentially, China is displacing the rest of Asia as a trade surplus country. But really it is an interregional imbalance.

Hatakeyama

Recently met scholar who said there is difference between manufacturing in Japan and Germany. Japanese industrial structure is to keep parts and component industries inside Japan, and outsource assembly to Asia, including China. Germany does the opposite. It outsources parts and components production to Eastern Europe, and does assembly in Germany.

Moskow

Think concern is overblown. Some think US and Japan are getting less competitive because China and India are moving up the value chain. If China and India develop something new, this will spill over to other industries and countries. The most important thing is intellectual property rights. Pirating of US or Japanese technology should be a major concern. The fact that China and India are becoming more competitive should not be a cause for alarm.

A. Kojima

Exchange rate risk is a concern for all manufacturers in China. This month last year, China adjusted currency by only 2%. In 1985, currently increased by 100% in only a few years in Japan, and this forced Japan to introduce innovations. In 1995, the largest deficit was with Japan, but currently the largest deficit is with China. There is no consensus about what level of deficit is sustainable. What happened to the relationship of US dollar to Asian currencies? All East Asia has a great surplus. China is a final assembly plant, and parts are coming from other Asian countries.

Madsen

The yen strengthened to 79 yen, but the deficit did not improve. Almost all countries are running a surplus. The only way to fix imbalances is to change saving behavior.

A. Kojima

There is a global savings glut, except for the US.

Overholt

Think US savings behavior is about to change. We have been in Greenspan economy, where Americans could spend a lot because of appreciation of houses and stock market. That is about to end. To maintain balance sheets, Americans must reduce consumption. It will be less than Chinese or Japanese. This will affect international balance, and will be more manageable in a couple of years.

Dam

What is the consequence for Japan and rest of the world economy?

Hatakeyama

For Japan, if the US economy shrinks, exports will drop.

Garrett

Believe for the last three days the lead story in Wall Street Journal was about facing the largest challenge in the next few months because of this reason.

Yellen

Facing classic stagflation problem. Regarding issue of current account balance, is it problem for Japan? Will require weaker dollar vs. Asian currencies. Will see improvement in current account deficit. Most difficult aspect will be for Japan and other Asian countries, which will be unable to export as much to the US. May be smoother for US than Asian countries as a whole.

Moskow

There are lots of stories. Growth has slowed. Is this transitory, or is this going to move back. Think it is going to move up.

Two parts to the problem. First is inflation going up and economy slowing. Whole world knew decisions were more complicated at five and a quarter than at one percent. There are two scenarios. Could be very rough, or could be gradual. Think that it will be gradual. Reduction in US demand for imports will be filled by domestic demand in developing countries and Japan.

It is unusual that all developing countries except for three are running huge surplus, but it should be the opposite.

Yellen

Would like to add that adjustment will be triggered in various ways, but could be triggered by decline in dollar. With weaker dollar, stronger Asian currencies, Asian countries will see exports decline, leading to unemployment. The Bank of Japan, when they see slackening will think they need to make up for drop in exports.

Hatakeyama

If dollar goes down, RMB also goes down.

Madsen

If there is a change in the US, sooner or later there will be a change abroad. Afraid that if US savings rate rises and consumption falls, the global growth rate will fall. Will be easier to make this adjustment if rest of world looked at exchange rates in neutral fashion. The Ministry of Finance in Japan could get involved again.

Hatakeyama

Ten minute coffee break.

Second part of afternoon session.

Dam

Let's discuss final outline of draft.

Oba

This is a session for technology sharing. First, would like to ask everyone to think about "What is innovation?" Technology is process technology or product technology. Would like to ask you to discuss this. The first question is how much do US and Japanese companies intend to transfer technology to China and India. The extent of transfer does not come to the level of new product technology. Suzuki entered Indian market in early 1980s. As a student there, I saw that Suzuki succeeded. Still Suzuki is still not conducting new product development. It launched a so-called Swift, but it was developed entirely in Japan. Even if Suzuki wants to share technology, it is difficult to do this. In order to realize technology sharing, Honda set up a division called Hero Honda. It is trying to train people in R&D, but it is difficult to have genuine R&D personnel, and in turn share technology.

Tanino

Why is that, the difficulty to share technology? They excel in many ways.

Oba

Suzuki tried to create a local model, but were not able to, and had to create the model in Hamamatsu. I don't know the exact reasons.

Dam

What kind of innovation are we talking about? Many of the innovations in the US, such as retail, have led to enormous productivity improvements. Some things are product or process specific. But it would be a mistake to make this solely a technology chapter.

Hatakeyama

IP issue should also be included. Regarding technology transfer from Japan or the US to China or India, it should be up to the market mechanism, and individual companies.

Dam

Raised question about US and Japanese law that prevents technology transfer.

Whitman

Statement implies that there is less venture capital in US and Japan.

Schoppa

Question of increasing FDI going into India and China raises fear of technology leak.

Dam

Lots of business interest in China and India. Focus on intellectual property issue.

Bouton

One quick footnote. In case of India, two venture capitalists who are looking at bio-tech sector in India. One concern after India's joining process patent standard, there is a history of disputes between the US and Indian pharmaceutical companies.

M. Kojima

Japan and Indian recently formalized tax treaty, reducing tax rate from 20 to 10%.

Tanino

On IPR protections, companies based in China were timid about raising issues with Chinese government, individual companies would be intimidated, but this is not the case anymore. JETRO is doing a big campaign. They demonstrate all kinds of fake goods. JETRO has a couple of officers to constantly monitor and increase awareness. Yamaha sued because Chinese motorcycle company began exporting a motorcycle with the Yamaha name at one fourth the price. There has to be concerted action, and the Chinese government is very aware, and they are doing a good job. The problem is local people don't listen to the central government.

Dam

There is a particular problem with copyright. Decentralization of the system is very important. The court systems are very beholden to local government and local officials. Expected to consult with local government, and there is not a review system like that in the US. Has been some improvement, but do not guarantee review at the center. There is judicial or local protectionism.

In India, the problem is different, it can take 20 years to go through the system. There are many specific issues. What exactly are we going to recommend?

Hatakeyama

Even if you win, it may be in civil court, and you may not be able to win in criminal court. There are some products made in India with the label made in China.

Bouton

Got briefing in China from US embassy about Olympics. Johnson & Johnson is a sponsor, and they became a sponsor because of trademark protection in China with lots of knock-offs. By becoming a sponsor, they were allowed to put the Olympic logo on their products, and the Chinese government has been so strict at enforcing the use of the Olympic logo, there are no longer any knock-offs. This

shows that they can enforce the issue if they really want to.

Overholt

We have to be clear about our different audiences. When talking to Chinese and Indians, we have to be very hard. There is a common view in industry that it is a uniquely Chinese problem. Need to get at this by layers. Because China and India are so big, we have the right to come down hard, because they are such big problems. If you go to Nagoya to the Toyota museum, half of the technology was copied from Chevrolet, half from Ford, and the design was copied from Desoto.

Spent a lot of time studying China, India and Russia. Found they were similar except for details. Important that there is universal acceptance of the idea of Intellectual Property. The Chinese came on first, then the Indians. So the principle is straight. What is next? That is hard. There are enforcement problems, criminal vs. civil issues. Need to choose one or two things that are the next step.

Dam

In 1980s, Singapore was a major pirate country. Singapore is one thing, and China is another. What do we say in the report?

Kokubun

China joined WTO in 2001, and it must obey regulations. Looked at studies of Chinese behavior. In 1920s, Chinese behavior is always the same. The goal is becoming a member. China uses veto because of Taiwan issues. Now, China must be a stakeholder in international system. Next is how to make China a real member. In addition to looking at Beijing government, we must also look at local government, because China is so big. There is de-facto federalism.

Schoppa

There is only one line for dealing with IPR. Suggestion came that this should be made a priority in any kind of free trade agreement. To get into this next organization, they will be asked to increase enforcement of IPR, and the agreement will be written with much higher standards. Will have to get control of local governments. As soon as there was a WTO agreement on procurement, it gave central government in Japan excuse to crack down on local government, and it really made a difference. This could be a model to shame the Chinese government into enforcing down to the local level.

Hatakeyama

It depends on how items are classified. A level, local governments should comply, B level, not necessarily comply.

Marukawa

Comment about IP. China has a problem in enforcing IPR, but on behalf of Japanese enterprises, especially small and medium. They have a problem, and are unconscious about enforcing their rights in China. Recommend Japanese companies to be more aware of their rights and what they can do in China.

Hatakeyama

Increasingly, Japanese companies are becoming more enthusiastic, and are more conscious.

Dam

To what extent is Japan in its bilateral free trade negotiations emphasizing IPR?

Hatakeyama

No difference, except in attitudes. Maybe we are a bit softer.

Tanino

Why is Japan weak on investing in infrastructure? Have to do good surveys, level of material. Japan

is good at selling commodities, at selling power plants, but not at systems. Need to address this with BOT method. This is very important.

Bouton

Been some discussion about compressing report. Possibly this whole section could be folded into the one being discussed this morning.

Garrett

Seems to be disjuncture between views of innovation. US National Science Foundation report has title "Rising Above the Gathering Storm." Interesting thing in this discussion is there is not a lot of innovation at the cutting-edge, so stopping piracy is what is needed. Is it fair to say that they is not a big innovation challenge from China and India. Should be thinking about a way to help India and China.

Talk about win-win model of innovation with these economies.

Dam

Need to look at that report, and make our mind about substance. Do other people agree? US is not being threatened and going to fall behind, but rather there are unfair policies. What is our judgment? We would be better off if they were more innovative.

Oba

We should think that technology is not confined to product technology. The strong point of Japanese technology is the human focus. Is technology on a company level or society level? Japanese companies are trying to motivate workers and managers, and there is a spill over to society. Japanese companies are very good at training people, and there is a rumor that people in China and India do not stay there a long time, and move to American companies for the better salaries. Developing human resources is quite important. Should talk more about common interests with China and India.

Dam

Companies are doing a good job, and society is taking it for granted.

Yellen

Not teaching math and science to students.

Dam

Need to do a better job at making society learning more math and science.

Garrett

Point that this is win-win. Make observation not to overestimate innovation, and that this should be stimulated. This is different from prevalent view in the US.

Overholt

There is not any crisis, and will not be in the foreseeable future. 84% of tech exports are from foreign companies. India, a third of the population is illiterate, 5% speak English. These are things that cannot conceivably threaten us in the 10 year period, but we better be smart and learn math.

Moskow

Made this comment this morning, and agree, should drop it as a separate chapter, should be folded in. But piracy point should not be dropped. Rather than more resources on math and science, a different focus is needed.

Garrett

US report does not talk much about innovation being produced in China and India, but only numbers of engineers. Bright young people used to do science and math, and now they go into business.

Madsen

Would be a mistake to underestimate importance of financiers.

Schoppa

Awkward to fold big section on technology with section on strategy. Chapter could be shortened. Talk about some of the concerns. Number of engineers as a reason for concern. But group feels that the real opportunity is win-win.

Bouton

Reviewed paper on this issue. Need to get some material that takes NSF report to task. Biomedical research has gone rapidly up, but physical science research has gone rapidly down. At Univ. of Chicago, they have concerns about what is happening in physical sciences.

Hatakeyama

Japan is a bit different from US. It is also lacking in education in math, physics, etc. Also, financial engineering is important in order to strengthen service sector. Japan needs both. US can cooperate with Japan in the financial services area. Mr. Dam and some others need to work on how to write. Ms. Whitman says this is too long, and we need to concentrate on four or five important items. Tend to agree for public announcement. The physical paper can include many items. Can discuss the paper at dinner.

Additional meeting by:

Schoppa Dam Bouton Faust

Garrett Hatakeyama Inoue Tsuchiya

Hatakeyama

Need to do two things: Outline and Schedule.

Bouton

Schedule first. Has implications for process. Not prejudging decision about schedule. Can start on schedule. Want to bring to attention to JEF colleagues and Len, if we are going to publish in the first week of October, it will be very rigorous schedule. Then for bringing report from near final draft to point it goes to the printer. All the activities of copy editing and design. Very aggressive schedule. Have to turn around things very rapidly. Leaves zero tolerance for slippage. PCIP and CCFR need to bring to attention of colleagues. Should not start unless everyone is aware.

In order to have printed reports by Oct. 2, have to without fail deliver print ready manuscript on Sep. 15. Just started discussion on schedule.

That means would look to Len to produce very advanced draft by Aug. 1. Then have two weeks, or a little more of process of vetting on US and Japanese side, on any differences. Then go into process of copy editing no later than Aug. 29. That assumes along the way we are working on other processes like producing a foreword. The co-chairs' preface. This can be done in advance, in parallel. At end of Aug., it all comes together.

Look at stage 2 process, where real pressure is. On Japanese side, we would give you first draft that Len comes up with by Aug. 1 sent to you, Hatakeyama-san at the same time. Would have two weeks to look at it on both sides, bring it back together, and turn it back to Len for redraft.

Schoppa

Japanese date for original plan for Aug. 10th to 17th. Includes Japanese Obon holidays.

Hatakeyama

From when to when?

Bouton

Send draft on Aug. 1st. You, Hatakeyama san review it yourself, or send it to team. Then would have a week to collect Japanese and US reactions. Give those back to Len. He then produces 2nd draft, but about Aug. 15th. Then have about a week to close everything, text of report itself, has to be completely done by Aug. 28th. Chris no time to revise anything at that time. Do copy editing for grammar by Aug. 28th. Cannot be making any more than word changes. Len produces second draft by middle of Aug. In second draft, not in position to add new things or completely reorganize. There are basically two weeks of review and revision by the two teams...

Between Aug. 1st and 28th. But a portion of that is Mr. Schoppa's time for 2nd draft production. A portion of it is finally sending it out to everybody.

Hatakeyama

When should Jeff send back to you?

Bouton

About 8th or 9th of Aug. Same would be for US team. Then Len takes it, since you are dealing with both team's reactions. Week to turn into 2nd draft, goes out to both sides, Aug. 15th. Then basically, that's it. At that time, the co-chairs take over. Any substantive terms at that point, it is the two of you. That would be around Aug. 22nd.

Hatakeyama

Reason for change is consideration of Obon holiday?

Bouton

Originally thought would make US changes, then send it to Japan. But it seems should not go step by step that way.

Both teams have one week with the first draft, and one week with the second draft, and Mr. Schoppa has one week to produce 2nd draft. That leaves the last four or five days to produce final draft.

Hatakeyama

Think this is reasonable. Some tolerance is included. If my co-chair agrees?

Dam

Yes.

Garrett

We all have to sign in blood.

Hatakeyama

Only problem is we do not know what kinds of proposals will be made from the American side, and you do not know what kind of proposals will be made from the Japanese side.

Schoppa

Each should read others comments, and you give me guidance.

Hatakeyama

Might be helpful if you have strong opinions, can express these.

Then on Aug. 9th or 10th, send our opinions to Mr. Schoppa, as well as American people.

Bouton

We will produce a new schedule roughly along these lines. I think I have an obligation to put on the table, the alternative is to delay by some months the publication of the report, to sometime early in the new calendar year, Jan. 2007. When we approached CGP for funding, we originally hoped to have the second round of meetings in the Spring. There was six months between the second meeting and publication. There is nothing inherent in schedules that ties us to Oct. 06 release. The other factor is, if we are interested in getting to US congress, it may be in recess. Sometime in first couple of months of 2007. We all want highest quality product, and best possible leveraging, financial, human and otherwise.

There is nothing that says this has to be published.

Hatakeyama

If we publish in January, what do we delay?

Dam

Publication and public activities could come together.

Bouton

Would still want Japanese team to come to the US, and better plan set of activities. Would have to be Feb. if we are interested in congress. Don't know if there are any down sides to this. If we decide to move to early 07, the difference is minimal.

Garrett

Would all like to have an aggressive timeline, because deadlines are powerful. Have become more concerned about this very aggressive timeline. Innovation chapter may look much different. Your short paper for tomorrow about Asian regionalism is profoundly important. Am a big believer in the quality of written communication really mattering. Worried about that. This is one side of the coin. Getting this finished and moving it out. Think there are arguments for both directions.

Schoppa

Main writing needs to take place in July and August anyway. Do my main part in August. Concentrated writing time ends once school starts.

Faust

With a delay until Feb, it is hard to predict what will happen until then.

Dam

There will be other things that happen.

Bouton

Would give us time to take into account lesser events.

Schoppa

Even if wrote my part in August, final revision would also make sure that it is timely.

Hatakeyama

My instinct is to stick to current schedule. Why don't we finish this business first. Everything going on as scheduled.

Dam

OK with me. Think it can be done.

Bouton

Alright. Proceed on that basis.

Invite attention to stage 3, dissemination activities in Oct., envisages day of activities on Tue. Oct. 3rd, Monday is Jewish holiday. So Tuesday would be Washington day, on Wednesday morning Japanese and US members fly to Chicago, activities in afternoon and evening.

Thursday morning Japanese and US members fly to LA for activities, then possibly San Francisco.

Faust

Talk about JETRO branch in LA, would like to host something.

Garrett

Redress imbalance. Will have to bring summer clothes.

Dam

Suppose planes are delayed. Is it better to fly in the evening from Washington?

Bouton

My experience is it is more dependable in the morning. Arriving at Ohare in morning is less of a problem than at night. First week of October, good time weather wise. Then have final set of activities on Friday, Oct. 6th, and then depart for Japan on Friday or Saturday.

Hatakeyama

Presentation in SF?

Bouton

Early morning flight from LA to SF. Is there a benefit of doing something in SF?

Garrett

Because of Expat community, there is greater interest in SF than in LA. On West Coast, the LA Times is a long way in front. Most people believe Mercury News is second strongest paper.

Hatakeyama

How long a presentation?

Bouton

Maximum amount of time in any city would be three hours. In Washington, need to do exploration about cosponsoring with other organization. Other part is to look to the team to call on people in administration, members in congress or their staff. Another possibility would be to invite Japanese ambassador to host something. Dinner or something else.

Dam

There is substantial Indian community in Washington.

Garrett

When we did a presentation, media presence was quite stunning.

Bouton

Difficult to know how this will play? Will need to think about this. Will get India media for pure Indian. Little trickier when 3 – 4 countries are bracketed.

Dam

People are going to be tired of China and India. Maybe should have more of a science / technology flavor, emphasizing different recommendations.

Bouton

Congress may be in recess. Will have to give audience some thought.

Hatakeyama

Three of us maximum will be divided into four stories, four key topics. That is a whole other set of questions.

Garrett

One could do both. Launch piece should be short, and focus on you two (Hatakeyama and Dam). Could follow up with symposium that would go into more detail for people who are more interested than media types. Three hours is a long time to ask for people's attention.

Dam

You get staff level people at a symposium.

Bouton

Do you have relationships in Washington?

Hatakeyama

Yes, but I do not know how this will work out.

Bouton

OK. ADI does not work very well... We have a good relationship with CSIS. Who does China at CSIS? Mike Green, Jim Lilly. Think more about this, and then ask Hatakeyama san if you are willing to make initial approach to John?

Hatakeyama

No, you should do this.

Bouton

We will do much better if we can get Washington organization that has automatic reach.

Hatakeyama

Do we have time to discuss paper?

Dam

Number of recommendations is too many, but really have just four subjects.

Bouton

Had conversation, think we got comfortable with first, the report now concentrates on three of four subjects... Trade, Energy, Technology and broad point of China and India's growth is good for everybody. Like to point out bullet point recommendations are throwaways. Big science project will just go away.

Dam

Some can be discussion points.

Bouton

Think her concerns will get addressed in the process we are involved in. Think basic structure of the report is consistent with her concern.

Hatakeyama

Think desirably this report must be report of telling an interesting story to have many people pay attention to it. Examples should be incorporated to illustrate cases. For example, instead of saying sustainability of Chinese growth, there is the household registration act prohibiting movement of

people to cities. This is very unusual for development of countries. Japan experienced development naturally through market forces. In China, situation is quite different. Since we seeking a win-win game, our real concern is that China will fail to grow. We should really promote China to enjoy sustainable growth. For this reason, we should list some interesting points. Prof. Du wrote that instead of Chinese government investing in hard infrastructure, it should invest in soft infrastructure, meaning social security, is very necessary. This will increase domestic demand. Because of the concern about social security, Chinese people don't spend much money for consumption. If the government of China can provide some assurance, people will tend to spend a lot on consumption.

Dam

Believe it is correct that percentage of consumption is less than 50 percent.

Bouton

Another point concerning number of recommendations, decision rules. We are not making recommendations to anybody other than US and Japanese governments. Some bullet points will come out because they are recommendations, and want to identify issues that could impede growth.

Garrett

Want to underscore point about examples. Think having powerful examples is the right way to go. The case of failure of Suzuki partnership to develop an India car, so what are Microsoft and Intel doing at R&D facilities?

Hatakeyama

FDI in India is one tenth that of China. This is partly because of closure of plants. This type of example will be convincing part.

Schoppa

Telling stories will rely heavily on the people who have participated in these meetings.

Dam

Reminds me of conversation concerning biggest population movement was in England from the West to the East. There are very good statistics on it.

Hatakeyama

Then in that case, the first two lines might have to be deleted.

Garrett

Would tend to think that the content is true.

Bouton

There is a discussion of potential impediments to continued robust growth in China. Labor market flexibility issue. Do not have labor market flexibility in domestic markets.

Hatakeyama

Household registration act is a law prohibiting worker's movement to the cities. Because of this law, it is not always fair for foreign countries, because it prohibits movement unless they have jobs and dwellings in cities. Factory owners are taking advantage of this system to order workers to go back to their home state three years after hiring. Then another group will join the same factory, with the same wage as three years ago. This guarantees low wages. However, thanks to participation in the WTO, as well as a demographic way of thinking, this system cannot be supported any longer. Therefore, many cities started relaxing the enforcement of this law. It has become very non transparent.

Bouton

You are not disagreeing, we are not in a position to recommend to the Chinese government directly that it should abolish the Household Registration law.

Hatakeyama
I have not decided.

Bouton
For a group like this comprised only Americans and Japanese, that has not engaged in any consultations with Chinese or Indians, making recommendations to those governments risks being either hard to defend, offensive, or dismissible. It would be awkward at best to do so.

Hatakeyama
We have not consulted with our governments. This is a decision up to the two of you.

Dam
Win-win, we want China and India to grow. You can talk about it, without making recommendations.

Schoppa
There are enough recommendations, IPR, electric privatization, those will be phrased. It implies that something needs to be changed.

Dam
India is constrained from doing economically efficient electricity since it is giving free electricity to farmers. You can make it an implicit recommendation without listing it. You have to see if this works in practice.

Hatakeyama
I think in the morning on Monday, we can continue to discuss this.

Dam
At dinner, more free flowing discussion of India and China.

Hatakeyama
Then we need a moderator. Mr. Bouton.

Bouton
With a very light hand.

Dam
We just want information. Want one conversation.

Meeting closed.