

Rapporteur's Summary of Discussions
San Francisco / Chicago Study Tour of the Bi-national Group on the Implications of
the Rise of India and China for Japan and the United States

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As we gathered in San Francisco, the goal of our group was to evaluate the current and expected effects of the rapid growth of China and India on the United States and Japan and to begin formulating suggestions for dealing with this looming challenge to the international system.

Since this study tour brought the bi-national group to the United States, we naturally focused on the challenges and opportunities as they are perceived here, but our discussions ranged broadly—covering those faced by Japan as well as the current and future challenges faced by the governments and peoples of India and China. We agreed that the interests of all four countries are best served by policies that enable China and India to continue growing in ways that integrate their large populations and growing businesses into the international economy. Containing their growth in an effort to limit losses in the relative power of Japan and the United States is not an option—both because carrying out such a strategy would be difficult, if not impossible, and because it would create more problems than it would solve.

Helping China and India to continue growing and integrating into the world economy, however, will require farsighted leadership by policymakers in the United States and Japan. The rapid growth of these countries, especially the expansion of manufacturing in China and outsourced services in India, is already causing workers and competing firms in the United States and Japan to lobby for protection and a rise in the value of the Chinese currency. The large bilateral (and overall) imbalances in the Chinese and American current and capital accounts have raised concerns about how these imbalances can be reduced. The rapid growth in Chinese and Indian energy demands have led to growing tensions over control of energy resources, companies, and pipelines. Growth in both India and China is generating social tensions between rich and poor as some regions and individuals grow prosperous more rapidly than others. In China, inequality and growth can both be expected to increase pressures on the government to open up its political system, a transition that is not likely to be smooth. In the meantime, the lack of transparency and uneven rule of law in a nation that continues to be ruled by a Communist Party increases tensions between this nation on the one hand and Japan and the United States on the other. India's roads, ports, electric utilities, and other infrastructure are being overwhelmed by the pace of growth and the inability of the government to keep up, creating the risk the growth will slow even as young people continue surging into the workforce. Few of these problems can be solved by India and China acting alone. The United States and Japan can best assure that the rise of these two Asian giants reinforces, rather than upsets, political stability in the world by working together and with India and China to address them.

Rather than providing a chronological account of our study tour, the remainder of this report provides a topical summary of what we learned about the implications of the rise of China and India for the US and Japan, while also identifying a few areas where we want to know more (Section 1) and what we agreed about how the US and Japan should respond, along with areas where we didn't quite come to agreement and look forward to further discussions (Section 2).

The Challenges

Trade competition. Chinese and Indian exports to the United States and Japan are increasing rapidly. We learned that concern in the Midwestern part of the United States is centered, in particular, on the rise in auto parts imports from China (see Chicago Fed presentation, pp. 10-14). China is likely to start exporting assembled vehicles to the US in the next several years. If the rise of Chinese auto parts and auto imports coincides with a period in which the American (or Japanese) auto industries are closing plants and laying off workers, we should not be surprised to see a strong protectionist reaction.

Our visit with Cisco managers and with the staff of the San Francisco Fed suggested that the mood in California is more relaxed. They see the loss of manufactured goods markets to China and service sector jobs to India as part of a natural process of economic specialization and adjustment. The Cisco managers expressed little fear that the software industry of India was a threat to their firm. They described India and China more as business *opportunities* than as threats. They began investing in India as a way to cut software code-writing costs, but they have stayed because they've been impressed by the quality of the work done there and are now "investing for innovation"—which means, I assume, that they are now hoping that their investments in the Indian software industry will produce new technology that helps the firm as a whole.

This optimism about the returns on economic integration was even more pronounced at our other stop in Silicon Valley: our visit with the members of The Indus Entrepreneurs (TiE). They noted that the US software industry has stopped growing. It is only doing "shrink-wrapped software" that can be packaged for the mass market whereas the Indians, who are taking over much of the labor-intensive work of tailored software production, are expanding their industry at a rate of 50 percent a year. Nevertheless, these entrepreneurs pointed to the many businesses that were being created in Silicon Valley by those working with India and coming from India. Indian engineers continue to come to Silicon Valley to get rich—and contribute to the American economy. The problem, they suggested, is not too much economic integration but too little. The recent restrictions on H1B visas have slowed the inflow of Indian engineers. This has constrained the ability of local firms to grow their American operations and has caused them to outsource more work.

While these representatives of the business community in California expressed an overall sense of optimism about economic ties with China and India, they also raised some specific concerns about unfair competition. First, they worried about intellectual

property rights protection, especially in China. This concern was echoed by one of our Japanese panelists who mentioned the wide array of fake goods on display at JETRO's exhibition hall in Beijing. Second, they worried about regulatory policies (such as Chinese and Indian regulations limiting the growth of VoIP telephony) that are designed to protect domestic firms. In China, the problem of regulatory barriers is compounded by the slow movement toward transparency.

Trade and Capital Account Imbalances. At the present time, China's "trade threat" gets much more attention than India's not only because Japanese and American trade with China is much greater than its trade with India but also because America's bilateral trade balance with China is deeply in the red. Japan enjoys a trade surplus with China, but I would not be surprised to see its trade balance go into the red as China's manufactured exports grow and Japan's capital goods exports slow. Maybe we could get some projections on this point when we travel to Japan and talk about what implications this might have on the trade policy preferences of Japanese industries.

We all know from our economics textbooks that bilateral balances have no significance for our economies (and even deficits in our overall trade are not necessarily bad), but bilateral deficits nevertheless get featured in headlines and magazine cover stories and fuel demands for protectionist trade policies and currency revaluations that might close the gap. We also know from our economics training that trade imbalances are the flip side of capital account imbalances, so that we cannot expect one to change without the other. In the case of the United States' bilateral balances with China, the large red ink in the trade account means there is an opposite and offsetting flow of capital from China to the United States. The United States relies on this capital to offset its low savings rate and fund the budget deficit.

While our own conversations and comments by Fed economists all emphasized that the current pattern was mutually beneficial and sustainable in the short term, it is also true that imbalances at current levels cannot be sustained economically forever and—at least as important—cannot be sustained politically for very long when they are blamed for job losses and factory closures.

At the present time, all efforts to deal with imbalances have focused on the Chinese exchange rate and the exchange rate mechanism. The San Francisco Fed economist who spoke to us on this topic explained that the new mechanism introduced this summer has produced a revaluation of just 2.1 percent against the dollar, only partly offsetting the 9-10 percent devaluation the RMB has experienced against a trade-weighted basket of currencies since 2001. In other words, despite the step taken this summer, the RMB has a lower value today against the currencies of its trading partners than it did in 2001, and China has an export advantage as a result. But he emphasized that there is no way to know whether the value in 2001 was any more "right" for the RMB than is the current value. One of our members pointed out that a floating rate might lead to a *devaluation* of the RMB (rather than the revaluation that would be the hope of competing firms in the US and Japan) if it were accompanied by changes in financial regulations and capital controls that allowed Chinese savers to send their money overseas.

At the present time it seems Chinese are eager to save much more than Americans are, so capital flows from China to the United States (along with the offsetting trade imbalance) are the natural result—regardless of the exchange rate mechanism.

Despite these reasons for us to tread carefully in our analysis, we have to contend with the fact that the Chinese exchange rate is currently set—even after the recent changes in the exchange rate mechanism—in a process that is controlled by the Chinese authorities. These officials appear likely to allow the currency to revalue very slowly (if at all), and they also appear likely to move very slowly toward an open capital account and a floating exchange rate. If trade balances remain as unbalanced as they are now and the American or Japanese economy move into a recession, the exchange rate is likely to be a flashpoint.

Energy Competition and Environmental Degradation. The rapid growth of India and China means that both countries are consuming more energy and other natural resources and emitting more pollutants. The Chicago Fed economist who spoke to us presented a great deal of data on trends in Indian and Chinese energy consumption and pollution, all of which show trend lines extending sharply upward.

We had several conversations during the week about the recent controversy over the China National Offshore Oil Corporation (CNOOC) bid for Unocal—which CNOOC abandoned after it caused a stormy reaction in Washington, DC. We agreed that it was a sign of China’s eagerness to “secure” more of the oil it needs to import in order to keep growing at its current pace, but noted that it was also a sign of how the geopolitical context (discussed below) allows companies to exploit concerns about the “China challenge” for commercial advantage. In this case, Chevron avoided having to bid more for Unocal by drumming up the xenophobic response to CNOOC’s bid. The episode is a harbinger of increasing friction between the US, Japan, India, and China over energy deals—including the just-announced Indian deal to build a pipeline from Iran.

There was some disagreement about how desperate the competition for energy resources is likely to become. The Chicago Fed economist presented us with evidence that previous predictions of oil shortage have always proved false. Higher prices tend to produce additional supply. On the other hand, one of our members warned that this rosy past will not be our future if we have reached the “peak” of world oil production, the point after which it becomes steadily more difficult to extract the remaining oil resources.

I expect we will want to talk more about the energy and environmental challenges associated with the rise of China and India when we reconvene in Japan. Perhaps we can focus too on specific hot spots (such as the East China Sea and Russian pipelines) where the competition for oil and gas has brought China and Japan into direct conflict. Can these disagreements be resolved in ways that are mutually beneficial? And/or can we count on the market to deliver the energy we need?

Inequality and Lack of Democracy in China. One of the most interesting patterns in our conversations during the study tour was the tendency of the Japanese participants to voice stronger concerns about the lack of democracy and transparency in China while a number of Americans urged the group not to make these demands too explicit. Japanese participants noted that one of the reasons they worry about the rise of China's economic power is because they cannot see how much of the nation's growing national income is going into military spending. China's military spending and programs remain shrouded in secrecy and lack of transparency. Others pointed to the many ways in which the government supported its state-owned enterprises and suggested that Japan would not be ready to join a free trade area with China until it was no longer Communist.

Some of our American members expressed concerns of this type as well. It was pointed out that one of the reasons the CNOOC bid was so controversial was because the Chinese bid was funded by state-owned Chinese banks. How could American firms compete with Chinese firms if they were backed by banks that were not constrained by the need to stay solvent or make profits? All of these comments suggested that tensions between China and the United States / Japan are likely to be aggravated in coming years by concerns that Chinese firms are *not playing by market rules* and may be aggravated further by concerns that China is *not democratic*. Perhaps we should talk further about which of these concerns is greater.

All of those with whom we spoke emphasized that India's status as a mature democracy with stronger rule of law gave it a tremendous advantage over China in terms of its ability to avoid these types of tensions. One of the TiE entrepreneurs pointed out that the fact that India is a democracy should make Japan and the United States eager to see its economic growth continue. If India (as a democracy) stopped growing and China (as a non-democracy) continued to grow, many leaders around the world might conclude that China had found the better path to development. He also pointed out that China was likely to face a difficult transition to democracy at some point in the future—a step that India had already taken.

At the present time, rapid economic growth is causing tensions in Chinese society as some regions and individuals grow in wealth much more quickly than others. China has few non-governmental organizations or media organizations to warn of corruption and other abuses that deprive citizens of the opportunity to share in the country's growing wealth, so frustrations often erupt in the form of street protests and wild-cat strikes. The nation's leaders continue to be nervous about these protests and are torn between cracking down and opening up. Even if they decide to open up at some point in the future, it is not clear that the nation will be able to move toward democracy in the way Korea and Taiwan did—without significant bloodshed or economic turmoil. In many other nations, the transition to democracy has caused major social disruptions, economic decline, and war. How China negotiates this transition has major implications for both Japan and the United States.

Inequality and Poor Infrastructure in India. India has been able to grow at rates of six percent and higher over the past decade *despite* its poor infrastructure. Roads are overcrowded, ports and airports inefficient, and electrical power chronically insufficient, leading large firms to construct their own “islands” of power, roads, and even ports to serve their operations. With Indian fiscal deficits running at ten percent of GDP, it is unlikely the government will be able to catch up soon without significant financial assistance and domestic reforms. Structural problems include the public ownership of 95 percent of the electricity industry, which has led to underinvestment and subsidized (or free) power for the poor. Major ports are also state-run and slowed down by union contracts. They are so poorly-run that firms have turned to secondary “minor” ports that are private, growing, and better-run. The lack of decent rural roads and the inadequacy of the highway network have limited the ability of Indian farmers to move into higher-value-added horticultural products.

India’s infrastructure shortcomings have kept India from growing at China’s pace, but they have not kept it from growing steadily at a slightly slower rate. What they have done is limited the geographical scope of India’s economic miracle. Areas of the South are growing at rates as high as ten percent a year, but some in the Northwest and Northeast are growing at rates as low as one percent. One of the TiE entrepreneurs pointed out that Indians in these slower growing areas have the same aspirations, desire for education, and potential for entrepreneurship, but without roads and power they have been unable to grow. Poverty remains common, and inequality between these areas and the successful regions of the South is growing.

India has a youthful population that continues to grow at a rapid rate. If it cannot expand its infrastructure to link rural and disadvantaged regions of the country to domestic and foreign markets, it is likely to experience growing social tensions. Though the maturity of India’s democratic institutions makes it likely these tensions will be expressed through politics rather than through violence, the political expressions of these frustrations could nevertheless complicate the ability of the Indian government to stay the course of its liberal economic policies.

Geopolitical Complications. Some of the issues listed above were causes of bilateral friction between the United States and Japan in earlier decades. They were also causes of friction in the United States’ relations with Korea, Taiwan, and other Newly Industrializing Countries—all of whom expanded exports to the United States, recorded trade surpluses, and were blamed for “stealing jobs” and “stealing industries.” The fact that the United States and its Asian trading partners were able to work through these difficulties without escalating conflict gives us cause to be optimistic that the US and Japan should be able to work through similar differences with India and China. Indeed, we propose to borrow ideas (for what to do and *not* do) from our joint experience in dealing with past U.S.-Japan economic disputes in the section below.

One important difference between this earlier period of economic conflict and negotiation and what we foresee in our relations with India and (especially) China is the geopolitical context. During the Cold War, the US and Japan disagreed over trade but

shared a common security interest in containing the Soviet Union. Even after the Cold War, we have shared common security and political interests (the war on terror, concern about North Korea) that have encouraged us to resolve our economic differences amicably. It could be that similar common interests will encourage peaceful resolution of our differences with India, but it is likely that the geopolitical context will make resolving economic conflicts with China *more difficult* than was the case when the United States and Japan fought their trade battles. China is already larger than Japan in purchasing power parity terms, and according to some scenarios it will equal the United States in nominal size sometime in the 2030s. China is already attempting to replace Japan as the leading regional power in Asia. Protectionist demands to stop China from “stealing” jobs, technology, industries, and oil resources will resonate much more strongly within Japan and the United States if they come at a time when China is building up its military forces on the Fujian side of the Taiwan Straits or expanding military relations with the nations of Central Asia or building naval facilities in South Pacific. As we consider how to deal with our expected sources of economic conflict with China (and India), therefore, we need to think about how our economic conflicts are likely to interact with political and military tensions.

Recommended Policy Responses

The challenges listed above make it very likely that there will be tensions in our relations with India and China in coming years. Given the geopolitical context, it will be especially difficult for us to continue working smoothly with China on economic issues as China becomes our primary rival in international security and political affairs. Nevertheless, our bi-national group was united in the view that China and India’s growth should *not* be met with policies designed to slow their growth. Even if it were possible to “contain” China and India’s economic rise—which we believe it is *not*—such policies would only create more problems than they would solve. If these nations felt that we were trying to rob them of the chance to share in the prosperity our nations enjoy, it would merely provoke them to adopt more aggressive strategies, to use their ability to complicate our efforts to maintain stability in the Middle East or North Korea, for example, to make us change our policies. Both nations’ moves to improve ties with Iran and other oil-rich nations after we blocked the CNOOC deal offer an early warning of how our moves to contain them might be greeted.

Rather than working to contain India and China, our best interests lie in working *with* these two countries to help them overcome barriers to smooth growth and integration into the world economy. Even if they continue growing at current rates for another two decades, and even if China equals America’s economic size in 2030, we will be better served by policies that facilitate this growth and deal cooperatively with the challenges their growth presents than by those that attempt to block it. Below is a list of policies that we might recommend, most of them suggested by one or more members of the study group during our discussions:

Challenge claims that China and India threaten us. The argument that we must contain a rapidly-growing China and stop both countries from stealing our jobs is based

on a poor reading of economic statistics. China's size is exaggerated by the custom of presenting its GDP in "per capita purchasing power" terms. What China can purchase on the international market is dictated by its nominal GDP, and projections tell us that China will not surpass Japan by this measure until 2015 at the earliest and will not equal US size until 2030. Even at these dates, China's large population means that this income will be distributed over a much larger population, making it difficult for the government to direct it toward a military arms race with the still richer populations of the US and Japan. Furthermore, by 2030, China will be aging rapidly, struggling to support a growing population of older citizens without adequate pensions. Its ability to convert its wealth into military power will be hampered by pressure to support the care-giving and health needs of its population.

Trade statistics also exaggerate the China and India threats. China's trade surplus is distorted by the way Chinese imports tend to be recorded in Hong Kong while its exports get credited to China proper. China's export figures are also exaggerated by its dominance of final assembly of manufactured goods. China typically adds just 20 percent of the value of manufactured goods in its plants, importing the rest (mostly from other Asian nations), but it gets credit in trade figures for the final value of the products sold. This effect is in part responsible for a remarkable pattern in American trade with China: the entire increase in China's share of American imports has come at the expense of other Asian nations. Most of our imports from China replace imports from Taiwan, Korea, or SE Asia—which continue to make the parts.

Finally, it is important to keep India's trade statistics in context. Despite the nation's large population, rapid growth, and much-publicized expansion of outsourcing, India still accounts for a very small portion of US and Japanese imports. Placed in their proper perspective and compared to the gains the United States and Japan enjoy from expanding trade and investment in China and India, it becomes clear that our interests lie in helping these two countries continue to grow smoothly.

Refrain from protectionism. Despite the mutually-beneficial character of our economic interactions with China and India, some of our industries are facing stiff trade competition, losing business, closing factories, and shedding jobs. There will be a great temptation to respond to the problems facing specific industries in the US and Japan by adopting protectionist policies or pressuring China and India to accept voluntary export restraints (VERs). We are already seeing this with Chinese textiles today. Our group, which includes many individuals with personal experience of the earlier trade battles between the US and Japan, is well positioned to urge our governments to *learn* from that experience. One thing the United States learned is that VERs simply push the industry that is limiting its exports to move up the product cycles: after VERs, Japan began to export Lexuses instead of Toyotas and large-screen TVs rather than cheaper models. The targeted industry actually profits from the artificial scarcity VERs create. Our own industries get some time to adjust, but they often waste this time rather than using it to improve their competitiveness. We urge the governments of Japan and the United States not to fall prey to the temptation to adopt protectionist measures of this kind.

Stress structural reform. The experience of the US and Japan also shows, however, that the best strategy for countering protectionist demands lies in a strategy of assertive market-opening and structural reform negotiations. Many segments of Indian and Chinese business remain protected by regulatory barriers, and we should continue to press these governments to remove them both through our negotiations in the WTO Doha Round and in our bilateral communications. A particular concern in the Chinese case is the nation's system of state-owned banks, which frequently make financing decisions based on political calculations rather than economic ones. The CNOOC episode showed how this system makes it easy for protectionists in the United States to argue that China is an unfair competitor that does not play by the rules. We should continue pressing the Chinese to aggressively clean up these bank's balance sheets, move them into the private sector, and open up the financial system in general to market forces.

Other areas that deserve continued negotiating attention include the intellectual property rights regimes in both China and India. It is difficult to resist calls for protection when Chinese and Indian firms are reported to be copying American and Japanese auto and motorcycle designs. India's system of "reserving" certain sectors for local small firms is another source of tensions. Both India and its trading partners would gain from reforms that opened up these sectors to competition and encouraged them to become more productive. Similarly, a relaxation of India's labor laws—which require government approval before a firm with over 100 employees is allowed to lay off any workers—would also benefit all sides: making Indian industry more competitive and encouraging foreign investment. Structural reforms would benefit the United States and Japan as well, especially in the area of immigration policy. The US needs to expand the number of H1B visa made available each year, and Japan needs to adopt a similar policy to plug its engineer gap. It might be possible to leverage American and Japanese concessions in the immigration area for concessions on other structural reforms from the Indian and Chinese side.

The mutually-beneficial character of most of the reforms suggested here implies that there should be interests on the Indian and Chinese side that would benefit a great deal from the changes. The experience of the United States and Japan shows that our negotiations produced greater compromise when the US was able to tap into sources of "inside pressure" (*naiatsu*) to support American demands (*gaiatsu*). Potential support for the reforms we have suggested might come from bureaucratic supports of reform in China (who might find their ability to clean up the banks enhanced by foreign scrutiny of the problems) and Indian industry (which would benefit from labor law reform).

Free trade area talks. Our first priority should be to move the Doha Round of WTO forward to a successful conclusion, but the round is bogged down and the multilateral process might benefit from the pressure created by enhanced and expanded regional free trade areas. At the present time, both Japan and China are involved in talks with the ASEAN states and Korea about a regional free trade area. Japan has already signed FTA agreements with Singapore and Mexico and is working on more with Korea, Thailand, and others. Japan has obvious interests in how these talks proceed, and the

United States does too. It is not in America's interest to be left out of an Asian regional FTA, so it might be time for the United States to become much more involved.

Key issues in these FTA talks include: the degree to which agriculture is liberalized; the degree to which Japan opens itself to immigration; and the degree to which the regional trade liberalization creates trade distortions. We only began talking about these issues during this study tour and agreed we would benefit from a background paper on this topic before we discuss it further in Japan next spring. What position should we take on free trade areas as an approach to engaging China and India or responding to their rise? Should we encourage Japan (and the US?) to create a FTA with Asia ex-China, or should we encourage the inclusion of China?

Macroeconomic policy coordination. In the golden age of the G-7, the United States, Japan, and their leading economic partners worked to manage imbalances in trade and capital accounts by coordinating their monetary and fiscal policies. At Plaza in 1985, they negotiated a major realignment of exchange rates that eventually (after adjustments in monetary and fiscal policies) closed the major imbalances that had grown up between the United States on the one side and Japan and Germany on the other. It is clear that the current imbalances between the United States and China will only close when a variety of policies on both sides change (US budget deficits; Chinese restrictions on financial markets). Given that the exchange rate is still set by Chinese authorities, an exchange-rate driven adjustment will also require concerted action. This mutual dependence suggests that it might be time to revive the G-8 or some other forum as a locus for coordinating these policies. The United States and Japan might use this opportunity to pressure China to move toward market-determined exchange rates and financial market reforms in a steady, orderly process in exchange for American moves to address some of its own problems in areas like energy and budget deficits. This was the formula for a deal at Bonn in 1978 and Plaza in 1985, and it might be one again.

Expand overseas development assistance to India. For India to get ahead of its infrastructure problems, it needs structural reforms (such as the introduction of more market forces into the electric utility system and ports), but it also needs money. It needs foreign investment and overseas development assistance to develop its infrastructure and bring a larger portion of country into contact with domestic and foreign markets. Japan is in an excellent position to direct more of its ODA budget to India, and its tradition of funding infrastructure projects gives it ample experience managing these programs. We strongly urge it to expand aid to Indian infrastructure, especially in the areas of roads, rail, and airports. The electricity sector would benefit more from foreign investment (including from US firms), encouraged by structural reforms in the sector designed to reassure the firms that they will not be forced to renegotiate contracts after investments have been made and won't be forced to sell power at a loss. The ports would benefit from similar measures.

Energy and environmental cooperation. The finite supply of energy resources as well as clean air and water suggests that tensions in these areas might be much more zero-sum than in others discussed above. Oil used by China, it would seem, is not available

for Japan. On the contrary, these are areas in which the four countries are in an excellent position—as the leading energy consumers, importers, and polluters—to make deals that address critical challenges facing the world. In an earlier era, before World War II, states raced to occupy oil fields through imperial and pseudo-imperial arrangements, firms locked up overseas contracts, and the competition for energy shaped the outcome of the war. Today, however, most world energy resources are controlled by the states in which the oil is produced (this is especially true in the Middle East, Russia, Mexico, and Venezuela). These oil sellers have occasionally attempted to leverage their position to embargo their enemies, but the record of these attempts show that the market makes it difficult to keep energy supplies from reaching users. The main way in which energy shortages affect economies today is through prices, and all of the efforts to buy companies, develop gas fields in disputed territories, build pipelines, and make deals with oil-producing states will not protect China, India, Japan, or the United States from the price effects of shortages.

Rather than competing in these volatile ways, the four countries should cooperate to expand use of alternative energy sources, including nuclear, wind, and solar; and reduce oil use and carbon emissions. In many cases, the key to expanding alternative energy use lies in cooperation in the development of new technology and spreading the use of the best technologies (which requires investment). The US and Japan can help China and India use energy more efficiently and cleanly, even as they improve their own performance on this score. We can also maximize the availability of petroleum resources (and minimize prices) by cooperating to develop energy fields rather than fighting over them to the point that no one gets access to the energy. As mentioned above, our study group might benefit from additional conversations about concrete ways in which we could contribute in these areas.

Democracy and transparency. Finally, cooperation between China and its partners is made more difficult by the lack of transparency about what is going on within China's government and by the absence of democracy. The inability to see how much money China is putting into military spending aggravates geopolitical tensions. Similar problems in the financial system and the exchange rate mechanism raise concerns about how these systems are functioning. These problems suggest that China could make it much easier for us to cooperate with them and help overcome the challenges presented by their rapid growth if it would take steps to release more information about government activity to the public and allow freer media coverage. Some members of our group made the argument that it would be difficult to cooperate with China—for example to set up a free trade area—unless the country became a democracy. Our group was not able to come to a consensus on the question of whether to call for China to take this step, but it should certainly be on our agenda for the next meeting.