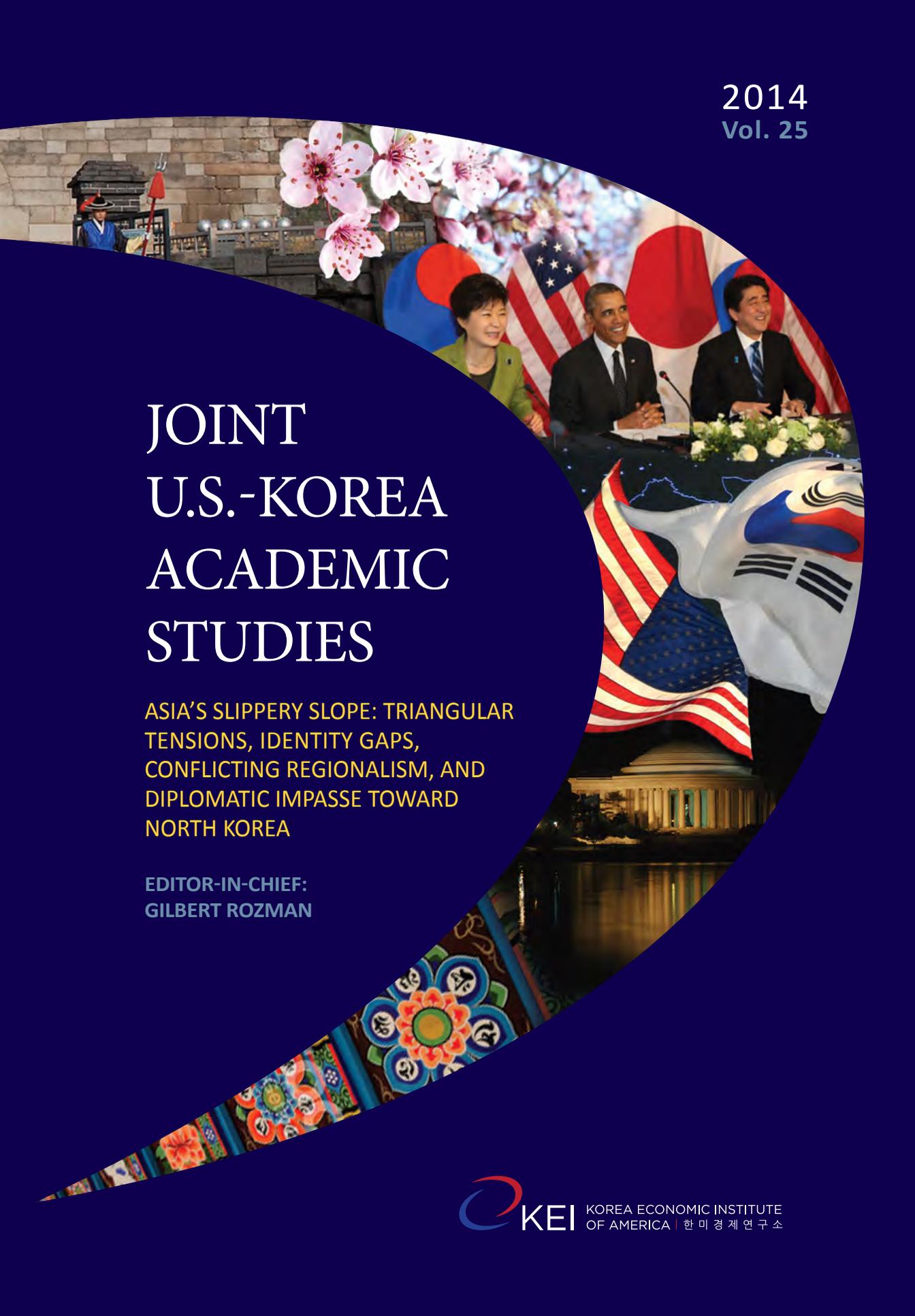


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DIVERGENCE ON ECONOMIC REGIONALISM





Asia-Pacific Regional Economic Integration: U.S. Strategy and Approach

Matthew P. Goodman

America's economic engagement in the Asia-Pacific predates the republic itself. In February 1784, the merchant ship *Empress of China* set sail from New York to Canton seeking to trade coins and ginseng for Chinese tea.¹ The profitable 15-month expedition sparked a wave of American merchant trade in the region.² It was not long before commercial considerations began to shape U.S. foreign policy in the region, as epitomized in 1853 by Commodore Perry's arrival in Tokyo Bay in his "black ships" seeking refueling rights for the American whaling fleet and the opening of Japan to trade. Over the ensuing 150 years, as trade and investment across the Pacific have grown to trillions of dollars a year, economic policy has become a central feature of broader U.S. strategy in the Asia-Pacific. Washington today pursues a robust, multilayered economic policy in the region that is designed both to promote U.S. growth and jobs and to underpin regional peace and stability.

While the United States has pursued an array of initiatives at the bilateral and multilateral level to advance its economic interests in the Asia-Pacific, for the past 25 years it has invested particular time and energy in regional initiatives. Starting with its co-founding of the Asia-Pacific Economic Cooperation (APEC) forum in 1989, Washington has been an active participant in regional economic integration, bringing a distinct approach to the effort. Like its recent predecessors, the Obama administration has put regional economic integration at the center of its Asia-Pacific strategy. Indeed, the overall success of the administration's policy of "rebalancing," or "pivoting," to Asia rests on its ability to carry out a successful regional economic strategy, in particular completion of a high-standard Trans-Pacific Partnership (TPP) trade agreement.

THE ECONOMIC PULL OF ASIA

U.S. economic engagement in Asia is driven first and foremost by the numbers. The 21 member economies of APEC account for roughly 55 percent of global GDP.³ The region contains the world's three largest countries by GDP—the United States, China, and Japan—and, counting India, half of the top 20 economies. According to the IMF in its most recent outlook, the Asia-Pacific is the fastest-growing region of the world, with real GDP growth in developing Asia expected to average 6.7 percent in 2014.⁴ The APEC region also accounts for 44 percent of world trade, with nearly \$10 trillion worth of goods and services flowing around the Pacific last year.⁵ U.S. exports to APEC economies, among which are six of its top ten trading partners, equaled nearly \$1.2 trillion in 2012, more than half of the U.S. total.⁶ These have more than doubled over the past decade.

Financial flows across the Pacific in the form of both direct and portfolio investment are also substantial. The stock of U.S. FDI in Asia totaled more than \$650 billion at the end of 2012, an increase of some \$45 billion that year.⁷ In the same year, nearly \$20 billion worth of FDI flowed into the United States from Asia-Pacific countries, adding to an accumulation of over \$400 billion invested here.⁸ China and Japan each hold well over \$1 trillion of U.S. Treasury securities,⁹ and Asians and Americans have trillions of dollars invested in each other's stock markets and other private financial instruments. This enormous volume of economic activity across the Pacific translates into jobs for Americans. According to one estimate, roughly 2.8 million American jobs were supported by exports to Asia in 2012.¹⁰ Asia-Pacific companies

investing in the United States directly employed some 900,000 Americans in 2012 with several times that number of jobs supported indirectly by these operations.¹¹

Asians overwhelmingly welcome U.S. economic engagement in the region. First, the United States has a lot to offer in commercial terms: the world's largest market, investment capital, technology, and innovative ideas. Second, as discussed further in the TPP section below, Asian countries may chafe at specific demands but broadly value U.S. leadership in shaping the region's economic rules, which support policy discipline and reform at home. Finally, the American military presence in the Asia-Pacific, while generally welcome as a stabilizing force, is seen as more acceptable if it forms part of broader U.S. participation in regional affairs, particularly in the economic domain.

Economic engagement in the Asia-Pacific also poses challenges. The United States has had large and persistent trade imbalances with a number of major Asian countries, including a \$299 billion deficit with China in 2013.¹² American companies face an array of barriers both at and behind the border in these countries, as well as policies that tilt the playing field toward domestic competitors. In addition, macroeconomic imbalances—including an excess of savings in many Asian economies—produce large financial flows from Asia to the United States that bring near-term benefits but may pose longer-term risks to the U.S. economy. These challenges require active U.S. policy engagement in the region.

U.S. POLICY OBJECTIVES IN ASIA

Against this backdrop of opportunities and challenges, U.S. economic policy toward the Asia-Pacific region over the past several administrations has been driven by three broad objectives. The first is *promoting growth and jobs*. As one of the world's largest and fastest-growing economic areas, the region is an increasingly important source of demand for the U.S. (and global) economy. Stronger demand and growing purchasing power in Asia mean more U.S. exports, which in turn are a vital source of growth and jobs at home. For more than 30 years, the U.S. Treasury Department has worked to promote the macroeconomic objective of strong domestic-demand-led growth in large Asian surplus economies. Japan, then the world's second-largest economy, was the initial target in the 1970s-80s. Attention has broadened in recent years to other large, emerging economies with persistent current-account surpluses, notably China. With U.S. consumers and businesses forced to borrow less and export more in the wake of the 2008-09 financial crisis, Treasury has argued that large surplus economies need to consume and import more, or global growth will suffer. It has persistently criticized Asian governments that impede current-account rebalancing by intervening in foreign-exchange markets to keep their currencies weak. U.S. trade policy has complemented the macroeconomic growth agenda, including through the George W. Bush administration's initial negotiation of the KORUS FTA and the Obama administration's launch of the TPP negotiations. Enforcement of existing trade agreements has also been an increasingly important feature of trade policy in the past two administrations. These efforts have been designed to reduce barriers to U.S. exports, enhance America's own competitiveness, and boost growth and jobs.

The second broad objective of U.S. policy in the Asia-Pacific is *upholding and updating the rules of the international economy*. The open, rules-based system of trade and investment

championed by Washington since World War II has produced broad benefits not only for the United States but also for the rest of the world. But the prevailing rules are increasingly out of step with the realities of today's global economy, which is characterized less by cross-border trade per se than by integrated global value chains and digital connectivity. Asia is at the center of these trends. Over the past decade, the United States has sought to address the gap between rules and reality through the multilateral Doha Development Round negotiations launched by the WTO in 2001. Washington has been seeking to establish new "21st century" disciplines on behind-the-border issues that affect global supply chains, such as intellectual property protection, regulatory transparency, labor and environmental standards, and the investment regime. It has used regional mechanisms like APEC to catalyze and reinforce the multilateral efforts. As discussed further below, with the Doha Round floundering after a decade of negotiations, the Obama administration shifted emphasis toward regional approaches by launching the TPP negotiations in 2010.

The third objective of U.S. economic strategy in the Asia-Pacific is *supporting America's long-term presence in the region*. The United States is a Pacific power by nature, necessity, and design. Some 7,600 miles of the country's shores are lapped by the Pacific Ocean, more than three times the length of the Atlantic seaboard. The United States fought four hot wars¹³ and one cold war in the Asia-Pacific theater between 1898 and 1975. Largely as a legacy of these conflicts, roughly 100,000 American troops remain deployed in the Pacific. The U.S. military presence is a vital source of stability in a region fraught with unresolved historical tensions and potential future conflicts, from North Korea to the South China Sea, and the United States is inextricably linked with the region through extensive trade and investment ties. To support these enduring interests, successive administrations since World War II have worked deliberately to embed the United States in the Asia-Pacific through an array of political, security, and economic arrangements. The network of alliances with Japan, South Korea, Australia, and others, and the troops and ships deployed in the region, are the most visible manifestation of that policy. Binding trade arrangements like the KORUS FTA and TPP can be seen as the economic equivalent of America's security alliances in the region; that is, they enmesh the country in regional affairs and give all Asia-Pacific countries an increased stake in each other's prosperity and security.

LEVELS OF ENGAGEMENT

In support of all three objectives—growth, rulemaking, and long-term presence—recent U.S. administrations have pursued a multilayered approach to regional economic engagement, involving policy initiatives at all levels: bilateral, global, and regional. Bilaterally, administrations since the 1970s have conducted an active economic diplomacy with the major countries of the region. For example, the United States and Japan have established a plethora of bilateral processes to manage trade frictions and to encourage Tokyo to restructure its economy to generate sustainable growth.¹⁴ Many contentious issues discussed in those forums—from restrictions on agricultural market access to allegedly favored treatment of Japanese automakers—remain at the heart of the TPP negotiations today.

As the relative weight of China in policy toward Asia has increased in both economic and political terms, Washington has established similar bilateral arrangements with Beijing. In

addition to the longstanding Joint Commission on Commerce and Trade (JCCT), which seeks to manage trade frictions and expand commercial opportunities between the two countries, the George W. Bush and Obama administrations have established high-level “strategic” dialogues to discuss broader, longer-term economic challenges and opportunities in the bilateral relationship. Along the economic track of what is now known as the Strategic & Economic Dialogue (S&ED), the Obama administration has sought to encourage more balanced growth in China, promote financial liberalization and a more flexible currency regime, and advance negotiations toward a bilateral investment treaty (BIT).

Other major Asian economies have also been the target of U.S. economic diplomacy over the past two administrations. With South Korea, the KORUS FTA has been the organizing principle for bilateral economic relations over the past decade. The Bush administration also negotiated FTAs with Singapore and Australia, and economic dialogues have been held with these and other important regional players such as India and Indonesia.

Engagement *at the global level* is another implicit element of Washington’s Asian economic strategy. The Clinton and George W. Bush administrations worked to bring China into the WTO to more deeply embed it in the global rules-based system. For its part, the Obama administration embraced the G-20 as the premier forum for international economic cooperation in 2009 and has worked within that group to encourage strong, stable, balanced growth in Asia-Pacific economies, which make up roughly half of the G-20’s membership. The United States engages bilaterally and through global institutions with most major countries of the world, but what has made U.S. economic policy toward the Asia-Pacific distinct is that it invests heavily in engagement *at the regional level*.

REI: THE U.S. APPROACH

Presidents since George H.W. Bush have deliberately sought to tap into and shape aspirations in the Asia-Pacific for regional economic integration. (The concept has such currency in regional affairs that it has its own acronym: REI.) For a quarter century, APEC has been the organizing framework for U.S. REI efforts. It was founded in 1989 when Secretary of State James Baker embraced his Australian counterpart’s proposal to create a venue for foreign ministers from across the region to discuss trade and investment liberalization. APEC does not negotiate binding agreements but tries to develop consensus around voluntary efforts to eliminate frictions in the regional trading system. Where member economies are ready to move forward faster toward integration, APEC allows for this through a “pathfinder” approach; TPP is effectively a pathfinder initiative among 12 of APEC’s 21 members. Rather than create different tiers of members based on state of development, APEC offers less-developed members help in building capacity and working toward more open trade.

APEC’s footprint and ambition have grown in a quarter century. From 12 founding members in 1989, it now includes 21 economies from around the Pacific Rim.¹⁵ It was given top-level political imprimatur in 1993 when Clinton invited his counterparts to a summit on Blake Island off Seattle. In 2007 APEC set an ambitious vision for the endpoint of its REI efforts: a Free Trade Area of the Asia-Pacific (FTAAP). While that goal remains a long way off, APEC has done useful pick-and-shovel work in removing operational barriers to trade, and created

valuable networks among officials across the region. It has also served as an incubator for broader liberalization efforts at the regional and global level, e.g. APEC leaders agreed in 2011 to reduce tariffs on environmental goods below 5 percent by 2015, following years of failure at the multilateral level to agree on the definition of an “environmental good.”

Washington’s support for APEC reflects two distinct characteristics of its approach to regional economic integration: a preference for trans-Pacific rather than Asia-centric mechanisms, and an emphasis on comprehensive liberalization and high-standard rulemaking. The trans-Pacific nature of the U.S. approach to REI is, of course, largely driven by geography: the United States is a Pacific but not an Asian country, but higher-level policy considerations also play a part. In promoting APEC, Baker was clearly animated by concerns about East Asian aspirations for community building that would exclude the United States; he later noted that such efforts would “draw a line down the middle of the Pacific.”¹⁶

Strategic considerations in the Western Hemisphere have also played a part in U.S. insistence on including Pacific-facing Latin American countries in regional economic integration efforts. Clinton invited the Mexican president to the Blake Island summit and soon after championed Chile and Peru’s membership in APEC. It is no coincidence that the TPP negotiations include all five APEC economies in the Western Hemisphere: Canada, Chile, Mexico, Peru, and the United States. In addition to strengthening political ties with these countries, Washington wants to pull them into Asia-Pacific REI efforts because of their generally liberal views on trade and support for U.S. positions.

The second distinguishing feature of the U.S. approach to regional economic integration is its emphasis on comprehensive liberalization and high-standard rules of the road. This has inspired Washington’s approach to APEC since the inception but took on new weight with the launch of “21st-century” treaty negotiations with Korea and the TPP partners. The George W. Bush and Obama administrations have insisted on the broadest and deepest possible liberalization, as well as state-of-the-art disciplines on trade and investment-related policies both at and behind the border. By contrast, Asia-only integration initiatives, including bilateral and sub-regional FTAs, have generally covered only border measures and included numerous exceptions to full liberalization. A mix of economic and political considerations lies behind this interest in removing most impediments to trade and investment and imposing tough rules of the road to maximize economic efficiency and growth. Washington believes that the narrower and “shallower” agreements reached to date in Asia have done little to improve efficiency. The Obama administration also worries that low-standard agreements may pose a threat to U.S. competitiveness. As U.S. Trade Representative Michael Froman said in an interview in late 2013, “A race to the bottom is not a race we can win.”¹⁷

Domestic political support for trade agreements in the United States increasingly hinges on not only breaking down barriers to U.S. exports but also advancing other policy objectives such as enhanced labor rights, environmental regulation, and intellectual property protection. These issues are among 147 negotiating objectives listed in trade promotion authority (TPA) legislation tabled in both houses of Congress in January 2014. Without substantial progress on these issues, it is unlikely that a final TPP deal will be approved

by Congress. Thus, the U.S. insistence in the TPP negotiations on a “high-standard, 21st century agreement” reflects the realities of trade politics at home.

The above two characteristics of the U.S. approach to REI explain its cool attitude toward the other major track of trade negotiations in the region, the Regional Comprehensive Economic Partnership (RCEP), which is purposefully Asia-centric, thus far not including any countries from the eastern Pacific. Insofar as it appears focused mainly on tariffs and other border measures and is likely to contain numerous exceptions to full liberalization, it does not pass the U.S. test of being “high standard” and “21st century.”

THE TRANS-PACIFIC PARTNERSHIP: FACTS AND MYTHS

At least for now, Washington has put all its weight behind TPP as the centerpiece of its REI strategy in the Asia-Pacific region and its preferred path to APEC’s vision of an FTAAP. In fact, as discussed below, TPP has moved to the heart of broader Obama administration strategy in the Asia-Pacific, but it did not start out that way. TPP was conceived in the waning days of the George W. Bush administration, when the White House notified Congress of its intention to negotiate a trade agreement with four small, open APEC economies: Brunei, Chile, New Zealand, and Singapore. Known as the Pacific-4 (P-4), these countries had already reached their own FTA a few years earlier. In keeping with its search for “coalitions of the willing,” the administration decided to dock onto this group of pro-trade countries as the next step in its regional trade policy following initial completion of the KORUS FTA in 2007.

After roughly a year of consideration, the Obama administration decided to embrace TPP in late 2009 as an element – though not yet a dominant one – of its regional trade strategy alongside a renegotiated KORUS. Australia, Peru, and Vietnam also joined the partnership, and the eight original countries launched formal negotiations in March 2010. Malaysia joined the talks later that year, Canada and Mexico came aboard in 2012, and Japan came to the table in the summer of 2013, bringing the number of participants to 12.

As of this writing, TPP negotiators have held over 20 rounds of talks but have been unable to reach final agreement. Although most of the agreement’s 29 chapters had reportedly been closed by the middle of 2013, significant differences among the parties remained on a number of contentious rulemaking issues, including intellectual property protection, state-owned enterprise disciplines, and environmental standards. In addition, substantial gaps remained on the market-access provisions, notably those revolving around Japan’s restrictions on access to its agricultural market. Despite a renewed mandate at the October 2013 APEC Leaders’ Meeting in Bali to complete the negotiations by the end of the year, TPP trade ministers were unable to reach agreement at their December meeting in Singapore. However, by all accounts there remained a shared sense of determination in the room to wrap up the talks as soon as possible, and Obama’s planned trip to Asia in April presented an early action-forcing event that was expected to put pressure on negotiators to reach a final deal.

As this author has argued elsewhere, a number of myths cloud regional perceptions of TPP.¹⁸ One is that the negotiations are “splitting Asia,” since not all Asian economies are eligible to join, while those that are eligible must “choose” between joining TPP, viewed as led by the United States, and RCEP, the alternative track supposedly preferred by China. On the first point, as an initiative housed within APEC, TPP is an approved pathway to FTAAP and is in principle open to any APEC economy willing to strive for high-standard rules. Indeed, several APEC members—including Korea, the Philippines, and Taiwan—have publicly expressed interest in joining TPP, and even China quietly began studying the possibility after Japan joined in the summer of 2013. Conceptually there is no reason that even non-APEC economies like India and Myanmar should forever be excluded from TPP. The Obama administration has been preparing the ground for such an expansion. In 2012, it launched an Enhanced Economic Engagement (E-3) initiative with ASEAN. By building capacity on TPP-related disciplines in smaller ASEAN members—notably the three non-APEC members, Myanmar, Cambodia, and Laos—, E-3 is designed to bring all 10 members of the group into a high-standard trade arrangement with the United States.

As for having to “choose” between TPP and RCEP, the seven countries participating in both negotiations clearly view the two approaches as compatible. Moreover, TPP and RCEP could one day converge in a region-wide agreement, or at least become interoperable, with potential annual gains to world income as high as \$2.4 trillion by 2025.¹⁹ In a November 2013 report, CSIS proposed that China, as APEC host in 2014, expand the forum’s existing work on supply-chain connectivity in an effort to begin the process of stitching together the quilt of trade agreements in the region and making them interoperable.²⁰

Another myth that until recently was popular in Beijing is that TPP is part of an effort by Washington to “contain” China. Yet no Asia-Pacific country—including the United States—wants to exclude China from regional integration; on the contrary, all want to deepen their economic ties with the world’s second-largest economy. To be sure, one goal of TPP is to create a level playing field that, among other things, will allow other countries to better compete with China; however, this is a far cry from “containment.”

In the first half of 2013, elite opinion in Beijing began to shift from rejecting TPP outright to seeking a better understanding of the negotiations. There were signs—such as Beijing’s willingness to negotiate a comprehensive BIT on the terms proposed by Washington, as well as the launch of a free trade zone in Shanghai in late September—that China’s leadership was preparing the ground for eventual membership in a high-standard regional agreement, if not TPP itself. This helps to dispel a third myth, i.e., that the high standards Washington is espousing in TPP are too ambitious for Asia. All participants have made clear that they believe there are substantial welfare gains to be had from a high-standard agreement that opens up new market opportunities and helps each country address structural impediments in its own economy. Vietnam, for example, is often thought to be the main obstacle to agreement on TPP’s state-owned-enterprise (SOE) chapter; yet Hanoi clearly recognizes that its SOEs need discipline if the country is going to fully enjoy the benefits of a market-based economy.²¹ China, too, has made market discipline of its SOEs an organizing principle of economic reforms announced in the fall of 2013. Its more positive attitude toward TPP likely reflects a calculated desire to use external pressure to drive domestic reform, as it did with WTO accession over a decade ago.

TPP AND THE “ASIA REBALANCE”

TPP exemplifies both key characteristics of U.S. REI strategy. It is trans-Pacific in nature, incorporating both Asian and Western Hemisphere countries, and it is explicitly designed to produce, as Obama said in announcing his embrace of TPP in late 2009, “the high standards worthy of a 21st-century trade agreement.”²² TPP is also consistent with the three enduring objectives of U.S. economic policy toward the Asia-Pacific discussed earlier. Its explicit aim is to stimulate American growth and jobs. According to the Office of the U.S. Trade Representative, “Through this agreement, the Obama Administration is seeking to boost U.S. economic growth and support the creation and retention of high-quality American jobs by increasing exports in a region that includes some of the world’s most robust economies and that represents more than 40 percent of global trade.”²³ The welfare gains to the United States and the world from a completed TPP agreement could be substantial. According to one estimate, agreement among the 12 current members could generate annual income gains for the United States of some \$77 billion by 2025, and for the world as a whole of \$223 billion.²⁴ These gains would be increased several-fold if TPP ultimately led to a broader regional free trade area.

TPP is also aimed at strengthening the rules of the regional trading system. Establishing new disciplines on an array of behind-the-border measures that impede trade and investment such as excessive or non-transparent regulation, preferences for SOEs, and inadequate intellectual property protection, Washington hopes through TPP to ensure open markets in the region and a level competitive playing field. An unstated objective is to do this on U.S. terms before the lure of China’s large market tilts the rulemaking table in Beijing’s favor. Moreover, the administration clearly hopes that, if successful, TPP will become the driver and *de facto* template for a new global system of rules on trade and investment. Having failed to achieve this objective via the first-best route of multilateral negotiations under the Doha Round, it is trying to find another path to the multilateral summit by way of TPP and a similar high-standard agreement under negotiation with the EU, the Transatlantic Trade and Investment Partnership (TTIP).

Arguably the most important objective of TPP is to embed the United States more deeply in regional affairs. Indeed, it is not an exaggeration to say that TPP has become the *sine qua non* of the Obama administration’s strategy of “rebalancing” (or “pivoting”) to the Asia-Pacific. From its earliest days in 2009, it has put the Asia-Pacific at the center of its foreign policy. This was signaled at a symbolic level when Hillary Clinton made her first overseas trip to the region as secretary of state, and when President Obama received the Japanese prime minister as the first foreign visitor to the Oval Office. Early substantive decisions then gave weight to the policy, with the announcement in 2010 that the president would join a second regional leaders’ forum alongside APEC, the East Asia Summit, and with the launch of TPP.

It was not until the fall of 2011 that the administration first gave voice to the rebalance as the defining feature of its policy and posture in the Asia-Pacific. Hillary Clinton’s article in *Foreign Policy* magazine said that the United States “stands at a pivot point” after a decade fighting two wars in Iraq and Afghanistan; going forward Washington would “lock in a substantially increased investment—diplomatic, economic, strategic, and otherwise—in the region.”²⁵ She identified six dimensions of what came to be known as the rebalance:

strengthening alliances; deepening relationships with emerging powers, including China; engaging with regional institutions; expanding trade and investment; forging a broad-based military presence; and advancing democracy and human rights.

Insofar as these were longstanding elements of U.S. strategy in the region spanning several administrations, the rebalance was nothing radically new. But the packaging by the Obama administration clearly represented a significant raising of the stakes. To make good on that rhetoric, the administration must put new, substantive meat on the bones of the rebalance and ensure lasting follow-through. This is where the economic elements emphasized by Clinton in her *Foreign Policy* article come into play. America's security role in the region is enduring, but in light of both budget realities and strategic force-posture considerations, a substantially increased U.S. military footprint in the region is unlikely. Diplomatic endeavors, meanwhile, come and go, but economic engagement holds the promise of introducing a new, substantive, and enduring element to the overall rebalancing strategy. And TPP is the sharp end of the spear of U.S. economic engagement in the region.

Thus, the stakes involved in TPP could not be higher for the Obama White House. Conclusion of a deal is the sine qua non of success not only for the administration's regional economic policy but for the entire Asia rebalancing strategy. In addition to its economic benefits, a successful agreement would anchor the United States more firmly in the Asia-Pacific and bolster American leadership there. Without TPP, the rebalance would contain little of substance that is new and would likely be perceived in the region as driven primarily by military considerations.

CONCLUSION

America's interests in the Asia-Pacific are broad, deep, and enduring. None is more important than the U.S. economic stake in the region. As Hillary Clinton explained in laying out the rationale for the rebalancing strategy, "Harnessing Asia's growth and dynamism is central to American economic and strategic interests and a key priority for President Obama. Open markets in Asia provide the United States with unprecedented opportunities for investment, trade, and access to cutting-edge technology. Our economic recovery at home will depend on exports and the ability of American firms to tap into the vast and growing consumer base of Asia."²⁶

A successful economic strategy in the Asia-Pacific is essential to sustaining American growth and jobs into the 21st century. It is also central to Washington's efforts to remain a champion of the global rules-based order and underpins America's long-term presence in the Asia-Pacific, which in turn contributes importantly to the region's security and prosperity. For all these reasons, the United States is likely to remain an active—even impatient—participant in regional economic integration efforts in the vital Asia-Pacific region.

ENDNOTES

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