

A REPORT OF
THE CSIS ASIA TEAM

Crafting Asia Economic Strategy in 2013

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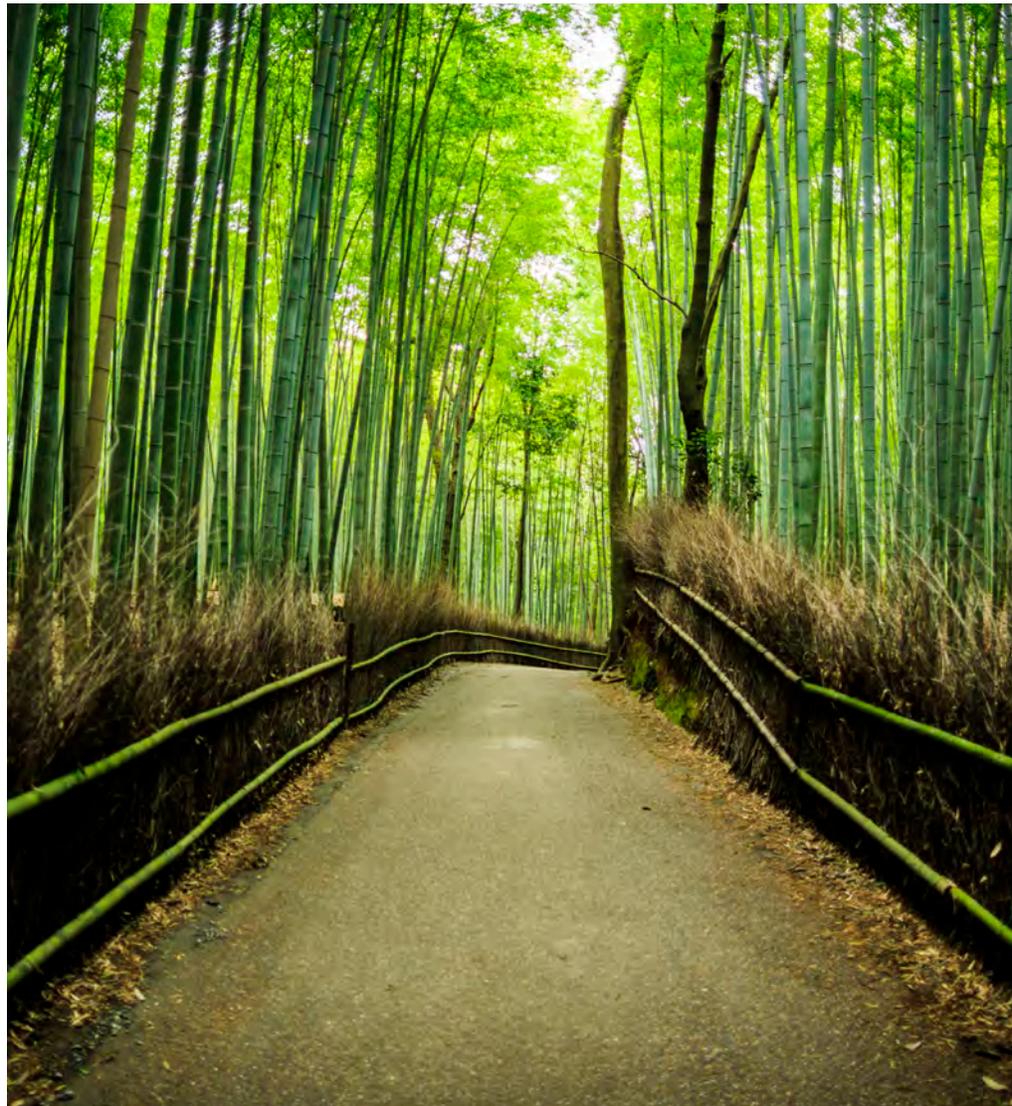
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50
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CHARTING
OUR FUTURE

January 2013

CSIS

CENTER FOR STRATEGIC &
INTERNATIONAL STUDIES

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CONTENTS

Acknowledgments	IV
1. Introduction and Overview	1
2. China	5
3. India	9
4. Japan	12
5. Korea	15
6. ASEAN	18
Appendix. Crafting U.S. Economic Strategy toward Asia: Lessons Learned from 30 Years of Experience	21
About the Authors	22



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*Observer

1

INTRODUCTION & OVERVIEW

By traveling to Southeast Asia immediately following his reelection in November 2012, President Barack Obama made clear that “strategic rebalancing” to the Asia-Pacific region will remain a central focus of his second-term foreign policy. In a speech at CSIS previewing the trip (<http://csis.org/event/statesmens-forum-honorable-thomas-e-donilon-us-national-security-advisor>), National Security Adviser Thomas Donilon said, “The United States is a Pacific power whose interests are inextricably linked with Asia’s economic security and political order. America’s success in the twenty-first century is tied to the success of Asia.”

Economics is critical to Asia-Pacific affairs and to U.S. interests there. The region accounts for roughly half of global GDP and trade and includes some of the world’s fast-growing economies. American growth and jobs increasingly depend on trade and investment with Asia, and many of the rules of the global economic system over the coming decades will be shaped there. Effective U.S. economic policies in the region are thus an essential complement to other dimensions of the rebalancing strategy, reinforcing and being reinforced by the military, diplomatic, and political elements.

The Asia-Pacific region poses a number of unique strategic challenges for U.S. economic policymakers: demonstrating to Asian partners, in a resource-constrained environment, that the United States is committed to remaining an active participant in regional affairs; responding to China’s rise and its growing use of economic power to shape international norms; encouraging a shift among major Asian economies to more sustainable growth models; enforcing existing rules of the global trading system while winning support from the world’s largest trading area for new, high-standard rules for the twenty-first century.

In an effort to provide practical assistance to U.S. policymakers grappling with these challenges, a CSIS task force set up in 2008 released a report (<http://csis.org/publication/crafting-us-economic-strategy-toward-asia>) offering 14 “lessons learned” from over 30 years of U.S. economic policy engagement with Asia. A list of those lessons is attached in the Appendix. As another presidential election approached in 2012, CSIS reviewed the previous list with a similar group of experienced experts, who agreed that most of the lessons remain valid today and offered their own simple list of “do’s” and “don’ts” (see below) for administration policymakers as they pursue economic initiatives with major Asian countries.

With the help of regional experts who participated in a series of roundtable discussions in the fall of 2012, CSIS also prepared short papers on a number of key economies of the Asia region: China, India, Japan, Korea, and the Association of Southeast Asian Nations (ASEAN). These papers, which follow, are intended to offer practical advice to Obama administration policymakers as they set a strategic course for economic relations with these important countries over the next four years.

We recognize that this report does not cover the entire Asia-Pacific region, the result of a conscious decision to keep the project manageable. However, a number of other significant economies in the region merit strategic attention from administration policymakers. In particular, Taiwan is the 6th-largest economy in Asia and the 10th-largest trading partner of the United States; the administration should build on the recent promising progress on the longstanding beef dispute by deepening economic engagement with Taiwan under the bilateral Trade and Investment Framework Agreement (TIFA). Australia and New Zealand are also vital economic partners of the United States, including in the Trans-Pacific Partnership (TPP) trade negotiations; over the next four years, the administration should enhance regional economic cooperation with these two countries, including through closer coordination on trade and finance issues in the East Asia Summit (EAS).

Key Elements of Asia Economic Strategy

As mentioned, economic policy is a core element of strategic rebalancing to Asia. Job 1 is to get the U.S. house in order; a strong economy is the underpinning of American power in the region. The task for international economic policymakers will be to engage energetically with key Asian countries at all levels—global, regional, and bilateral—in pursuit of American growth and jobs in the near term, while building the foundations for longer-term prosperity by encouraging better macroeconomic, trade, financial, and other relevant policies in the region.

- *Globally*, the United States should continue to play an active leadership role in international economic institutions, including the Group of 20 (G-20), International Monetary Fund (IMF), and multilateral development banks, in which Asia-Pacific countries are already key players and will have an increasing “share of voice” in the years to come. While all face challenges, these institutions will continue to play a critical role in shaping global rules and norms of economic behavior, and the United States retains an important position of influence in each.
- *Regionally*, the Obama administration should seek an early conclusion to the TPP negotiations, which involve 10 U.S. partners in the Asia-Pacific region. With global trade negotiations effectively moribund, TPP is the principal forum for establishing new, twenty-first century rules for trade and investment. At the same time, as Asian countries move forward with regional arrangements that do not include the United States, such as the Regional Comprehensive Economic Partnership (RCEP) launched in November 2012, the administration should find creative ways to deepen its engagement in other ASEAN-centered trade and finance initiatives. And the United States should continue to play a leadership role the Asia-Pacific Economic Cooperation (APEC) forum, which has a solid track record of encouraging practical progress toward regional trade and investment liberalization. All of these efforts are complementary and should be pursued in tandem.
- *Bilaterally*, the effort required will vary from country to country, but China and India deserve particular attention given their size and complexity; high-level economic dialogue with these countries should be enhanced and intensified. The administration should try to draw Japan, Korea, and other key Asian partners into the TPP negotiations if they are prepared to accept the same level of commitments as the current participants. Specific recommendations for each of the five economies covered here are offered in the sections that follow.

All of this will require resources. For the United States to have an effective strategy in Asia, and to be taken seriously by partners there, it must have sufficient talent and resources for the job. At present, U.S. government personnel and funding devoted to Asia policy, especially in the economic arena, are insufficient to the size, challenges, and opportunities of the region. In particular, the State Department and other agencies traditionally focused on political and security issues need more senior officials versed in Asian economics.

Procedural Lessons Learned

The CSIS group of experts assembled in 2012 broadly endorses the list of lessons learned from 2008 (see Appendix) and recommends it to Obama administration economic policymakers. In addition, the group went through a similar but more streamlined exercise in 2012 and came up with a list of practical “do’s and don’ts” to help guide the new policy team as they pursue specific economic initiatives with major Asian countries:

Five Things to Do:

1. *Do your homework before starting.* Study the detailed structural barriers to U.S. exports and investments, including specific policy impediments and administrative barriers. Take time before announcing any approaches. Use analysis and policy recommendations sourced in the target country whenever possible (“Your own institute of X states that Y policy causes problems”).
2. *Prioritize your goals.* Under White House leadership, order your goals for the region and each significant country. Rank the list by both likelihood of achieving results and effect on the U.S. economic climate. Make sure the interagency team supports the priorities.
3. *Work with the career staff.* Institutional knowledge is invaluable to negotiating success and goal determination. Career staff should be included at the beginning of the exercise and listened to. Most of the issues are not new and have been studied before.
4. *Quietly meet with counterparts from the targeted nation.* Meet out of the glare of publicity and hold intense discussions on the agenda for the bilateral framework. Secure agreement on the process, agenda, and time frame. Remember the other side needs to come out of the negotiations with something, too; seek to understand and address their core concerns.
5. *Design a consistent public relations approach.* Develop and maintain a core set of messages that are delivered by a limited number of designated officials to the media (both U.S. and foreign) on an ongoing basis. Provide background on the issues and benefits to both countries of successful talks or negotiations.

Five Things NOT To Do:

1. *Don't rush*, either to start the negotiations or during the negotiating itself. Americans have a well-deserved reputation for impatience, and other countries, particularly in Asia, have done well simply by waiting us out. Don't set an artificial deadline for the negotiations, or create a domestic imperative to reach agreement; the other side always knows when reaching an agreement becomes more important to Washington than the contents of the agreement.
2. *Don't overreach in the first round*. Second phases of negotiations provide another chance. Too many demands make it easy for the other country to reject all.
3. *Don't publicly attack the other side*. Relationships count over time. Never embarrass foreign officials. Attack problems, not people. Use positive analysis to win points, not negative comments—especially in public.
4. *Don't allow the interagency team to be split*. The other side will try to find areas of tension or disagreement within the U.S. team; hold together. Be watchful for exploitable differences on the other side; don't assume they are better at interagency coordination than we are.
5. *Don't crow after negotiations are finished*. In all likelihood, these topics will be revisited in a year or two. Don't leave ill will behind.

The opportunities and challenges of U.S. economic engagement with Asia are substantial. It will be important for the Obama administration in its second term to continue to pursue well-considered strategies for managing economic relations with key Asian countries that maximize U.S. growth, exports, and jobs, while reinforcing the broader goals of strategic rebalancing. The collection of ideas here is designed to offer international economic policymakers some practical advice, based on hard-won experience, as they launch these efforts early in 2013.

2

CHINA

China's rapid emergence over the past decade as the world's second-largest economy has presented the United States with a daunting array of economic opportunities and challenges. On one hand, the net benefits of ties with a fast-growing \$7 trillion economy have been substantial. U.S. exports to China grew over 500 percent between 2000 and 2011, while American consumers have benefitted from imports of relatively inexpensive Chinese products. China has become an important link in the global supply chain for U.S. companies, while growing Chinese direct investment in the United States has helped create American jobs. And China's new wealth can be brought to bear in helping the United States tackle global economic challenges, as demonstrated by the two countries' cooperation in the G-20 in response to the 2008–2009 financial crisis.

On the other hand, China's rise presents formidable challenges for U.S. economic policy, ranging from macroeconomic imbalances that threaten growth to an expanding list of serious trade and investment barriers. There are widespread perceptions in the United States that China is not "playing by the rules" and is thereby undermining U.S. economic strength—or even, in some areas, national security. American companies are no longer the pillar of support for the U.S.-China economic relationship that they were a decade ago: while still highly dependent on the Chinese market, they are increasingly frustrated by a plethora of on-the-ground impediments and a playing field tilted in favor of domestic—notably state-owned—competitors. Meanwhile, the United States and China are competing for economic leadership in the Asia-Pacific region, championing different models of regional integration: the TPP negotiations pursued by Washington; "ASEAN-plus" and other arrangements advanced by Beijing that do not include the United States.

These opportunities and challenges arise at a time of political and economic change in both countries. Beijing's 18th Party Congress was marred by intense political wrangling and the fallout from a number of high-profile scandals. Incoming officials will be eager to establish credibility early on, but major headwinds are weighing on the country's growth outlook. Policies to boost short-term demand could complicate and delay a needed structural shift away from investment and exports toward private consumption. Beijing has made this shift a centerpiece of its latest five-year plan, and a more balanced growth model in China is clearly in the U.S. interest. However, obstacles to reform are significant, including likely resistance from powerful state-owned enterprises, local governments, and other vested interests, as well as endemic corruption.

Against this complex and fluid backdrop, managing economic relations with China over the next four years is likely to be one of the most challenging elements of international economic policymaking for the Obama administration in its second term. It will be important, early in 2013, to review and recalibrate the existing strategy and to reach out to the new leadership in Beijing to agree on a *modus operandi*.

Existing Channels of Engagement with China

Every U.S. president since Nixon has pursued a strategy of engaging China economically in an effort to draw the country into the global rules-based system and encourage domestic reform in China. For nearly two decades, the primary focus of that strategy was Chinese accession to the World Trade Organization (WTO), which was achieved in late 2001. The George W. Bush and Barack Obama administrations have worked vigorously on implementation of China's WTO commitments in the years since, while eliciting cooperation and managing competition in other areas of the economic relationship. The G-20 and APEC have filled some of the role played by the WTO as a locus for U.S.-China cooperation, but neither has had the same impact in managing many of the contentious aspects of bilateral economic ties, let alone in spurring domestic reform in China.

The past two administrations have relied on two principal forums for bilateral engagement with Chinese economic policymakers: the Joint Commission on Commerce and Trade (JCCT) and the Strategic & Economic Dialogue (S&ED). Founded in 1983, the JCCT was elevated by the Bush administration in 2003 to a semiannual meeting led by the secretary of commerce and U.S. trade representative and a vice premier on the Chinese side. Under Secretary Henry Paulson, the Treasury Department established the Strategic Economic Dialogue in 2006 to bring together top policymakers across both governments twice a year to discuss longer-term dimensions of the U.S.-China economic relationship. This was subsequently transformed into the annual S&ED in the Obama administration by merging the Treasury-led process with an elevated "strategic" track led by the State Department.

High-level dialogue between Washington and Beijing through formal and informal channels is essential to trouble-shooting contentious issues in the relationship and to building habits of engagement across the two governments. However, with half a dozen cabinet officers accompanied by sizeable retinues traveling to the other capital each year, ceremony has come to overwhelm substance in the S&ED over time. Moreover, pressure for short-term "deliverables" at each event has detracted from the dialogue's objective of fostering long-term strategic cooperation. And the merger of the Treasury- and State-led tracks without strong White House oversight has not produced the desired synergies and has arguably detracted from the efforts of individual agencies working on critical elements of the relationship.

Recommendations for China Policy

In its second term, the Obama administration should continue its strategy of engaging with China bilaterally, regionally, and globally, using all available tools—dialogue, negotiation, remedies, litigation, etc.—to elicit Chinese economic cooperation where feasible and to manage competition where necessary. The political transition in both countries offers an opportunity to review and recalibrate elements of the strategy. Specific recommendations include:

- *Modify the existing framework for high-level bilateral dialogue:* As noted above, the S&ED has become routinized and unwieldy over time. The administration should propose to the new leadership in Beijing a modified framework for bilateral dialogue—still called "the S&ED"—that allows for more substantive interaction. Rather than a single annual gathering of multiple cabinet officers, the secretaries of state and treasury should meet separately with appropriate Chinese counterparts at least once a year to discuss both long-term strategic issues and more

immediate challenges. The State-led dialogue would be the principal forum for discussion of broad political and security issues; the Treasury-led process for strategic economic issues. The JCCT, led by Commerce and USTR, should be retained as a useful forum to address ongoing trade and investment issues. Precise interlocutors for all of these meetings should be determined after the government reshuffle in Beijing in the spring of 2013, but they should be at an appropriate level of seniority in the Chinese system (i.e., State Council level). To ensure high-level political support for the cabinet-level interactions, the vice president should meet annually with the new Chinese premier; the agenda for those meetings should include extended, frank, and strategic discussion of economic issues. In addition, more frequent opportunities should be sought for quiet, informal dialogue between senior officials in the two countries, such as the meetings between the U.S. national security adviser and director of the National Economic Council and their respective Chinese counterparts held in the first term of the Obama administration; the objective of these meetings—ideally held at least twice a year—would be to enhance trust, reduce scope for misunderstanding, anticipate tensions, and seek common ground on both opportunities and challenges in the U.S.-China relationship, including economic ones.

- *Pursue both cooperative and competitive elements of a regional integration strategy:* The U.S. strategy of pursuing a high-standard, twenty-first century trade agreement through the TPP negotiations is sound and should continue. Chinese membership should remain a long-term objective, to further integrate China into the rules-based system at a high standard; this objective should be more clearly communicated to the Chinese side. At the same time, the administration should find other ways to engage with China, ASEAN, and other players on regional trade and financial integration, including via the East Asia Summit. And the United States should continue to elicit Chinese cooperation on regional trade and investment liberalization through APEC.
- *Deepen engagement with China in the G-20:* The early cooperation between the United States and China in the G-20 in 2008–2009 was beneficial both for the global economy and the bilateral relationship. While there has been greater divergence at more recent summits, the underlying interests of the two sides—in strong, balanced growth; robust trade; sound financial regulation; shared responsibility for global governance; etc.—are not so far apart in substance, suggesting scope for renewed cooperation. In any event, the two sides should spend more time consulting on G-20 positions before sherpa, finance official, and leader meetings.
- *Increase multilateral pressure on China to adhere to higher standards:* Washington should step up its efforts to enlist the support of allies in Europe, Japan, and elsewhere in holding Beijing to international norms and rules, and in seeking its constructive contributions to global economic governance. There are various existing and prospective channels through which these efforts could be pursued, including the U.S.-EU High-Level Working Group on Jobs and Growth, a possible U.S.-EU free trade agreement, and the TPP. The goal should be to seek a convergence of worldview with China on key issues, including trade practices, intellectual property rights, access to information, currency policy, and climate change.
- *Enhance communication with China and at home:* U.S. intentions and actions on a range of economic issues—from TPP to inward investment policy—have been widely misinterpreted in China. The administration should strive to communicate clearly to Beijing its broad strategies and specific actions that support them. Where there are differences on trade or other issues, the

administration should use frank language behind closed doors but avoid inflammatory rhetoric that causes China to lose face or to be less willing to cooperate. At home, the administration should work to explain to Congress and American citizens both the benefits and costs of economic engagement with China, while offering credible plans to maximize the opportunities and manage the challenges.

3

INDIA

Relations between the United States and India have evolved rapidly over the past 15 years through Democratic and Republican administrations to a point where President Obama has declared the U.S.-India relationship “a defining partnership of the 21st century.” As the world’s second-most populous country, one of its largest economies, and its leading arms importer, India will increasingly be looked upon as a regional economic anchor and provider of security in the broader Indian Ocean region. Deepening economic relations between the United States and India will provide important ballast to the U.S. “rebalancing” strategy toward Asia and yield substantial growth opportunities for India.

The U.S.-India economic and trade relationship is one of the key foundational elements driving the U.S.-India Strategic Partnership. Total bilateral trade reached \$86 billion in 2011 and is estimated to have exceeded \$100 billion in 2012. However, as India increasingly diversifies its portfolio of trading partners, the U.S. share of global trade and investment with India is falling. Other nations are pushing ahead on their economic engagement with India. Today, India has investment agreements with upwards of 80 countries, including all major European nations, ASEAN, Japan, and South Korea. A comprehensive free trade agreement with Canada could be concluded in 2013. Over the next four years, the United States should step up its efforts to solidify its economic partnership with India, lest it cede ground to India’s other trading partners and fall short of realizing the full potential of a truly “defining partnership.”

U.S. Economic Policy Engagement with India

Bipartisan support for enhanced economic engagement with India has been the engine of growth in the U.S.-India strategic partnership. Following President Bill Clinton’s landmark visit to India in 2000 and the establishment of a U.S.-India Economic Dialogue, the Bush administration accelerated the diplomatic momentum by taking the relationship to an even higher level. In July 2005, President George W. Bush and Prime Minister Manmohan Singh revitalized and realigned the Economic Dialogue to incorporate a number of existing and new bilateral dialogues, including ones on trade, finance, environment, energy, and high technology, as well as a Track-1.5 “CEO Forum.” All of this helped to provide the strategic economic undergirding for broader areas of cooperation, including the signing of a 10-year defense framework agreement in June 2005 and a landmark civilian-nuclear agreement in 2008.

The Obama administration has carried the agenda forward through a U.S.-India Strategic Dialogue chaired by Secretary of State Hillary Clinton and External Affairs Minister S.M. Krishna. The purpose of the annual Strategic Dialogue is to assess progress, provide policy guidance, and propose new areas of cooperation across the breadth of the U.S.-India relationship. While the United States and India have some 20 other ongoing formal dialogues and working groups con-

necting various departments and agencies, the Strategic Dialogue has become a key platform for focusing attention on ways to increase bilateral trade and investment.

Along with these positive developments, however, there have also been a number of “speed bumps” in bilateral economic engagement. Both countries have been affected by a significant slowdown in economic growth. In India, the growth forecast has been lowered to a projected 6.0 percent in the current fiscal year from a high of 9.8 percent in 2007. Meanwhile, the private sectors in the United States and India have been unnerved by an erratic economic reform agenda in New Delhi, although recent signs of progress have emerged. Prime Minister Singh’s Congress-led government in September 2012 unveiled a set of highly anticipated economic reforms, including liberalization of foreign direct investment (FDI) limits in various sectors, most prominently multi-brand retail. Fully implementing and then going beyond the announced reforms, while necessary, will be politically difficult. State and national elections loom large—the latter to be held no later than 2014—as defections of political allies and a series of corruption scandals have shaken the Congress-led coalition government.

Some commentators opine that the U.S.-India bilateral relationship is “adrift” or was “oversold,” pointing to the absence of any new, high-profile agreements. Moreover, there has been disappointment in realizing the economic potential of the 2008 civilian-nuclear agreement, which remains stalled. However, such rhetoric fails to recognize the benefits derived from the growing “routinization” of the relationship. The U.S.-India strategic partnership is moving toward a state of normalcy, as the two countries’ political establishments and bureaucracies become more accustomed to working with each other. That said, there is a need for better coordination and collaboration on practical matters of mutual, long-term economic interest.

Recommendations for India Policy

- *Establish a “New Framework for U.S.-India Economic Cooperation”:* The Obama administration should reignite U.S.-India economic and trade relations by establishing an ambitious, 10-year “New Framework for U.S.-India Economic Cooperation.” Such a framework would serve as the organizing principle for bilateral discussions and negotiations at the highest levels. This framework should be issued as a joint statement at the next Strategic Dialogue and should set out a detailed agenda for the two countries to pursue, starting with a high-standard Bilateral Investment Treaty (BIT); prioritizing the Infrastructure Debt Fund (IDF); moving ahead with individual sectoral agreements and regulatory reform; improving the movement of high-skill professionals; and potentially culminating—over a 10-year horizon or beyond—in a full-fledged free trade agreement. In addition, as the U.S.-India Business Council (USIBC) and the Confederation of Indian Industries (CII) have proposed, a goal of achieving \$500 billion in annual bilateral trade by 2020 should be established.
- *Restart the Trade Policy Forum (TPF) and establish a Tax Forum:* The TPF has been the premier venue for discussing multilateral trade issues and expanding bilateral economic engagement. However, it has been postponed indefinitely. While the TPF may need restructuring, it is a critical platform for advancing the relationship and should not be permitted to languish. A focused tax dialogue should also be established between the Treasury Department and Finance Ministry—as was hinted during Secretary Timothy Geithner’s visit in the fall of 2012—to look at domestic, bilateral, and multilateral tax issues.

- *Reinvigorate the CEO Forum and initiate an SME Forum:* The CEO Forum gives business leaders from both countries a platform to provide input on trade and investment policy initiatives. However, the 2012 meeting was postponed and is yet to be rescheduled. In addition to setting a date for the next CEO Forum, a complementary Small and Medium-sized Enterprise (SME) Forum should be established.
- *Look to U.S. and Indian states as “laboratories” for progress and reform:* Several of India’s more progressive and prosperous states are emerging as power centers in their own right, pursuing dynamic economic and policy agendas. The State Department has recognized the importance of this development by focusing some of its efforts to promote greater state-to-state interaction and investment. U.S. officials and trade delegations should regularize visits to Indian states and state leaders to deepen these relationships and find incremental “wins” that benefit both countries.
- *Actively engage the U.S. Congress and Indian Parliament (including the opposition):* Bipartisan support for the U.S.-India relationship in the U.S. Congress has facilitated the growth of the partnership. Likewise, in India, both the Congress-led and Bharatiya Janata Party (BJP) governments have championed the bilateral relationship. Bold economic initiatives will benefit from the buy-in and support of legislators in both countries. Continued engagement with government and opposition parties at both the national and regional levels will only strengthen ties.

Much remains to be done to unlock the full potential of the economic dimensions of the U.S.-India relationship. At the same time, patience and realism are in order when engaging in economic discussions with India. It takes time, often many years, to change policies in large, diverse democracies. No bilateral economic dialogue between the United States and India can have a short-term perspective or be pursued with a transactional mindset. But it can capitalize on breakthroughs and build momentum in order to fuel the dialogue needed for continued progress. Pursuing a “New Framework for U.S.-India Economic Cooperation” will make an important contribution to this joint endeavor.

4

JAPAN

Japan remains an indispensable partner of the United States. The country faces a number of serious challenges, including economic stagnation, political uncertainty, an energy emergency prompted by the March 2011 earthquake and tsunami, and an unfolding demographic crisis. Yet Japan remains critical to U.S. regional and global strategy, not only in the diplomatic and security realms but also in economics; among other things, it remains an important source of global demand and is a valuable ally in addressing the challenges of China's rise. The United States has a vital interest in a Japan with a healthy, vibrant economy, enabling it to play an active role in Asia's economic and political developments. International economic policymakers in Washington will be naturally drawn to other, more dynamic parts of the region, but getting Japan right will be key to a successful Asia—and global—economic strategy.

It is easy to forget that Japan remains the world's third-largest economy, with a GDP of nearly \$6 trillion. U.S.-Japan trade is close to \$300 billion; Japan is the second-largest source of direct investment into the United States (after the United Kingdom); and it holds over \$1 trillion of U.S. Treasury securities. Japan also has a formidable global role that still dwarfs that of other Asian powers: it has the largest voting weight after the United States in the International Monetary Fund, and it is the only Asian country in both the G-8 and G-20. As the largest foreign assistance donor to Southeast Asia with substantial commercial investments throughout the region, it is also a regional powerhouse. And despite a legacy of bitter trade disputes between the two countries, Japan today is aligned with the United States on most of the rules and norms of the international economic system, including many of the high-standard, twenty-first century rules Washington is advancing in the TPP trade negotiations.

For the better part of two decades, Japan has been unable to achieve domestic consensus on a new model of sustained growth that would secure its own prosperity, as well as its role in the world. This stems from a number of factors, including deeply embedded structural impediments, a chronic lack of political direction, and even bad luck—among other impacts, the triple disasters of March 11, 2011, dealt a body blow to an incipient economic recovery. The stalwart response of the Japanese people to those events was inspiring, but by prompting the shutdown of virtually all of the country's nuclear reactors, the disasters knocked out 30 percent of Japan's electricity-generating capacity and forced the country to enhance its already world-leading energy efficiency and to seek new sources of supply from abroad.

Tokyo missed a prime opportunity to join the first round of TPP negotiations in 2010–2011, and there is little immediate prospect that either of the leading political parties will be willing or able to revive the domestic debate about joining TPP. However, eventual Japanese membership in a high-standard TPP would be strongly in the interest of both countries. Movement toward TPP membership would help prompt essential structural reforms in Japan's labor markets, agriculture sector, and other elements of the economy that impede higher productivity and growth. And hav-

ing Japan in TPP would substantially increase the net economic gains to the United States from the agreement and give Washington an important ally as it tries to extend the new high-standard rules being sought in TPP to other important economies in the region, notably China.

U.S. Economic Policy Engagement with Japan

For over 30 years, U.S. administrations of both parties have managed bilateral economic relations with Japan under a succession of frameworks with more or less memorable acronyms, from the MOSS (Market-Oriented Sector-Selective) talks launched in the Reagan years, through SII (the Structural Impediments Initiative) under George H.W. Bush, to the EHI (Economic Harmonization Initiative) announced by President Barack Obama and Prime Minister Naoto Kan in November 2010. These forums have had mixed results, whether in opening the Japanese market—the focus of earlier efforts—or in coordinating economic policies bilaterally and in Asia, as the EHI aims to do.

The United States and Japan have also had a history of productive engagement in regional and global economic forums. The two have championed trade and investment liberalization through APEC, most recently coordinating their positions in back-to-back host years in 2010 and 2011 to advance a number of meaningful initiatives. Japan has played an important balancing role in Asian forums in which the United States does not participate, such as the ASEAN+3 grouping, which brings together the 10 countries of the Association of Southeast Asian Nations with China, Japan, and Korea. And Tokyo has been a reliable partner of Washington on key agenda items in global economic forums, notably the G-20 and G-8.

Recommendations for Japan Policy

Early in 2013, the Obama administration should explore the opportunities for deeper economic engagement with Japan. A comprehensive framework to house bilateral economic issues, once a common feature of the relationship, is no longer needed. Instead, the administration should develop a more limited economic strategy toward Japan that has three main strands: encouraging Tokyo to take the steps necessary to eventually join TPP; helping Japan meet its energy needs; and deepening coordination on shared global and regional economic concerns. Specific recommendations include:

- *Continue working to bring Japan into TPP:* The administration should reach out to Tokyo early in 2013 to make clear that the United States believes that both sides have compelling economic and strategic interests in Japan's accession to an eventual TPP agreement; and that in the meantime, Tokyo should resume working to prepare the ground domestically for the substantial market-opening and reform commitments that will be required for Japan to enter. An informal dialogue between designated cabinet-level officials on each side could be established to map out a pathway to Japanese entry, similar to the dialogue between the U.S. and Korean trade ministers that preceded the KORUS free trade agreement. The administration should also begin working in parallel with Congress to persuade them of the merits of Japanese participation on appropriate terms in a high-standard TPP agreement. Competitive pressure on Japan could usefully be created by persuading South Korea to reconsider its current reluctance to join TPP and/or by more seriously exploring new trade deals with other key partners, notably the European Union.

- *Enhance bilateral energy cooperation:* Given the unique circumstances of Japan's energy crisis, the Obama administration should, using executive authority, immediately announce that exports to Japan meet the public interest test under the Natural Gas Act, thereby accelerating the export approval process. The two countries should also agree to establish a sub-cabinet-level Energy Strategy Dialogue that meets twice a year to consider practical steps to address the main policy issues emerging from Fukushima, including best practices for nuclear safety. The main obstacle to restarting nuclear plants in Japan is overwhelming public concern that nuclear power cannot be managed safely. To rebuild confidence, the Japanese government must build a transparent, competent, and independent regulatory agency, and develop credible contingency plans; and the Japanese utility industry must demonstrate its commitment to safe operations of nuclear plants. Japanese experts have proposed that the new regulator establish an international advisory panel with respected private experts, such as former members of the U.S. Nuclear Regulatory Commission; the administration should support and facilitate this proposal, as well as other feasible efforts to help Japan bolster nuclear safety and regain public trust.
- *Expand coordination in the G-20:* The administration should propose to Tokyo that G-20 sherpas and finance deputies from both sides hold regular informal "2+2" meetings to coordinate positions in the forum. U.S. and Japanese interests are generally aligned in the G-20, but more regular dialogue, especially on the core issues of balanced growth, financial regulatory reform, trade and investment liberalization, and global governance reform, would help advance progress on these issues in the face of resistance from major emerging market participants in particular.
- *Work with Japan in Asia:* Taking advantage of the many regional forums at which their senior officials meet during the year (APEC, EAS, the ASEAN Regional Forum, etc.), the administration should propose regular consultations on the margins of these meetings on important regional economic developments in Asia, such as ASEAN+3 trade and financial integration, support for ASEAN's "connectivity" initiative, and commercial opportunities in Myanmar. The administration should also explore deeper trilateral cooperation with Japan and India on regional economic issues.

5

KOREA

The first six months of 2013 present a window of opportunity—and peril—for U.S.-Korea relations. Little more than a month after Barack Obama has been sworn in for a second term as U.S. president, new Korean president Park Guen-hye will be inaugurated in Seoul on February 25. The opportunity is for a fresh start in the relationship with new teams on both sides; the peril lies in the risk of miscommunication or uncoordinated action by either side that could get the new relationship off on the wrong foot.

Fortunately for economic policymakers, the greatest hazards are on the security side of the relationship, particularly regarding North Korea policy. U.S.-Korea economic relations are fundamentally strong, following entry into effect of the bilateral free trade agreement, the so-called KORUS FTA, in March 2012. KORUS is the most ambitious trade agreement negotiated by the United States since NAFTA, not only because Korea is a \$1.1 trillion economy and the seventh-largest market for U.S. exports, but also because of the scope of the agreement, which establishes groundbreaking disciplines on goods, services, and agriculture trade; investment policies; government procurement practices; and regulatory transparency.

However, the U.S.-Korea economic relationship is not without its challenges. Concerns on the U.S. side about inadequate Korean implementation of its KORUS commitments, particularly in the automobile and pharmaceutical sectors, began to emerge soon after the agreement came into effect. No doubt “FTA fatigue” on the Korean side has contributed to slippages in implementation, as has the replacement of key officials responsible for negotiating the agreement. But rising popular concern about inequality and favored treatment of *chaebol* conglomerates has had a more pernicious effect in undermining support for free trade in Korea. Both leading presidential candidates in 2012 played to this sentiment, promising to pursue policies of “economic democratization” or “compassionate growth” if elected.

These forces have complicated U.S. efforts to take bilateral economic relations to the next stage. One clear U.S. interest is in having Korea join the TPP negotiations. Korean participation would help reinforce and uphold the higher standards already embodied in KORUS that Washington is trying to win in TPP. Yet to date, Washington has been too preoccupied with KORUS implementation and concluding the existing TPP negotiations to persuade Seoul on the merits of “docking” onto TPP. For its part, Seoul has chosen to prioritize its bilateral FTA talks with China and its trilateral discussions with China and Japan and to put other trade negotiations on the back burner.

Meanwhile, a perennial challenge in U.S.-Korea economic relations relates to U.S. Treasury Department concerns about Korea’s large current-account surpluses (which reached 4 percent of GDP in 2011) and foreign-exchange intervention (which Treasury has argued in its semiannual report to Congress goes beyond Seoul’s stated goal of smoothing currency volatility). These issues will remain part of the policy dialogue between the two countries both bilaterally and in multilateral forums like the G-20.

U.S.-Korea Economic Engagement

Since Presidents George W. Bush and Roh Moo-hyun announced their intention to negotiate a free trade agreement in February 2006, U.S.-Korea economic relations have been dominated by the negotiation, ratification, and implementation of the KORUS FTA. Most other channels of bilateral economic dialogue were effectively subsumed under KORUS, which established a Joint Committee chaired by the two countries' trade ministers to oversee implementation; the committee held its first annual meeting in Washington in May 2012.

Washington and Seoul have also collaborated extensively and constructively in regional and global forums. Korea has been an active member of APEC, hosting the group in 2005 and supporting U.S. trade liberalization initiatives—particularly in the area of green growth—in the 2011 U.S. host year. Seoul has also “punched above its weight” as a member of G-20, including serving effectively as the first Asian and first emerging market host of a G-20 summit in November 2010.

Recommendations for Korea Policy

As the fourth-largest economy in Asia (following China, Japan, and India) and a reliable partner on many shared regional and global economic interests, Korea deserves more time and attention from senior U.S. economic policymakers than it has received since passage of the KORUS FTA. Realistically, a new administration in Washington is unlikely to have the bandwidth for new formal processes to manage economic relations with a relatively trouble-free partner in the region. Instead, Washington could propose to Seoul a new organizing principle for bilateral economic relations post-KORUS: a “U.S.-Korea New Economic Partnership” that incorporates a number of discrete strands, including:

- *KORUS implementation:* This remains the top current priority in U.S.-Korea economic relations and should be highlighted as an important element of the partnership, with the new Joint Committee under the direction of trade ministers accountable for oversight of KORUS implementation.
- *Laying the groundwork for Korean entry into TPP:* While neither side has pushed for Korean participation in the first phase of TPP negotiations, they share a strong economic and strategic interest in Korea's entry. The Obama administration should use every opportunity to persuade Seoul of the merits of TPP accession and keep it fully apprised of progress in the negotiations.
- *Working with Korea in Asia:* Taking advantage of the many regional forums at which their senior officials meet during the year (APEC, EAS, the ASEAN Regional Forum, etc.), the Obama administration should propose regular consultations on the margins of these meetings on important regional economic developments in Asia, such as ASEAN+3 trade and financial integration, support for ASEAN's “connectivity” initiative, and commercial opportunities in Myanmar.
- *Expanded coordination in the G-20:* Sherpas and finance deputies from the two countries should hold more regular informal meetings to coordinate positions in the G-20. U.S. and Korean interests in the forum are generally aligned, but more regular dialogue, especially on the core issues of balanced growth, financial regulatory reform, trade and investment liberalization, and global governance reform, would help advance progress on these issues in the face of

resistance from major emerging market participants in particular and could also help address the Treasury concerns mentioned above.

- *“Innovation Leadership” project:* KORUS is the first trade agreement that allows for the free flow of data transfers in financial services. This reflects the fact that the United States and Korea are leaders in both information and communication technology (ICT) and financial services. In light of a number of factors—the importance of ICT in enabling productivity growth worldwide, the weight the Obama administration has placed on ICT development, the huge role that technology is playing in Korea, and Seoul’s longstanding aspiration to be a “hub” for regional and global economic activity—there is an opportunity for the two countries to take a joint leadership role in, among other things:
 - *WTO services agreement:* The United States and Korea could jointly push for an ambitious plurilateral agreement on trade in services, including areas such as greater data transparency and cross-border service provision.
 - *Development:* Washington and Seoul could jointly work to expand efforts on increasing broadband access in the developing world.
 - *Green finance:* Korea is now hosting the Green Climate Fund, while the United States has been working with the World Bank over the last few years to set up a number of climate-related funds. Bringing the various green-finance initiatives together could provide an opportunity for better financial leverage and exploiting U.S. and Korean technological prowess.

The Obama administration is likely to send a high-level delegation to the new Korean president’s inauguration in late February 2013. Washington could take advantage of this occasion to propose a partnership along the lines above to Seoul’s new economic team. The details could be worked out by officials over succeeding weeks, with the two presidents formally launching the partnership at their first meeting in the spring.

6

ASEAN

The 10-member Association of Southeast Asian Nations (ASEAN) is at the core of the United States' plans for developing regional architecture for the Asia-Pacific region. Emphasizing alliances and special relationships within new security and economic architecture is key to U.S. long-term strategy for the region. A strong relationship with ASEAN is fundamental to balanced engagement with the region's largest countries, including China and India.

ASEAN members want to see deeper, more substantive engagement by the United States. President Obama's focus on the region, his willingness to raise the relationship to a strategic level, and his efforts to institutionalize high-level engagement by elevating the annual meeting with ASEAN leaders to a U.S.-ASEAN Leaders' Summit, all send reassuring signals to the region. ASEAN is encouraging the United States to pursue a balanced approach, combining an increased security focus with enhanced economic engagement. While Southeast Asia has benefited from China's economic rise and has seen China move to the top of the list of its trading partners, investors, and providers of economic assistance, the region has been alarmed by China's aggressive actions in the South China Sea and in Northeast Asia and is proactively seeking to hedge and balance China's expanding roles.

The United States has every reason to focus on ASEAN. The region comprises 10 of the mostly rapidly growing countries, has a collective gross domestic product of over \$2 trillion, is home to over 640 million people, and is the fourth-largest overseas trading partner of the United States. Economically, the United States has more invested in ASEAN countries than in China and India combined, totaling \$122.9 billion in 2009. Two-way trade has risen significantly over the past decade, from \$122 billion in 2000 to \$182 billion in 2011. While economic relations suffered during the global financial crisis, trade flows of goods and investment have recovered fully and surpassed pre-crisis levels. Myanmar's recent opening provides new opportunities for engagement, including with the U.S. private sector.

Nonetheless, challenges remain. While overall trade has risen, the U.S. market share in ASEAN has fallen significantly over the past decade. In 2000, the U.S. share of ASEAN trade was 16.1 percent, while in 2010 this was down to 9.1 percent. This is partly due to a rising China, which has come to dominate trade flows in the region. Asia's economies are integrating quickly, and it behooves the United States to participate in this process and become a key player in growing Asian economic prosperity.

The security relationship with Southeast Asia has always been important to the United States. ASEAN includes two U.S. treaty allies: the Philippines and Thailand. It has also developed strong strategic relationships with other countries such as Singapore and Malaysia. Efforts to develop more strategic relationships are underway with Indonesia and Vietnam, and new opportunities in countries like Myanmar, Cambodia, and Laos are being explored. Initiatives such as the Comprehensive Partnership with Indonesia have been successful on political and strategic fronts, and re-

forms in the military following earlier concerns about human rights violations allowed the United States to begin normalizing security relations in 2005. In mainland Southeast Asia, there has been more recent progress. As the political situation in Thailand has stabilized since riots crippled its capital in 2010, both countries have begun to refurbish their alliance, which lagged as domestic politics dominated Bangkok's capacity. In Myanmar, the dramatic reforms and reopening of the country has renewed the possibility of military interactions that were previously unthinkable.

The most pressing issue for the United States in ASEAN is building a long-term domestic political foundation to support sustained engagement in the region. Policies in the areas of security, defense, and trade are generally moving in the right direction. However, the region is concerned about the ability of the United States to remain focused. Countries in ASEAN ask whether the United States has the pocketbook, people, and political will to stay the course outlined in the rebalancing rhetoric over the past two years. The region is looking for a signal to back up the stated commitment to the region, and that signal could be for the United States' top leaders to talk with Americans about the compelling case for raising our game in Asia generally and Southeast Asia specifically.

Recommendations for ASEAN Policy

- *Work toward a free trade area with all of ASEAN:* Integrating the United States and ASEAN in a free trade and investment area is supportive of U.S. geostrategic goals in the Asia-Pacific region and will fuel economic growth and prosperity in the United States and ASEAN. Currently, the United States is pursuing the TPP as the dominant trade paradigm, but not all ASEAN members are eligible to join TPP negotiations yet. The United States and ASEAN announced the Enhanced Economic Engagement (E3) initiative at the 4th U.S.-ASEAN Leaders' Meeting in Phnom Penh in November. The E3 is a creative and constructive plan allowing the United States to engage all of ASEAN while strengthening ASEAN as an institution. The E3 process could be used to prepare countries for the TPP and a U.S.-ASEAN free trade area; the first areas of focus under the E3 should be trade facilitation and a regional investment treaty.
- *Institutionalize mechanisms supporting U.S.-ASEAN business relationships.* A cornerstone of U.S. efforts to strengthen its economic engagement with ASEAN is strong, institutionalized mechanisms that support businesses operating on both sides of the Pacific. This requires the United States to:
 - *Develop mechanisms for local growth:* The United States has a deep bench in state and local governments, and U.S. localities can contribute greatly to developing exchanges and relationships between leaders at the village, district, and sub-district levels. This would strengthen relationships at all levels of governance, allow for sharing best practices, and identify areas of cooperation that may be overlooked by national-level governments.
 - *Facilitate investment and job creation:* The United States should support the creation of "one-stop shops" where businesses can go to obtain permits, licenses, survey data, and other needed resources, and facilitate the identification of best practices and standardization between markets where possible.
 - *Review the U.S. visa process:* The U.S. government should streamline inefficient visa security review processes to make it easier for Southeast Asians to travel to the United States for business, collaborative work, study, and tourism without threatening U.S. security. Visa delays hold back business missions, undercut new investment, and limit students who come to the United States to study and for tourism.

Both the United States and ASEAN should recognize the importance of roles for small and medium-sized enterprises in these endeavors, as they will likely have the biggest overall impact on the economic relationship.

- *Bring all ASEAN countries into APEC, and support integration of regional architecture:* The United States should support efforts to bring Cambodia, Laos, and Myanmar into APEC, so that all ASEAN member states can be involved in this forum. If all ASEAN members can be brought into regional organizations, both ASEAN and these regional organizations will become stronger and more effective. This is particularly important as ASEAN works to create its unified ASEAN Economic Community in 2015.
- *Establish a U.S. taskforce to collaborate with the ASEAN Connectivity Coordinating Committee (ACCC):* The concept of “connectivity” is a priority interest of the ASEAN countries, corresponding roughly to a code word for effective integration of the region and connecting it to major markets in China and South Asia. Myanmar’s opening enhances the viability of this agenda. The United States should specifically align itself with this ASEAN-initiated effort. One important way to achieve that goal is to institutionalize U.S. interagency engagement in the ACCC, which was established by ASEAN in 2011 to implement the Master Plan on ASEAN Connectivity. ASEAN and the United States have a common interest in enhancing both hard and soft infrastructure and encouraging government agencies and private companies to build that infrastructure. This taskforce will work closely with the ACCC to help implement current projects and recommend innovative ways to enhance ASEAN connectivity. Other ways to support connectivity include linking new Overseas Private Investment Corporation (OPIC) Southeast Asia funds, U.S. Export-Import Bank (EXIM) lending initiatives, and Trade Development Agency (TDA) feasibility studies and training to ASEAN connectivity efforts.
- *Make a concerted effort to inform and educate individuals in the United States about the importance of ASEAN:* U.S. ambassadors and other policy leaders should spend more time in the United States educating policymakers, leaders, and students about the countries in which they serve and their role in the region. This will build the understanding and cooperation needed to create a political base for deeper engagement in Asia by the United States.



APPENDIX

CRAFTING U.S. ECONOMIC STRATEGY TOWARD ASIA: LESSONS LEARNED FROM 30 YEARS OF EXPERIENCE (CSIS, 2008)

Drawing from the experience of a bipartisan group of then current and former U.S. government officials and other experts who, among them, had been involved in all of the major Asian economic policy initiatives of the three decades prior to 2008, the report reviewed the most important lessons learned from that experience. In doing so, it attempted to offer a practical “user’s guide” to managing U.S. economic relations with Asia, a dynamic region that looms ever larger in U.S. economic, political, and strategic interests. The full report is available at http://csis.org/files/media/csis/pubs/081016_freeman_craftusecon_web.pdf.

List of Lessons Learned

1. Don’t throw the baby out with the bath water.
2. Define the problem.
3. Identify negotiating objectives and points of leverage.
4. Align policy proposals with objectives and interests in the target country.
5. Match the means to the ends.
6. Involve the White House throughout as driver, coordinator, and enforcer.
7. Delineate agency roles, leadership, and coordination.
8. Determine the appropriate role for the private sector.
9. Identify the appropriate centers/levels of decisionmaking.
10. Set clear expectations with counterparts in advance—and in private.
11. Offer a “two-way street” where appropriate.
12. Set appropriate expectations with Congress, consult regularly, and establish rules of engagement for agencies.
13. Develop a strategy for outreach to media and allies in the target country.
14. Save the tough language for private sessions with counterparts.



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