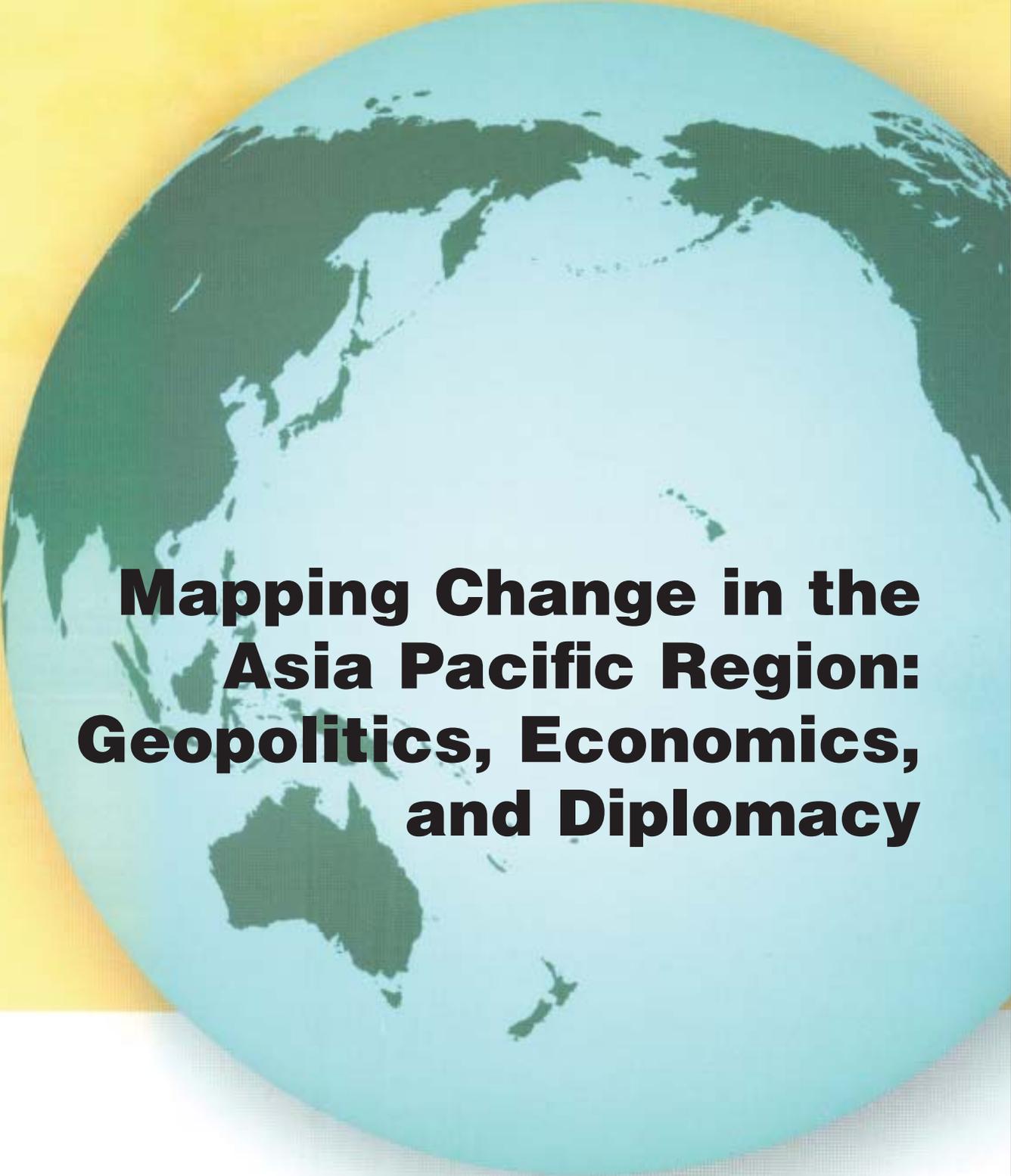


SENIOR POLICY SEMINAR 2007



**Mapping Change in the  
Asia Pacific Region:  
Geopolitics, Economics,  
and Diplomacy**



EAST-WEST CENTER



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EAST-WEST CENTER

The Senior Policy Seminar Series summarizes discussions and conclusions at an annual meeting of senior security officials and analysts from countries of the Asia Pacific region sponsored by the East-West Center. These seminars facilitate nonofficial, frank, and non-attribution discussions of regional security issues. The summary reflects the diverse perspectives of the participants and does not necessarily represent the views of the East-West Center. The price per copy is \$7.50 plus shipping. For information on ordering contact:

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# **Table of Contents**

v	Preface
vii	Executive Summary
1	Introduction
1	The United States and the Region
5	Shifts in the Regional Balance of Power
11	Changing Economic Geography
17	Soft Power
19	Conclusions
23	Appendix: Participants



# Preface

**CHARLES E. MORRISON, PRESIDENT, EAST-WEST CENTER**

The Senior Policy Seminar is a keystone event in the East-West Center's annual calendar. It brings together senior foreign policy officials, private sector leaders, and analysts from countries around the region for nonofficial, frank, and non-attribution discussions of security issues in the Asia Pacific region.

In keeping with the Center's founding mission, the objective of the Senior Policy Seminar series is to promote mutual understanding and to explore possibilities for improving problem-solving capabilities and mechanisms in the region. The seminar series also supports the Center's current operational objective of contributing to the building of an Asia Pacific community by facilitating dialogue on critical issues of common concern to the Asia Pacific region and the United States. In addition, the discussions help inform the agenda of the East-West Center's other research, dialogue, and educational activities.

The 2007 Senior Policy Seminar at the East-West Center was the eighth in an annual series. In view of the profound changes that have been occurring in the Asia Pacific region over recent years and in anticipation of a 2008 presidential election in the United States that will shape the nature of the next U.S. administration if not its specific policies, we decided to focus this year's seminar on a retrospective on the ongoing "tectonic shifts" in various dimensions of power within the region. The three subareas were strategic/geopolitical power, economic power, and the more recently articulated concept of "soft power." A half-day session was devoted to each of these topics. The opening and concluding sessions considered a somewhat broader and more topical range of regional issues including implications and challenges for U.S. policy.

This report presents the rapporteur's summary of the group discussions and the theme sessions. As in past years, the report adheres to the "Chatham House Rules" under which observations referred to in the report are not attributed to any individual participant. All views expressed in these documents are those of the participants and do not necessarily represent either a consensus of all views expressed or the views of the East-West Center.

The Senior Policy Seminar series reflects the contributions of many individuals. Ambassador Raymond Burghardt, director of the Center's Seminars Program, was the overall organizer again this year and served as a moderator.

Richard Baker, special assistant to the East-West Center President, helped organize the seminar and facilitated the discussion of soft power. He also coordinated the preparation of this report. Benjamin Glahn of the Salzburg Seminar in Vienna, Austria, served as rapporteur and drafted the report.

As in other recent years, the 2007 seminar was supported by East-West Center Program Officer Jane Smith-Martin, Seminars secretaries Marilu Khudari and Carol Holverson, student assistants Alyssa Valcourt and Alexandra Hara, and student volunteers Wang Qinghong and Lee Hyeon-Ju. The staff of the East-West Center's Imin Conference Center under Marshal Kingsbury prepared the conference venue and managed the associated facilities. Editorial and production assistance for the report was provided by the East-West Center Publications Office.

The principal value of the seminar, however, is always found in the insights and contributions of the participants both those who made opening presentations at the various sessions and those who participated in the frequently lively discussions. It is their observations that provide the analysis and judgments recorded in this report.

## **Executive Summary**

The following points summarize the major observations and conclusions under the three themes of the 2007 seminar.

### **THE STRATEGIC BALANCE**

- Power distribution in the region is changing; the principal questions are how it is changing and how the region will deal with the changes.
- Relations among the main powers are generally positive. Examples include cooperation on the North Korean nuclear issue and a resumed India-Pakistan dialogue. No significant regional power is fundamentally dissatisfied with the status quo.
- Flashpoint issues still exist (e.g., North Korea, Mainland China–Taiwan, India-Pakistan), but are being managed, and the outlook is basically positive.
- The rise (or re-emergence) of some powers, and of Asia as a region, does not mean others are declining. It represents a move toward a more even distribution of power.
- Due to its continuing power primacy, the United States (with its alliance network) is still generally regarded as “who you call” in the event of a crisis. The issues for the United States in the region are the competing demands in other regions (currently Iraq and the Middle East in particular) and questions about the priorities of the senior U.S. leadership and attention being paid to the Asia Pacific region.
- The general response in the region to the evolving power distribution is best described as strategies of “engagement” and multiple “partnerships” rather than as the narrower “hedging,” balance of power, or traditional alliance approaches.
- Security forums and cooperative arrangements not based in the United States are proliferating in the region. Examples include the ASEAN Regional Forum (ARF), Shanghai Cooperation Organization (SCO), the Asian Summit, and bilateral/subregional mechanisms such as those designed to promote security in the Malacca Straits. Although they are not yet able to deal with the most pressing problems, including non-traditional issues such as energy security, regional institutions can help develop agreed-upon “rules of the game” and norms to manage challenges.

## ECONOMIC GEOGRAPHY

- The combination of the rise of Asia, globalization, and the emergence of economies driven by consumer demand and domestic investment presents the possibility that the dispersion of economic prosperity and power within the Asia Pacific region (and more broadly) could be a stabilizing development over the longer term.
- China is the model of rapid market-based growth. India's increasing opening and growth rates are influenced by Chinese experience and competition.
- There is encouraging evidence of a growing role for domestic consumption and investment as economic drivers in the more dynamic economies of the region. There is also broad recognition of the need for balance in overall international trade and financial flows.
- However, the immediate increases in interdependence, the rapidity and deep impact of changes, and the gaps in management systems (especially concerning financial flows) mean that continued stable growth is far from certain. Regional and global economies remain vulnerable to disruptions in one market quickly spreading to others. Key resource issues such as energy and water could overshadow the rest of the economic picture.
- The institutional arrangement of the Asia Pacific multilateral economic order is still in flux. Existing forums such as ASEAN-Plus-Three, Asia Pacific Economic Cooperation (APEC), and SCO are all evolving, overlapping, and attracting new applicants for membership. On trade, bilateral and small multilateral Free Trade Agreements (FTAs) are filling the economic and political gaps left by lack of progress in the Doha Development Round (DDR) of global trade negotiations. There are serious questions about whether such smaller-scale arrangements are an adequate alternative as well as about whether the transaction costs associated with them are so high that much of the private business community simply ignores them.

## SOFT POWER

- "Soft power" is an elusive concept that defies precise definition. Most generally, soft power is the ability of one nation to attract support and like-mindedness from other societies or governments without having to directly entice or compel such behavior. Diplomatic soft power is diplomacy by persuasion in contrast to diplomacy by pressure and coercion.

- The origins of soft power lie as much in society, values, and culture as in government attributes or policies. There is a relationship between soft power and “hard power” in that military and economic strength can command respect, but other features such as positive values and willingness to assist others are also very important.
- Governments try to utilize their soft power assets to increase their prestige and influence, to sustain their positions, or to reduce suspicions over increasing hard power. These uses of soft power are not illegitimate, but conscious efforts to build or utilize soft power are very difficult to manage.
- In the post-9/11 period, U.S. soft power is generally seen as having declined dramatically while that of China has greatly increased. Perceptions of U.S. unilateralism and growing Chinese multilateralism have contributed significantly to these differences.
- The key open questions include: How will China exercise its growing power and influence in the future? What will be the preferred multilateral institutions? How effective will those institutions be in producing rules and norms for the new regional order? When will the United States give higher priority and policy attention to the region as a whole? How might the region, and the U.S. position within it, have changed by then?



## Introduction

The 2007 Senior Policy Seminar looked at the major long-term changes and trends in the distribution of power in the Asia Pacific region. These factors were tracked in terms of several specific dimensions of power—strategic, economic, and soft power (a relatively new and less well-defined area). As in all the annual meetings of the Senior Policy Seminar, the themes that ran through the discussions were the evolution of regional institutions, community-building, and the specific position and role of the United States in the region. Inevitably, the selection of some subject areas results in less attention to other subjects. Topical issues such as terrorism, domestic conflicts, climate change, and other environmental issues did not receive emphasis in these discussions. The lack of discussion was not intended to suggest that these issues are of lesser importance to governments and leaders in the region, they were simply not a priority focus of this seminar.

## The United States and the Region

The first session of the seminar is traditionally devoted to an overall assessment of conditions in the region with particular reference to the U.S. role and regional relationships. Points made in the opening presentations are often reflected and amplified in the subsequent discussions. The major themes are summarized below.

### U.S. RELATIONS WITH THE REGION

The big question concerning U.S.-Asia relations, as described by one American participant, is “what sort of Asia will this administration be turning over to the next?” Despite harsh criticism of the Bush administration’s “Cold War” approach and a perceived lack of U.S. leadership in the region, this participant commented that, all in all, the situation now is “not as bad as it could have been.” He pointed to administration efforts to improve the basis of U.S.-China relations, strengthen the U.S.-Japan-South Korea and the U.S.-Japan-Australia trilateral arrangements, and use the Six-Party Talks to negotiate on the North Korean nuclear issue.

U.S.-China relations are now at the center of the overall U.S. relationship with Asia. The administration began its first term with a souring relationship with China (spiked by the early incident of the forced landing of an EP-3 surveillance aircraft in Hainan). Since then, three administration initiatives

were cited as having improved the U.S.-China relationship. First, the United States and China initiated senior-level dialogues concerning Iran, North Korea, and climate change. The second initiative was the U.S.-China economic dialogue, and the third was a conscious effort by the White House to cultivate a personal relationship between Presidents Bush and Hu. The success of the third initiative underlies the success of the first two.

U.S.-Japan relations overall were described as better than ever. Assisted by a strong personal relationship between President Bush and former Japanese Prime Minister Koizumi, the bilateral relationship has been substantially reshaped. Japan has made significant contributions to U.S.-led efforts in Iraq and elsewhere, including naval support for Operation Enduring Freedom in the Indian Ocean, and has provided financial support toward establishing a positive business climate in Indonesia.

Despite the extreme weakness of the Abe government domestically [which led to Abe's resignation a month after the seminar] and related internal political uncertainties, Japan-China relations also remain positive. Marking a significant change from earlier periods, the United States currently has strong relationships with both China and Japan.

U.S.-South Korea relations are undergoing a phase change. Five years ago many people were predicting the end of the U.S.-South Korea alliance. The now infamous "Axis of Evil" speech targeting North Korea produced negative political reactions in South Korea, and the subsequent crisis with North Korea over its nuclear program further stressed relations. Nevertheless, American participants argued that the relationship has recovered from these problems. South Korea is now the third largest supporter of the United States in Iraq and has supported U.S. efforts in Afghanistan. The base realignment program in Korea is also proceeding; and, marking a major shift in U.S. policy, the United States will transfer "wartime operational control" on the Korean Peninsula to South Korea by 2012.

The U.S.-South Korea trade relationship has also undergone a major restructuring. The U.S.-Korea Free Trade Agreement (KORUS FTA), long considered highly problematic, has been signed by both parties and submitted to the two legislatures for ratification. Although political opposition exists in both countries and prospects for approval remain uncertain, most participants thought it likely that the agreement will be ratified.

On North Korea, any incoming U.S. administration will find a functioning, multilateral negotiating platform in place. Practical steps are underway

toward the shutdown of North Korea's nuclear facilities and the eventual denuclearization of the peninsula. Additionally, and for the American participants very significantly, the Six-Party Talks framework opens the possibility of a forum for broader discussion of Northeast Asian peace and security.

U.S.-India relations were also cited during the seminar as very positive. These relations have been virtually transformed over the past decade and are steadily progressing. Trade, although it is still far below the level of U.S.-China trade, is growing at 30 percent a year. Some export controls remain from the U.S. sanctions following India's 1998 nuclear test. Those controls now only affect a very small percentage of bilateral trade. Investment is continuing in information technology and also in other sectors. The nuclear agreement was reached, and ratification is being sought by both governments. Other contacts are expanding across the board. Finally, India has indicated that it is ready to start talking about an FTA although the U.S. side has not yet been responsive in that area.

### **ECONOMICS: IS THE UNITED STATES THE MAJOR SHORT-TERM THREAT TO ASIAN PROSPERITY?**

An American participant described the current situation as "a truly unique period of prosperity" and the most benign period of economic growth in a lifetime. There is sustained global growth of 5 percent, and China, India, and much of Africa are now inextricably linked to the global economic system. In 2006, the only four countries worldwide to exhibit negative output growth were North Korea, Somalia, Zimbabwe, and Fiji. Africa and Latin America both grew by 6 percent, largely on the back of high commodity prices, and Asian stock markets grew 20 percent. Japan has had five consecutive years of 2 percent or higher growth rates. This growth is largely led by capital spending, although there are continuing uncertainties about the yen, monetary policy, and whether or not Japanese consumption spending can be spurred by an increase in wages.

A more immediate question is whether China is overheating. China registered 11.9 percent growth in the second quarter of 2007 despite central bank efforts to slow growth by raising interest rates. Consumption and wages are growing but lag overall growth. Interest rates remain low. The cost of capital is low. Export growth has increased by 30 percent, and foreign direct investment stands at \$700 billion. As a result, China is under heavy pressure to revalue its currency, but global capital markets are uncertain as to how much appreciation China will allow.

A potentially more serious threat to Asian prosperity today is the American economy. One American participant asserted that a continuing decrease in the U.S. housing market could dampen growth across the globe. In this view, weakness of the mortgage and housing markets could lead to a broad decline in U.S. consumption.

Another participant pointed to a lack of political will in Washington to take action to address the real estate downswing. This participant argued that the U.S. lack of savings and financial imbalances are a huge source of instability that will eventually “come home to roost.”

Should a broader U.S. consumption decline materialize, with 25 percent of Chinese exports currently going to the United States and several Chinese banks heavily invested in the U.S. housing market, Chinese export growth—and thus East Asian economies more generally—would also slow. Another American noted that in the 2006 Senior Policy Seminar, the slowdown in the U.S. real estate sector market was cited as a threat to China and the broader regional economy. Businessmen did not agree, however, and to date, the American real estate slowdown has had no discernable effect on Asia.

Other participants saw a greater threat to Asian prosperity in the potential for a return of protectionist trade policies in the United States (and related criticism of China’s monetary and export policies) driven by widespread fears of job losses and spurred by the rhetoric of a long and hard-fought 2008 presidential election campaign. The president’s fast-track trade negotiating authority, also known as the Trade Promotion Authority (TPA), expired on June 30 bringing almost all trade negotiations to a halt. There has been no Democratic pressure in Congress to reinstate the TPA and, with the Doha Development Round (DDR) global trade negotiations at an impasse, trade policy generally has suffered. Congressional action on ratification of the KORUS FTA is thus seen as a major litmus test. While some fear that resurgent protectionist sentiment could spill over into applied policies under the next U.S. administration, seasoned American participants noted that this kind of protectionist soapboxing has been a recurrent feature of recent U.S. political campaigns, but it rarely leads to action by presidents once they take office. Among other factors, sectors of the U.S. economy that benefit from trade and interaction with Asia would actively lobby against protectionist measures.

## **OTHER TOPICS**

The opening session of the seminar also considered issues facing two key countries respectively on the eastern and western edges of Asia. In the west,

the government of President Musharraf in Pakistan faces the triple challenges of extremism/terrorism, continuing severe poverty despite overall economic growth, and conflicted domestic politics that cloud the prospects for a projected national election. In Japan, the unprecedented loss of control of the upper house in the July election by the Liberal Democratic Party endangers the party's ability to govern as well as its ability to pass an extension of Japan's refueling operations in the Indian Ocean in support of the U.S. coalition in Iran and Afghanistan.

## **Shifts in the Regional Balance of Power**

### **THE EVOLVING REGIONAL SYSTEM**

Seminar participants broadly agreed that the concept of “balance of power” no longer adequately describes the changing economic and political relationships in the Asia Pacific region and that the overall pattern of influence in the region—as at the global level—is shifting toward a more multipolar configuration. One Southeast Asian participant stressed that peaceful cooperation, engagement, and even “peaceful competition” are all concepts that apply in the current situation. The saying “a rising tide lifts all boats” also applies.

Participants largely agreed that the current trends are not so much about “rising” versus “declining” powers as they are about the changing distribution and patterns of political influence. Some participants argued that even using the term “rising countries” to describe the broad trend can be misleading. Chinese participants argued that too much emphasis is being placed on the “rise of China” (which one participant noted was actually a “reemergence”) and that other factors deserve greater international attention including India's rise, the reemergence of both Japan and Russia, and the success of ASEAN. As one participant put it, “China's rise is taking place in the context of East Asia's rise.” That rise has been led by Japan, continued by the Four Asian Tigers, and is now incorporating ASEAN and its multipolar political and economic agreements. Another participant noted that India's rise is sometimes portrayed as a “bulwark” against the “dangerous” rise of China and cautioned that this terminology can have troubling consequences for Chinese perceptions and conduct. Still another participant commented that it is actually the response of other states to the rise of China (and India) that can be destabilizing especially if, as to a certain extent this participant saw happening, the response comes to a significant degree in military terms.

Another problem identified with applying balance of power considerations to the region is that regional countries are very hesitant to openly participate in balance of power politics or to take sides. They prefer to “navigate around” balance of power considerations. A Northeast Asian participant expressed doubt that either China or the United States would want to go back to a traditional “balance of power game,” but would prefer a system of “concert.” However, others pointed out that such calculations are difficult to avoid and will likely continue to influence regional geopolitics for many years to come. An ASEAN participant, while noting that ASEAN members prefer “strategic partnerships” to alliances, said that if ASEAN members faced serious threats they would go back to an alliance system to right the balance. One Chinese participant made the point that deterrence (beyond just raw military power) will be an important instrument in maintaining peace in the region. A Southeast Asian participant summarized the security outlook for regional states by observing that what is happening is a movement from imbalance to greater balance, but that this “may or may not” result in a better situation.

A variety of security mechanisms were identified as operating concurrently in the region today. There is the American-centered alliance system. China and Russia have maintained independent strategies and networks, and there are nascent multilateral regimes revolving around ASEAN (and around the Koreans in Northeast Asia). The major players are heavily engaged in different combinations of these systems.

One point of broad consensus was that the new situation requires reforms in international institutional structures. Several participants stressed that existing political and economic institutions (the UN, IMF, etc.) no longer reflect—or work effectively in—the new distribution of power. One participant specifically observed that the majority of world resources is no longer controlled by the G-7 countries, and this group is no longer the only center of economic power. Others pointed out that the increasing areas of common interests among the United States, China, and other regional countries, especially in the fields of energy and the environment, also underline the desirability of adapting institutions to promote cooperation. This adaptability is particularly necessary if multinational institutions need to be capable of taking action on problems.

Nevertheless, participants acknowledged that the development of more effective action-oriented mechanisms to respond to the new circumstances and issues inevitably will involve some surrender of sovereignty by governments. Thus, the outcomes will largely depend on the degree to which governments will be willing to surrender elements of sovereignty to supranational mechanisms.

## MECHANISMS FOR REGIONAL COOPERATION

Southeast Asian participants argued that their countries are moving purposefully toward a mature and resilient form of multilateral integration. As one Southeast Asian noted, these nations are now in the driver's seat of Asian development and are taking an approach of "welcoming all and threatening none" through a process of "mutual confidence and transparency." The financial crisis of 1997 was cited as providing the impetus for institutional innovation, specifically the establishment of the ASEAN-Plus-Three economic consultations at the end of 1997. Successive initiatives on the part of the ASEAN group have placed Southeast Asia at the center of the overall process of economic development and integration in East Asia. Another participant noted that by contrast with the European integration process, which was government driven, much of the process of East Asian integration is actually taking place outside of government control and relies on economic relationships and instruments.

Many of the comments on ASEAN's regional diplomacy showed that China is a significant if often unacknowledged factor in the political calculations of the Southeast Asian countries. One Southeast Asian participant stated that the big question over the next 10 years is what China will do with its growing economic might and the military power that grows along with it. For example, how will China meet its huge need for natural resources? While observing that the only real instrument ASEAN has is diplomacy, this participant commented that ASEAN is creating organizations and bringing in India, Australia, and others to avoid domination by China. "Everyone is hedging against China, and that is exactly what ASEAN is doing."

Despite the successes of the region in building a variety of multilateral structures, however, there was broad acknowledgement among Asians and non-Asians of the continuing shortcomings of the existing regional cooperation mechanisms especially in the security area. Several participants argued that the ASEAN Regional Forum (ARF), as the only high-level security organization in East Asia, has been largely ignored in the actual management of regional security problems and needs to play a more active and significant role in finding solutions to multinational security concerns. Specific issues mentioned were energy security, the unfolding consequences of environmental degradation, the impact of income disparities, and other nontraditional security issues including climate change. Nevertheless, these participants also recognized that states are still the main players in the region's international politics and that the governments of the region jealously guard their sovereignty even while recognizing the need for cooperation. This factor will

continue to slow progress in this area even though ultimately states will be forced by changing circumstances to surrender at least some of their sovereignty.

## **THE ROLE OF THE UNITED STATES**

The United States remains a critical partner in East Asia. As one participant put it, the United States is still considered the “country to call” in a real emergency. As an American participant stated, U.S. military spending and power are still the highest in the world. America spends far more than any other country and provides an important “public good.” Other participants pointed to the escalating costs of military power and questioned whether other countries want to or can spend enough to substitute for the American capability especially when free-riding or alliance relationships offer economically attractive alternatives. (The point was also made in this connection that the United States is still benefiting from investments made in the late Cold War years, and it is uncertain how long the American public will be willing to sustain this level of spending.)

Nevertheless, the U.S. track record in the region in recent years has been at best mixed. Asian and American participants argued that the hesitancy of the Clinton administration to engage early in the 1997 Asian financial crisis was taken by Asians as demonstrating that the United States was willing to “stand back” as East Asian societies suffered a debilitating financial meltdown and as an indication that the United States will only engage in areas it sees as directly profitable to itself. Broad appreciation in the region of the Bush administration’s reaction to the humanitarian disaster that followed the 2004 Boxing Day Tsunami did not repair the damage to Asian confidence, and the nonattendance by top U.S. leaders at recent Asia Pacific gatherings has reinforced the negative perception. As one Asian participant put it, many Asians would like to see more direct U.S. engagement and presence in their region as compared with the preoccupation with Iraq and the Middle East. Although several American participants argued strenuously that the United States remains fundamentally interested in and supportive of Asia, the problematic state of regional perceptions was acknowledged by all.

There was also near complete agreement that U.S. political and economic strength is being “sapped” by the ongoing war in Iraq and that, as a result, there has been “a seismic change in the East and Southeast Asian perspectives of the U.S. role in the Asia Pacific region.” A major consequence is that Asian community building must be done at the regional level using regional instruments and that consequently future shifts in political influence will be determined in Asia and not in Washington. Participants foresaw various

implications in this shift for the United States. First, the United States should carefully assess how much power and influence to invest in East Asia given its other global commitments in Iraq and Afghanistan and its ongoing diplomatic challenges in Iran and Russia. Second, the United States must take account of the changing nature of relationships in the region. While the United States still relies largely on bilateral relationships, East Asian structures—and especially Southeast Asian structures—are moving toward multilateral political and security alliances. Third, while the United States is distracted elsewhere, China is filling the “leadership vacuum.” Hence, in its own interest, the United States needs to increase its direct engagement in the region.

### **CHINA’S NEW STRATEGY**

China has restructured its global strategy under Hu Jintao. As one Chinese participant noted, President Hu has broken with the previous strategy of “big power diplomacy” and has instead engaged primarily in “neighborhood diplomacy.” This shift, according to some participants, is reflected in China’s emphasis on engagement with ASEAN-Plus-Three and the ARF, its signing of ASEAN’s Treaty of Amity and Cooperation, and its increasingly interdependent economic relationship with the region.

The shift in East Asian supply chains and the movement of final assembly centers to China have also had wide-ranging implications for trade and economic integration in East Asia as a whole. Today, East Asia accounts for 60 percent of foreign direct investment in China. As one Chinese participant reported, when people talk about things being “made in China,” what they really mean is “assembled in China.”

China’s new willingness to engage in emerging multilateral security systems was noted as a particularly significant change for China and the region especially at a time when the United States is commonly perceived as having neglected that system and, with the exception of the Chinese-led Six-Party Talks on the North Korean nuclear issue, as continuing to rely more on bilateral approaches to engagement. One example of the contrast in approaches cited in the discussion was the continuing refusal of the United States to sign ASEAN’s Treaty of Amity and Cooperation despite the accession of China and other states including Australia and India.

Chinese participants also stressed the unlikelihood of “overseas adventurism” by China. In the words of one participant, “China is not going to attack anybody.” This strong conclusion was based on China’s enormous domestic problems and vulnerabilities. Chinese participants acknowledged that the

Taiwan issue remains a “flashpoint,” but saw the internal issues as the real threats that concern China’s leaders.

## **THE UNDERLYING STRUCTURES OF EAST ASIAN SECURITY ARE LARGELY INTACT**

East Asian flashpoints are more stable now than they have been in the recent past with the Six-Party Talks making significant headway in North Korea, serious international tensions on hold in the Taiwan Strait, stable relations among the large powers, and a new condition in which most states in the region have mature self-defense capabilities. There was a broad consensus among participants in this regard, and participants also largely agreed that there are no major outstanding issues such as territorial designs that could change the underlying security mechanisms in the short term. This view contrasts with some of the more alarmist predictions of recent years including fears of conflict over competition for resources. Responsible management by the principal leaders in the region was credited for some of the current stability. However, the big unanswered question remains whether serious economic disparities, and perhaps internal ethnic conflicts, have the potential to spin Asia back into a period of internal strife. If this were to occur, the expressed fear was that external interests could become involved in domestic conflict in Asia for the first time since the 1960s.

### ***Key Judgments***

- A major shift is occurring in the region from political influence anchored in a U.S.-centered system to a system built on multilateral relationships. Future changes in the regional order will be determined in Asia rather than in Washington.
- Shifting patterns of influence both regionally and globally call for changes in the international institutional structure.
- China’s rise is taking place in the context of East Asia’s rise. This rise has been led by Japan, continued by the Four Asian Tigers, and is now incorporating ASEAN and its multipolar political and economic agreements.
- While China is increasingly joining systems of multilateral engagement, the United States is seen as still relying more on unilateral/bilateral approaches to engagement.
- Other East Asian states welcome China’s growing regional involvement, but are also building broader relationships to avoid domination by China.
- The growth of multilateral relationships in East Asia and improvements in relations among the major regional powers create opportunities for broader changes in regional and global institutions.

- The role of the ASEAN Regional Forum (ARF) in dealing with Asia Pacific security problems should be strengthened.

## Changing Economic Geography

### IMPACTS OF INTEGRATION

The major shifts in the “economic geography” of the Asia Pacific region, including the greater weight of Asia among the world’s regions, are due to globalization of the world economy which in turn involves both increased integration and increased competition. (One participant argued that sheer geographic proximity has been an important factor driving changes in economic flows in the region.) Participants discussed the impact of these changes on international economic institutions and instruments both within East Asia and at the global level. Several speakers noted that the new conditions have brought a need for new rules especially concerning trade and financial flows, but that this need raises questions about where the rules are to come from and where they are to be housed. A related question is whether the necessary rule-making is best or most feasibly accomplished at the regional level and, if so, which institutions are best suited for these functions (ASEAN-Plus-Three, APEC, and/or a forum including Central Asia). There was also discussion about whether rule-making is feasible at the global (World Trade Organization) level.

Despite a relatively positive assessment of prospects for continued Asian economic growth, participants also considered possible threats to that growth and stability. One participant observed that competition for resources to date has been handled “rather well,” and has not led to conflict. However, conflicts could still take place in the future. Competition for energy resources was cited as having particularly serious potential to generate conflicts. Another participant pointed to the fact that “there are clear limits to harmonization, and if there are clear limits to harmonization, there are also clear consequences [of incomplete harmonization].”

Further potential for conflict lies in differential rates of growth, which affect the relative strength of countries, and in changing levels of interdependence. As one participant noted, even relatively well-integrated economies can fall apart with destabilizing economic and political impacts. Speculative bubbles (for example, in many Asian stock markets) can lead to abrupt corrections and have an impact on other regional economies. Finally, an American participant saw a paradox in the possibility that both bad economic developments—a regional

economic crash and sustained growth that spurs increased military spending—can sow the seeds of conflict. All these factors underline the need for responsible political leadership and effective management.

## THE CHANGING NATURE OF TRADE

World trade growth over the last decade is at a historic high. The global trade growth rate in the 1990s was 3–4 percent. Today's growth rate is hovering at around 12 percent. One participant cautioned that to some degree the current rates may be artificially high given the growing proportion of intermediate goods, the particularly rapid growth of some new players (e.g., China and India) and the accompanying shifts in trade flows, the breakups of other economies (e.g., the USSR), and dramatic rises in the prices of some key commodities (e.g., oil). To the extent that these are short-term or one-time shifts, global trade growth rates could return to more traditional levels at some point.

The role of intermediate goods triggered considerable discussion. For example, only 17 percent of the value of China's exports is added in China and on some goods there is as little as 5 percent value added. Thus, while the entire product, if finished and shipped from China, is counted as a Chinese export, only a small percentage actually contributes to China's domestic GDP. There were suggestions that a revision of trade statistics calculations might provide a more accurate picture of real growth rates and balances. Other participants argued that it is possible to separate out components of trade increases such as the role of intermediate goods so that this element is not hidden. Participants also suggested that, regardless of the statistical systems used, shifting trade flows and balances, and the political management of the shifts and imbalances, are the real concerns in this area for governments.

Another fundamental, long-term change in regional trade patterns identified in this session was the growing importance of intra-Asian trade. Twenty years ago the majority of trade in the region was across the Pacific. Today, 60 percent of the trade is intra-Asian, and almost every East Asian country now has China as its dominant trading partner. In fact, despite China's huge trade surplus with the United States, it is actually running a trade deficit with the rest of East Asia. Asia Pacific trade as a whole is much closer to balanced than is often perceived.

Free Trade Agreements: There was a lively exchange over the role and impacts of Free Trade Agreements (FTAs) in the region. Participants generally acknowledged the current popularity of FTAs, both bilateral and subregional, among

Asia Pacific governments. This prevalence was attributed both to the greater negotiating simplicity of more limited agreements at a time of stalemate in the DDR global trade negotiations and to the political motivations that frequently underlie these agreements and ease their successful conclusion. (Underlining the general importance of political considerations in FTAs, a Chinese participant expressed the opinion that China's reaction to FTAs involving Taiwan would be influenced by the state of cross-Strait relations.)

Evaluation of the impacts of FTAs was more mixed. On the positive side, FTAs can at least provide some progress in reducing trade barriers, and they can stimulate similar steps by other governments and groups possibly even extending to the global level. For individual countries, they can also serve as vehicles to achieve domestic reform and to advance integration with other countries or subregions. The counterarguments are that they distract attention and resources from the global process and that they usually are very limited in scope and thus would not qualify under the World Trade Organization (WTO) charter.

Participants also pointed out that, due to such problems as the complex rules of origin and the extensive paperwork requirements, most businesses do not take advantage of FTAs so they are essentially ineffectual as trade-generating instruments. On balance, it would be unrealistic to expect an end to the negotiation of FTAs. The real issue is to maximize the positive trade effects for the regional and international order and keep the negatives to a minimum. One participant stressed the importance of networks of FTAs as opposed to bilateral agreements and the need for governments to carefully set the priority order in which they negotiate FTAs. Another suggested the value of developing a set of "best practices" for FTAs as is being undertaken in a current APEC project.

## **CHINA IS THE BIG SHIFT, THE RENMINBI THE BIG QUESTION**

China was described as the most dynamic and rapidly changing element of the Asia Pacific regional economy today driving regional growth and causing impacts and concerns elsewhere. With a manufacturing workforce of 108 million and a comparative advantage in labor costs estimated to last as much as another 20 years, China is learning how to manufacture and assemble not only faster and cheaper, but better as well. An estimated 31 percent of all China's non-fuel imports are now parts and components, and more and more of the supply chain has been moving to China. This shift has led to a concern among some in Asia that "China will end up producing everything." A Chinese participant countered that while China will upgrade its manufac-

turing processes, progress will inevitably be slow, and China will continue to need to import sophisticated components. Another participant stressed that China needs to rebalance its economy to rely more on domestic demand as an engine of growth. This point elicited the response that domestic consumption in fact has already begun to rise and much growth over the past five years has been domestically driven. This participant also cited a government objective to reduce dependence on exports (now 35 percent of GDP but targeted to fall to 15 percent).

As the supply chain and assembly points have shifted, the “real” value of the renminbi has become perhaps the biggest economic issue of our time. In global terms, many participants argued that the renminbi is not undervalued at all and that it is far more important to examine global imbalances than it is to emphasize bilateral imbalances like those with the United States. One participant noted that it is now easier for money to flow into China than for the renminbi to flow out and argued that if controls are lifted on the renminbi, the valuation might actually go down, not up. Further, given the relatively low portion of domestic value added in Chinese exports, revaluation of the renminbi would have only a very limited effect on either global prices or the trade imbalance with the United States.

The potentially significant—and destabilizing—role of “sovereign wealth funds” (funds owned by states) on financial flows and currency values was cited in this connection, but others argued that these funds are fairly passive, and that China (like many governments) has very limited control over major companies. One participant opined that China “will likely pursue a very diversified and passive investment strategy.”

Other participants stressed that significant constraints are also facing China. Labor costs are increasing in the coastal areas as workers demand more rights. Protectionism, especially from the United States, could prove damaging to China’s economy. Still more worrisome, serious and critical issues of pollution and environmental degradation suggest a coming recalibration of the economy. As one participant noted, threats include “geographical dehydration” and “desertification” due to a shortage of water resources in Northern China which could both create major constraints on industry and pose serious public health challenges. As one participant stated, “These constraints would not be so binding if China’s own environmental policies were enforced, but they are not.”

Chinese participants stressed that China’s agenda today is extremely focused on domestic reform. Other participants, however, questioned what it would

mean for the region should China's focus on domestic reform change. Will China be a cooperative partner, which is arguably in its own interest, or will it become more disruptive? Another participant raised the question of China's preferred multilateral order in the region. For the time being, ASEAN-Plus-Three seems to be the preferred institution, but China is also promoting the Shanghai Cooperation Organization (SCO) which has evolved into a larger forum involving Central Asian states including Russia with India and others wanting in. Within the SCO, there is also the question of the relationship between Russia and China. Neither country would accept junior partner status so their relationship will likely remain problematic. All these questions hang over China's economic and political relations with the region.

### **INDIA'S CHALLENGE, INDIA'S EAST ASIA STRATEGY**

India was described as a country whose internal challenges, like China's, are massive and for which China serves both as a model and a spur to progress. The process of liberalization in India began only 16 years ago, and although the information technology and service sectors are highly advanced, the manufacturing sector remains relatively small. Statistics on growth are imperfect, but official figures place Indian growth rates at 9–10 percent. However, both infrastructure, which is exhibiting 8 percent growth, and agriculture, which is crawling behind at 2 percent growth, need improvement.

Although India's east and parts of its center are not yet participating fully in the economic success, and 700 million rural people live on \$1 a day, India now sees its population as an asset for growth. With 500 million people under the age of 13, many workers acquiring skills, and 30–40 million people a year coming into the modern economy, India anticipates 10 percent growth for the foreseeable future.

India's growth is led by a private sector with reduced regulations, many players now working globally, and a huge workforce of young, skilled workers. India's vibrant private sector has created an explosion in consumption. Within this private sector-led growth, participants identified the need for greater levels of cooperation and communication between India and China as well as for an expansion of Indian investment and acquisition overseas. One Indian participant also noted that the trust factor between government and industry is exceedingly important, claiming that Indian industry's message to regulators is: "Please step back. Sometimes reform is not about doing something, but about getting out of the way."

Two new features are also unfolding in the Indian private sector. First, the private sector is leading investment into clean energy technologies and the fight against climate change. Second, the Indian defense industry is now 100 percent open to foreign direct investment. Indian participants anticipated that this openness will lead to huge growth in defense and technology centers. The government is now also promoting public-private partnerships in health care (including research), education, and infrastructure.

India's international trade relationships with Asia are another important priority, and India has specifically focused on free trade to spur growth. Having completed an FTA with Singapore, India's East Asian goals are to expand FTA coverage to include ASEAN, South Korea, and Japan. Another goal is the formation of a joint study group to create a future road map for an agreement with China. Looking forward, India's strategy is to use FTAs to link it with the entire region.

Indian engagement with Pakistan has also improved immensely, although the degree of cooperation and the prospects for solutions to longstanding issues remain contentious. Intra-South Asian trade today stands at only 5 percent which is a fraction of the level in East Asia. As one South Asian participant noted, "India cannot rise alone; it must allow the rest of South Asia to rise with it."

### *Key Judgments*

- The changing nature of integration and competition in the global economy calls for changes to international economic institutions.
- Integration can bring major economic benefits, but can also trigger conflict. Political management is the key factor in determining outcomes.
- Bilateral and small multiparty Free Trade Agreements (FTAs) will remain popular with governments, but a "best practices" model should be developed to help maximize economic benefits and minimize distorting effects.
- China's control of the value of the renminbi is a major issue in the region, but even a significant appreciation would probably not have a major impact on global prices or on the trade imbalance with the United States.
- China's current economic focus is domestic. A change in China's focus, however, would have major impacts in the region.
- India is relying on FTAs both as a vehicle for domestic reform and to connect India to the entire region.

## Soft Power

### THE SIGNIFICANCE OF SOFT POWER AND THE SHIFT OF GLOBAL INFLUENCE

A measure of commonly held values and interests, including the ability to convince others that their interests are aligned with yours, “soft power” was described as recognizable, but not quantifiable—important, yet amorphous. Some participants stressed “the power of ideas” as an important element of soft power. Although it was accepted that soft power is to some extent based on more tangible strengths and accomplishments, the practical relationship between hard and soft power proved very elusive. Participants found it particularly difficult to conceive ways of using soft power as an active instrument of national policy due to the inherent contradictions between assertive use and natural attraction. However, there was general acknowledgement that soft power is both difficult to build (usually requiring relatively long periods of time) and very difficult to rebuild once dissipated.

### CHINA AND SOFT POWER

China has just started to think seriously about its own “soft power potential.” According to some participants, China’s top leadership has recognized that soft power is crucial to its interests and has set about consciously building its soft power in the region. While agreeing that China’s other accomplishments will build soft power, participants also noted that China understands it has many obstacles to overcome in its pursuit of soft power. These obstacles include an imbalance between its own soft power and that of the United States, a sometimes mixed reputation in both the international community and the international media, mounting environmental and social problems, and a general fear of China’s growing military strength including a continuing concern over the situation in the Taiwan Strait.

China’s culture was identified as perhaps its greatest potential soft power asset. Some participants argued that the longevity and variety of Chinese culture have broad, global appeal although others pointed out that China has not yet figured out how to produce globally appealing content. Significantly, the upcoming 2008 Olympic Games in Beijing were seen as a major opportunity to enhance China’s soft power in the region. As one participant stated, it will be a big opportunity for China to project “a larger idea that is Chinese.” Still, as another participant suggested, there is the question of whether the Beijing Olympics “will be a state power show or a soft power show.”

## U.S. SOFT POWER

There was a very broad consensus that U.S. soft power has declined and is declining across the globe. In the post-9/11 period, this decline appears across all the traditional bases of American soft power including openness, diversity, values, and culture. American and Asian participants agreed that the controversies surrounding the U.S.-led “war on terror,” wars in Iraq and Afghanistan, the disastrous affects of Abu Ghraib and Guantanamo Bay, and much stricter U.S. visa regulations have contributed directly to this decline. Openness and inclusiveness seem to have yielded to unilateralism and arrogance. Importantly, however, while American participants expressed discouragement with the United States’ loss of soft power, they tended to believe that a more balanced international “influence landscape” is also a more normal and potentially beneficial state of affairs. As many participants noted, the post–World War II period of unchallenged authority and influence “was a total anomaly and one that a generation of Americans has taken for granted.”

The irony of the post-9/11 world, as referenced by one Asian participant, is that the United States, which was the architect of Bretton Woods and the multilateral system of global institutions, is seen as becoming more unilateral while China, a country that avoided multilateralism until 1972, is becoming a more multilateralist state. Some Chinese participants argued that in its desire for soft power influence, China is in fact becoming a status quo state. It has become a state that recognizes both the limits to and the significance of “hard power.”

## ASIAN SOFT POWER – MULTILATERALISM?

Some participants suggested that as multilateral cooperation increases in East Asia, East Asia’s soft power may also increase. As one participant noted, “Cultural diversity is an asset, not a liability.” While there were disagreements as to whether an East Asian “identity” either exists or could exist, many participants argued that if we are indeed on the cusp of the “Pacific Century,” we will see the rise of soft power in the region as well.”

Multilateralism based on consultation and consensus-building could constitute the most defining feature of East Asian soft power. As some Southeast Asian participants stated, the basic objective of multilateral systems, aside from balancing and shifting the centers of power, is to attempt “to create something better based on universal values.” As another participant said, “When we talk about shifts in economic and political power, we are not only

talking about American goods or Japanese goods, we are talking about the common good.”

Moving forward in a world in which Chinese hard power is increasing and the United States’ soft power is decreasing, some participants suggested that the groundwork may have been laid for a new form of influence based on East Asian economic cooperation, technological advancement, and new international norms and rules. In a discussion of managing public goods in these multilateral systems, one participant described the requirement as follows: “You need shared institutions and a shared sense of sovereignty.”

### *Key Judgments*

- Although the role of soft power in international affairs seems self-evident, both defining it with precision and using it as a practical instrument of national power are very difficult.
- China has started to think seriously about soft power. China’s assets are its culture and its recent achievements. The Beijing Olympic Games in 2008 give China a major opportunity to project a larger Chinese vision.
- U.S. soft power has been declining since 9/11. A major liability for the United States is that it is seen as becoming more unilateral as China is becoming more multilateral.
- Increasing multilateral cooperation in East Asia could provide a basis for a new, regional soft power based on shared institutions and a sense of shared sovereignty.

## **Conclusions**

The final session of the seminar, as always, was devoted to drawing together the observations and assessments offered in the subject area discussions. The following paragraphs summarize the main overall conclusions.

### **SHIFTING PATTERNS OF INFLUENCE**

Major changes are occurring in the distribution of power and influence both globally and regionally. Globalization has created one of the longest periods of economic growth and prosperity in world history. The dramatic increase in economic flows and interdependence in East Asia have transformed the region as a whole and are leading to what some are now referring to as a “Pacific Century.” Growth and integration across the region have been largely driven by the private sector and capital investment (with governments

reducing direct controls over economic activity). South Asia, however, lags in the transition to greater interdependence.

The shifts in economic and therefore political geography in Asia are driving the development of regional institutions but are not yet represented in the core institutions of the international community. These institutions reflect an old order and will require revision to accommodate the new dynamics.

## **OUTLOOK: POSITIVE**

Despite transformative and potentially disruptive changes, the general assessment was that the regional situation—in both the economic and security realms—is stable. Views of the economic outlook were more optimistic than at the 2006 seminar, although possibilities of downturns or disruptions remain. In the security area, there are still historical flashpoints, and “hard power” will continue to occupy a prominent place in East Asian affairs (and these capabilities will increase with economic growth), but the current security outlook was also assessed as generally positive. Major power relations are generally good, economies are continuing to improve and grow, and regional integration continues to expand.

## **THE CHINA FACTOR**

China’s reemergence as a major economic and political power is the most significant single change in regional and global affairs. India and Russia are also gaining strength, and Southeast Asia is building a multilateral cooperative structure to advance and protect its interests. China, despite its accumulation of wealth and influence, continues to face serious and significant constraints including shortages of key resources, the consequences of rapid societal change, and a host of environmental challenges.

Pressure on China to revalue its currency was a topic of extended discussion. The pressure was viewed as largely originating from the United States and as fueled by domestic political concerns over the huge U.S. trade deficit. Economist participants argued strongly that even a significant short-term appreciation of the renminbi would have negligible effect on the trade surplus for a number of reasons including the impact on Chinese imports and the limited value added in China’s exports. Some participants noted that a significant revaluation could actually hurt both the U.S. economy and other regional countries because of price and interest rate effects. One participant concluded trenchantly, “We don’t understand what problem we are trying to fix by asking China to revalue its currency.”

The general assessment of the regional reaction to China's rise was that no one is trying to *contain* China at the moment, but everyone is trying to *constrain* China through an interlocking series of commitments and obligations. Participants welcomed China's engagement in multilateral institutions and diplomacy and regarded the engagement as a "healthy development" for the region and for China. Uncertainty remains, however, over how China's growing power will be exercised as the next decade unfolds.

## REGIONAL INSTITUTION BUILDING

ASEAN has been the leading force in creating and shaping mechanisms for regional cooperation and the management of the evolving distribution of power and influence. This push reflects the priority placed by the ASEAN states on maximizing their collective influence on the regional agenda and in relations with the major individual powers (including China), but regional institutions are still characterized by very limited capacity to take action on concrete issues. As the broader changes in regional influence, power distribution, and economic integration continue, a major underlying question is: What are the preferred multilateral institutions and from where will the new rules and the new norms come?

## CHALLENGES FOR THE UNITED STATES

The challenges to the United States in the region begin with the U.S. relationship with China. One Asian participant urged that "China is here to stay and will provide leadership in Asia. We need to begin to get comfortable with that." An American participant responded that American officials hear a wide variety of views on Asia's comfort level with China including some strong criticism of U.S. "naiveté" regarding China and ignorance of China's impact on Asia. Nevertheless, American participants acknowledged that discomfort with China is already having negative effects on U.S. domestic politics as reflected in the reemergence of protectionist sentiment fueled by presidential election rhetoric. For the longer term, in the words of one American, "China is the biggest foreign policy challenge the United States has ever faced because of fundamental changes in both the region and in U.S. domestic politics." For the United States, China is the next generation foreign policy challenge. It is a challenge that will fundamentally shape U.S. policy in the new century.

American participants argued strongly that, in terms of economic engagement and security presence, the United States is not disengaging and will not "disappear" from the region. The potentially positive U.S. influence on

regional processes and outcomes was generally acknowledged. Concerns were expressed over the gap between perceptions and reality of U.S. interest, however, and some fear that the United States may be missing the “tectonic shifts” that are occurring in East Asia. With American distraction in Iraq, realignment of its regional force structure and military presence, and the changing profile in the East Asian economic and political landscape, it is clear that the region is not any longer, if it ever was, waiting for the United States to engage. As one participant asked, “When the United States comes back, will the game be the same or will it be changed?”

## **LEADERSHIP AND EDUCATION**

Various participants expressed concerns over the problem of leadership in the region. One Asian participant put it quite bluntly: “We face inadequate, weak, short-term, irresponsible leadership.” He saw the phenomenon as widespread across the region. Participants also noted the negative impact on national policies, especially on trade and other economic issues, of the very strong pressures on leaders from constituencies that are being hurt by change. Several participants stressed the importance of working with political leaders and educating them on the broader and longer-term benefits to their economies and societies from economic growth and integration. Without such efforts, politicians will respond more to the public and media outcries of the moment and will risk pandering and bad policy outcomes. One participant concluded, “We have to start educating our leaders.”

## Appendix: Participants

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