



Washington REPORT

News and analysis from Washington, D.C. about key issues in U.S.-Asia Pacific Relations

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The North Korean Challenge: Putting The Genie Back In The Bottle

USAPC Interview with Honorable James A. Kelly

For nearly 15 years, North Korea's quest to be achieve nuclear power status has created a tense environment in Northeast Asia. Those tensions came to a head on October 9 when Pyongyang tested a nuclear device, an act that not only appalled and outraged North Korea's neighbors but also provoked harsh condemnation and sanctions from the international community. By the end of October, North Korea had agreed to return to multilateral negotiations aimed at ending its nuclear program. However, it is far from clear whether the closed, recalcitrant dictatorship can be persuaded to fully abandon its long-held ambitions.

James A. Kelly, former Assistant Secretary of State for East Asian and Pacific Affairs, discusses how the pressures being brought to bear on North Korea by both internal and external forces may affect diplomatic efforts to bring North Korea into the global community in a peaceful manner.

USAPC: North Korea's defiant decision to test a nuclear weapon on October 9 has created a very dangerous situation in Northeast Asia. Although North Korea agreed on October 31 to return to the Six-Party Talks¹, there still are no easy solutions.

Kelly: Yes, this is a very difficult problem, and we must be patient even recognizing the substantial risks. The U.S. strategy has been to use multilateral diplomacy via the Six-Party Talks and it should continue to use diplomacy because the military options are so poor.

Importantly, the nuclear test has intensified what should be the dread of most Americans—the potential mar-

¹The Six Party Talks, launched in August 2003, are multilateral negotiations aimed at ending North Korea's nuclear program. Participants include: China, Japan, North Korea, Russia, South Korea, and the United States.

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Democratic Congress May Affect U.S.-Asia Policy

The November 7 mid-term elections will elevate senior Democratic members of the House and Senate to key leadership positions in the 110th Congress. The legislative records of these new leaders suggest that they may seek to influence U.S.-Asia relations in important ways. China, in particular, will probably come under tougher scrutiny on Capitol Hill in the next two years.

House Leadership—Rep. Nancy Pelosi (D., California), the expected new Speaker of the House, long has fought to improve China's human

rights record. In the past, she has sought to tie trade-related benefits to improved human rights standards in China. It is uncertain whether Pelosi will pursue such initiatives in the 110th Congress, but she clearly is on record as favoring a more aggressive U.S. policy toward China's human rights abuses.

House Ways and Means Committee—Rep. Charles Rangel (D., New York) will likely assume this chair; Rep. Sander Levin (D., Michigan) is expected to lead the Trade Subcommittee. In a post-elec-

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Official Washington

In each issue, Washington Report will provide the names and contact information for selected executive branch officials with jurisdiction over economic, political, and security issues important to U.S.-Asia Pacific relations. This issue will focus on pertinent personnel from the Department of Defense.

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riage of a terrorist group and fissile materials or nuclear weapons.

Recently, the North Koreans maintained that they would not engage in proliferation, but we cannot be certain. Kim Jong Il and his senior officials must understand that the United States will respond to a nuclear terrorist incident within its border, particularly one involving a device or technology that can be sourced to North Korea, in a way that literally would be devastating.

Beyond this kind of deterrence, we must continue to work very closely with allies that have real stakes in this crisis. Japan certainly is more directly threatened by North Korean nuclear capabilities than the United States. South Korea currently is undergoing a lot of political change and therefore is internally conflicted about what to do about North Korea. Seoul needs patient help from the United States, not lectures or threats.

China has a key role to play in resolving this crisis. Leaders in Beijing are genuinely infuriated by North Korea's actions. They did not take the test lightly. But I believe they want to see through events before taking precipitous action.

The Chinese are very concerned about the kind of roaring instability that might get rid of Kim Jong Il but would not necessarily eliminate the nuclear program and very well might flush millions of refugees into Northeast China. So, as always, they seek stability and are trying to handle this situation in a cautious way.

There are no guarantees that China's measured approach will work. But I believe that Beijing has a long-term strategy aimed at changing North Korea from within, which has important elements we have never seen before.

USAPC: How has China tried to affect internal change in North Korea?

Kelly: Beijing is trying to realize a kind of regime "transformation." Notwithstanding other perceptions, that always has been the policy of the U.S. government. Perhaps North Korea can change its orientation. It is being pressured in ways that it was never pressured before.

For example, in practice, North Korea was not a cash economy until about four years ago. The government issued rice and other food to families. It assigned houses and apartments to individuals and families in Pyongyang as well as in the countryside. It assigned people to "work units." The food, at least, and some of the rest changed with the advent of more of a cash economy.

In the past four years, small businessmen from northeast China have been traveling back and forth across the border between China and North Korea making small

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Congressional Watch

Legislation:

Senators Will Craft New China Currency Bill—Senators Max Baucus (D., Montana), Lindsey Graham (R., South Carolina), Charles Grassley (R., Iowa), and Charles Schumer (D., New York) announced September 28 that they would work together to craft a new, bipartisan bill addressing China's currency valuation. The legislation will be introduced in 2007 and differ significantly from the controversial measure that Senators Schumer and Graham championed this year. That bill would have imposed 27.5 percent tariffs on all Chinese imports in retaliation for Beijing's unwillingness to allow the *yuan* to appreciate against the dollar. It was widely viewed as illegal under World Trade Organization (WTO) rules.

Graham acknowledged that the tariff measure had virtually no chance of becoming law, but "served a useful purpose" in that it effectively pressured China to begin a process of small revaluations. The new bill will be "responsible and consistent with WTO rules," Baucus said. Insiders say the four Senators agreed to give Treasury Secretary Henry Paulson six months to persuade China to adopt a more flexible approach to currency valuation before actively moving their new bill through Congress.

FY07 Defense Authorization Bill Focuses On North Korea Policy—Just hours before Congress

recessed for the mid-term elections, lawmakers approved the FY2007 John Warner Defense Authorization Act. It includes a section pertaining to North Korea. The provision requires the President within 60 days of enactment to establish a North Korea Policy Coordinator to conduct a full and complete interagency review of U.S. policy toward North Korea and report to the President and Congress within 90 days on recommendations. It also requires a report to Congress every 180 days for FY07 and FY08 on North Korea's nuclear and missile programs. President Bush signed the bill into law on October 17.

Reports:

Panel Criticizes China's Efforts To Promote Regional, Global Peace—Despite recent praise by U.S. officials for China's role in bringing North Korea back to the nuclear arms talks, the U.S-China Economic and Security Review Commission (USCC) accused China of failing "to meet the threshold of international responsibility in the area of non-proliferation" in its October 31 report to Congress. China has allowed the transfer of weapons and technology across its territory from North Korea to Iran, the USCC charged. The USCC was created by Congress in 2000 to examine the national security implications of the U.S.-China economic relations. The report will be posted shortly at www.uscc.gov/.

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tion press briefing, Rangel reportedly criticized the Bush Administration for not being tough enough on China's currency policy and weak enforcement of intellectual property protections. But he is willing to give the Treasury Department and the U.S. Trade Representative more time to work with Chinese authorities on reforms. Rangel also wants to canvass the new centrist House Democrats about trade policy toward China before pursuing legislative remedies.

House International Relations Committee—Rep. Tom Lantos (D, California) probably will be the new chairman. Like Speaker-elect Pelosi, he an ardent advocate of human rights protections and may use his new platform to spotlight violations in China, Burma, and elsewhere. The defeat of Rep. Jim Leach (R., Iowa), the highly respected chair of the subcommittee on Asia and Pacific affairs, will deprive the committee of a member who possessed a keen understanding of regional politics and security issues. Rep. Eni Faleomavega (D., American Samoa) has the seniority to assume Leach's position, but as a delegate he cannot vote on the House floor.

Senate Leadership—In general, there are few differ-

ences between the two parties in this chamber on Asia policy. If confirmed as Majority Leader, Senator Harry Reid (D., Nevada) has pledged to work cooperatively with Republicans and the Bush administration in developing a new approach to the Iraq war. One can assume that he would approach other foreign policy challenges in a similar bipartisan manner.

Senate Finance Committee—The spirit of bipartisanship has prevailed on this committee since Senator Charles Grassley (R., Iowa) assumed the chair in the 1990s and likely will continue under the new leadership of Senator Max Baucus (D., Montana). Baucus and Grassley both are committed free traders, but believe that a more assertive approach may be necessary to affect changes in China's currency policy (see above box).

Senate Foreign Relations Committee—Similarly, when Senator Joe Biden (D., Delaware) likely assumes this chair from Senator Richard Lugar (R., Indiana), the two undoubtedly will continue to work closely on Asia policy. Both have urged greater bilateral engagement with North Korea as a means of securing Pyongyang's commitment to end its nuclear program. ♦

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joint ventures with local North Korean cadres, both civilian and military. By now, some of them are making a lot of money. They enjoy driving into Pyongyang and spending it in new ways.

This is the sort of insidious change that probably is of high concern to North Korea leader Kim Jong Il and the military officials that surround him. The money is eating into Kim's control because it is going to erode the instruments of that control. I think some Chinese leaders believe these cross-border business arrangements will change North Korea over time in what they hope will be a stable and peaceful way.

USAPC: On October 14, the U.N. Security Council imposed punitive sanctions on North Korea in response to the nuclear test [see box below]. Some observers maintain that China was more influential in bringing North Korea back to the negotiating table than the deprivation and isolation caused by the sanctions.

Kelly: The post-sanctions environment provides a great opportunity for the United States to work with China. The Chinese are seriously concerned by North Korea's nuclear test. I think our best chance of applying pressure on North Korea to ultimately abandon its nuclear efforts lies in continuing to work closely with China, but also Japan, South Korea, and Russia. But the North Koreans have a history of reacting badly.

USAPC: If Pyongyang defies the international community again and conducts a second nuclear test—perhaps out of displeasure with how the Six-Party talks proceed—is diplomacy still an appropriate U.S. response?

Kelly: The United States does not have many choices. If North Korea indeed tests another nuclear device, that certainly would be a defiant thrust at the international community. But it is also true that another test is not the same thing as an attack on the United States or on one

United Nations Security Council Resolution 1718

Unanimously adopted 14 October 2006
(excerpts of key provisions)

"The Security Council, acting under Chapter VII of the Charter of the United Nations, and taking measures under Article 41,

1. *Condemns* the nuclear test proclaimed by the Democratic People's Republic of Korea (DPRK) on 9 October 2006 in flagrant disregard of Resolution 1695, [which stated that] such a test would bring universal condemnation of the international community and would represent a clear threat to international peace and security;
2. *Demands* that the DPRK not conduct any further nuclear test or launch of a ballistic missile;
3. *Demands* that the DPRK immediately retract its announcement of withdrawal from the Treaty on the Non-Proliferation of Nuclear Weapons;
4. *Demands* further that the DPRK return to the Treaty on the Non-Proliferation of Nuclear Weapons and International Atomic Energy Agency (IAEA) safeguards;
5. *Decides* that the DPRK shall suspend all activities related to its ballistic missile program;
6. *Decides* that the DPRK shall abandon all nuclear weapons and existing nuclear programs in a complete, verifiable, and irreversible manner;
7. *Decides* also that the DPRK shall abandon all other existing weapons of mass destruction and ballistic missile programs in a complete, verifiable, and irreversible manner;
8. *Decides* that
 - (a) all Member States shall prevent the direct or indirect supply, sale, or transfer to the DPRK, through their territories or by their nationals, of (i) any battle tanks, combat aircraft, warships [or other conventional military equipment] or relat-

ed material including spare parts and (ii) luxury goods;

(b) all Member States shall prohibit the procurement of such items from the DPRK by their nationals;

(c) all Member States shall prevent any transfer to the DPRK by their nationals or from their territories of technical training, advice, services or assistance related to the provision, manufacture, maintenance, or use of the above items;

(d) all Member States shall freeze immediately the funds on their territories that are owned or controlled, directly or indirectly by persons designated by the Security Council as supporting or promoting the DPRK's nuclear-related, ballistic missile-related, and other weapons of mass destruction-related programs, together with their family members;

(e) in order to ensure compliance with the above requirements, all Member States are called upon to take cooperative action including thorough inspection of cargo to and from the DPRK;

9. *Decides* that [the above] provisions do not apply to financial or other resources necessary for basic expenses, including food, rent or mortgage, medicines, taxes, insurance premiums, and public utility charges;

10. *Decides* to establish a Committee of the Security Council to report every 90 days on ways to strengthen the effectiveness of the [above] measures;

11. *Calls upon* the DPRK to return immediately to the Six-Party Talks without precondition and to work towards implementation of the Joint Statement issued on 19 September 2005 by China, the DPRK, Japan, Russia, South Korea, and the United States . . ."

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of the Northeast Asian nations. A test is bad indeed, but should not be confused with a direct attack.

We should bear in mind that North Korea has been seeking nuclear weapons for more than 40 years. This is not a new effort. North Korea is not Libya. For many years, it has been training numerous nuclear engineers. It has derived benefits from Pakistan's nuclear program as well as from the nuclear efforts of Russia and the Eastern European countries during the Soviet era.

The North Korean leadership must generate tensions with countries in Northeast Asia and most of all with the United States in order to justify the hardships that ordinary North Koreans must endure as a result of Pyongyang's "military first" or *songun* policy.

Kim imposed this policy only about eight years ago when tensions were not especially high. By putting military interests and access to all resources above all else, this policy priority naturally has delayed much needed economic improvements.

The United States by itself simply cannot bring sufficient pressure to bear on North Korea to return to the negotiating table. That is why close cooperation with China, South Korea, and Japan is so critical.

USAPC: Would it be appropriate for the United States to offer China and South Korea substantial refugee assistance as a means of assuaging their concerns about a potential flood across their borders if conditions in North Korea take a dramatic turn for the worse? Could the United States provide that level of refugee assistance?

Kelly: No, the United States does not have that capability. China now has 200,000-300,000 North Korean refugees, many of whom go back and forth across the border between China and North Korea.

But both China and South Korea are deeply concerned that chaotic instability in North Korea will launch millions of refugees across their borders. The sheer scale of that kind of outflow is not something the United States could handle. The chaos would be overwhelming. There certainly is some level of assistance the United States could provide in the event of a crisis like that, but first we would want to ascertain what kind of support China and South Korea really need.

USAPC: Should the United States call upon South Korea to decrease its involvement in the Kaesong industrial park [the economic development project slightly north of the demilitarized zone] until the renewed Six-Party process is on sounder footing?

Kelly: Some Bush administration officials indeed have called upon the Seoul to shut down the Kaesong

USAPC in Action

General Fugh Joins USAPC

The U.S. Asia Pacific Council (USAPC) is pleased to announce that Major General John L. Fugh, U.S. Army (retired), has become a member. General Fugh brings to the Council considerable legal expertise, business management experience, and knowledge of the Asian market.

General Fugh, who was born in Beijing, China and emigrated to the United States with his family at age 15, served as The Judge Advocate General of the U.S. Army, retiring from that post in July 1993. He was the first Chinese-American to attain general officer status in the U.S. Army.

After his retirement, General Fugh served as president of McDonnell Douglas-China (MDC). Following MDC's merger with Boeing, he served as Executive Vice President of Boeing China. In 1997, General Fugh was appointed chairman of Enron International China, where he handled Enron's business development and project operations in China. He retired from Enron in 2001.

General Fugh has been active in organizations that promote U.S.-Asia relations. He is co-chairman of the Committee of One Hundred and a member of the Executive Committee of the Atlantic Council of the United States.

project, although I am not sure that Secretary Rice or Assistant Secretary Hill has asked this of South Korea.

I would go a little slower. I do not think the Kaesong project is providing any serious strategic or monetary advantage that sustains North Korea. But I think, more generally, the South Koreans should demand greater reciprocity in their relations with North Korea.

Seoul also should be careful about allowing unrestricted transfers of cash to North Korea. During the past eight or nine years, billions of dollars of hard cash have crossed the border. In the 1980s, large amounts of cash also made their way to North Korea from Japan, although my guess is that most of that stopped long ago, and most of what remains will stop as a result of the Japanese government's enforcement of the U.N. sanctions.

South Koreans generally feel they have worked hard and built a strong economy and a fine life for themselves. They understandably are very reluctant to assume the burden of bailing out their pathetically poor northern neighbor that lacks a modern infrastructure. At the same time, though, South Koreans see North Koreans as brothers and recognize that sooner or later they will have to come to their aid—they just do not want to do it now.

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Asia Pacific Dialogue

Asia Pacific Economic Cooperation (APEC):

APEC Energy Working Group (EWG) — Energy officials of the APEC member economies met October 4–6 in Yuzhno-Sakhalinsk, Russia for the 32nd Energy Working Group meeting. They agreed that at the 8th APEC Energy Ministers' Meeting in Darwin, Australia, May 2007, the ministers should move beyond the current focus on oil prices and examine long-term energy challenges facing the APEC region.

APEC Food Defense Outlook — Food protection technical specialists and foreign affairs officials working on bioterrorism-related issues from each APEC economy met November 1–2 in Bangkok, Thailand. They examined various methods of assessing the risk of deliberate terrorist contamination to the food supply and distribution system.

Asian Development Bank (ADB):

OECD/ADB Institute Eighth Roundtable on Capital Market Reform in Asia — Asian securities regulators, financial experts, scholars, and others met October 11–12 in Tokyo, Japan. Participants explored the status of capital market reforms in Asia, the financial policy landscape, and methods for assessing compliance with OECD good governance principles, among

other issues. The Roundtable was established in 1999 in the aftermath of the Asian financial crisis to provide financial experts an annual forum for such discussions.

2006 Asian Regional Forum on Aid Effectiveness — One-Hundred and fifty delegates from Asia Pacific nations and donor agencies gathered at ADB headquarters in Manila, Philippines on October 11–12. Their objective was to facilitate implementation of the so-called Paris Declaration on Aid Effectiveness at both the political and working levels. The Declaration, adopted in March 2005, commits participating countries to achieving 12 "Indicators of Progress" (see <http://www.adb.org/Documents/Events/2006/Aid-Effectiveness/default.asp#points>).

Key Official Meetings, November–December 2006:

- **Commerce Secretary Carlos Gutierrez** leads a U.S. business delegation to Beijing and Shanghai, China, November 13–17.
- **U.S. Trade Representative Susan Schwab** attends 18th APEC Joint Ministerial Meeting, November 15–16, Hanoi, Vietnam.
- **President Bush** attends 14th APEC Economic Leaders' Meeting, November 18–19, Hanoi, Vietnam.

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USAPC: Secretary Rice reiterated Washington's commitment to defend Japan in the event of an attack during her swing through Tokyo on October 18 to discuss implementation of U.N. resolution 1718. Can we correctly assume, then, that the United States would launch a retaliatory strike at North Korea if Pyongyang fired another Taepodong [long-range ballistic] missile and it hit Hokkaido?

Kelly: Yes. Under the U.S.-Japan Mutual Security Treaty, an attack on Japan would be treated as an attack on the United States. If North Korea attacks Japan using nuclear weapons, the United States would retaliate in a similar fashion. I believe strongly that we should honor this commitment to Japan. It was important for Secretary Rice to reaffirm this support.

If the Japanese begin to doubt the United States, they would feel they must greatly increase their defense spending, acquire offensive power projection capabilities, and even develop nuclear weapons. In the days following North Korea's nuclear test, however, Japanese Prime Minister Shinzo Abe made clear that Japan would not develop nuclear weapons.

USAPC: The U.S.-South Korea Mutual Defense Treaty provides the same security guarantee to South Korea. Correct?

Kelly: Yes. One of the reasons that North Korea is interested in developing nuclear weapons is because it is concerned that the conventional arms balance is less in its favor. North Korea has the ability to inflict enormous destruction on South Korea, but it is not at all clear whether North Korea could successfully attack, invade, and conquer South Korea.

South Korea has very effective, capable armed forces. U.S. ground forces in South Korea provide important reinforcement. But the idea of South Korea invading the North is absurd. And the United States has no such intent or capability at hand. ♦

James A. Kelly is president of EAP Associates, Inc., which provides international business consulting services. From 2001-2005, Mr. Kelly was Assistant Secretary of State for East Asian and Pacific Affairs. From 1994-2001, he was president of Pacific Forum, the Honolulu-based Asia-Pacific arm of CSIS. An expanded version of this interview is available at www.usapc.org/ResourceBlog/kelly.pdf.

Paulson Stresses China's Importance To The Global Economy

China featured prominently in Treasury Secretary Henry M. Paulson's much anticipated first speech about the international economic system on September 13. "The prosperity of the United States and China is tied together in the global economy, and how we work together on a host of bilateral and multilateral issues will have a significant impact on the health of the global economy," Paulson said.

Paulson acknowledged that while China, indeed, is transitioning from a planned economy to a market-driven economy, because of its size and role in world markets, China is, by definition, a global economic leader and deserves to be recognized as such. But with leadership comes responsibilities, he emphasized. The United States expects China to adhere to the spirit and letter of the rules and regulations of the International Monetary Fund and help to revive the stalled WTO multilateral trade negotiations, Paulson said.

Reform Imperative—Paulson applauded China's efforts to date to reform its economy, but cautioned that much remains to be done. "The tasks faced by Beijing are so daunting that the biggest risk we face is *not* that China will overtake the United States, but that China *won't* move ahead with the reforms necessary to sustain its growth and to address the very serious problems facing the nation," he said.

These problems range from modernizing and reforming the rural agricultural economy, to providing an adequate pension system and other safety nets, to modernizing its financial system, to freeing up an inflexible curren-

cy regime that "hinders the efficient allocation of capital and achievement of balanced sustainable growth." Noting growing anti-trade and anti-China sentiment in the United States, Paulson warned that if China does not move quickly to continue reforming its economy, "it will face a backlash from other international economic stakeholders."

Exchange Rate Policy—Paulson followed this up with very pointed criticism about China's "overly rigid exchange rate and outdated administrative controls," which increases the risk of boom and bust cycles. He further warned that China underestimates "at its own peril" the fact that its currency exchange rate increasingly is viewed by critics as a symbol of unfair competition.

This indirectly refers to legislation introduced by Senators Charles Schumer (D., New York) and Lindsey Graham (R., S.C.) that would impose 27.5 percent tariffs on all Chinese imports in retaliation for Beijing's unwillingness to allow the *yuan* to appreciate against the dollar. Schumer and Graham agreed not to press for a Senate vote on the bill in September reportedly after receiving Paulson's assurance that currency reform would be addressed at the highest levels of government. Schumer and Graham also undertook their own fact-finding trip to China and apparently were persuaded by Chinese officials that policy changes are in the works.

Asian Miracle—Another theme of the speech concerned the benefits of openness and competition. Paulson singled out Vietnam for praise, citing the 20-30 percent growth in its trade per year since launching the Doi Moi program of economic reforms. He said that rapid growth in Vietnam and other Asian economies benefits—rather than threatens—Americans by adding to the growth of the global economy, and over time, creating greater demand for our products and more jobs for our workers. ♦

Baucus Previews 2007 Trade Agenda

Senator Max Baucus (D., Montana), the likely new chairman of the Senate Finance Committee, delivered September 28 a Democratic counterpoint, of sorts, to Treasury Secretary Henry Paulson's speech about international economic issues (see above). Baucus' remarks also effectively previewed his trade agenda for the first session of the 110th Congress. These measures will probably be packaged into an omnibus trade bill:

- Conclusion of a U.S.-EU-Japan Services Free Trade Agreement, "an essential tool to shore up a highly competitive segment of the U.S. economy;
- Creating a network of Asia Pacific free trade agreements (FTAs);
- Addressing the "unsustainable" U.S. trade deficit by (1) improved export promotion programs, (2) better

enforcement of trade agreements, and (3) boosting private and public savings;

- Revamping the Trade Adjustment Assistance program to better enable U.S. workers to cope with the risk and the reality of trade-related dislocation;
- Bolstering the U.S. education system from universal pre-kindergarten to life-long learning for adults;
- Creating new incentives to "ignite private investment" in research and innovation;
- Supporting today's alternative energies and funding the "transformative research necessary to produce tomorrow's energy sources;"
- Improving workers' rights; and
- Renewing the President's Trade Promotion Authority (TPA) before it expires on June 30, 2007.



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The United States Asia Pacific Council (USAPC) was founded in April 2003 by the East-West Center (EWC). It is a non-partisan organization composed of prominent American experts and opinion leaders, whose aim is to promote and facilitate greater U.S. engagement with the Asia Pacific region through human networks and institutional partnerships.

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