Comparative Connections
A Quarterly E-Journal on East Asian Bilateral Relations

U.S.-Korea Relations:
Forward on Trade as Nuclear Talks Sputter

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In fits and starts, North Korea and the U.S. sought procedural common ground this quarter for resuming the Six-Party Talks on North Korea's nuclear program. The deputy head of Pyongyang's delegation, Ri Gun, traveled to New York in early March for a "working-level" meeting to discuss U.S. financial sanctions for North Korea's alleged counterfeiting of U.S. dollars.

The substantive positions of the two sides remained the same after the meeting: Pyongyang said it would continue to boycott the nuclear talks until Washington lifted the financial sanctions; Washington argued the sanctions were a purely "law enforcement measure" not linked to the nuclear issue. In mid-March, however, U.S. Ambassador to South Korea Alexander Vershbow proposed that discussions on the financial issue could continue bilaterally at the Six-Party Talks. At quarter's end, North Korea had not yet responded to this proposal.

In early February, the U.S. and South Korea announced the beginning of negotiations on a Free Trade Agreement (FTA) that U.S. Trade Representative (USTR) Rob Portman called the "most commercially significant free trade negotiations we have embarked on in 15 years." Not to be outdone, South Korean Trade Minister Kim Hyun-Chong said the initiation of FTA negotiations "is the most important event [in U.S.-Korea relations] since the signing of the military alliance in 1953." The first round of official talks is scheduled to begin in early June, following several procedural meetings.

The U.S. and South Korea held their first "Strategic Consultation for Allied Partnership" (SCAP) this quarter, not long after Presidents George W. Bush and Roh Moo-hyun agreed to initiate these talks at their summit meeting in November. During the consultation, the two governments reached a general agreement that the U.S. could exercise "strategic flexibility" and use its forces stationed in South Korea to meet military contingencies outside the Korean Peninsula.

Late in the quarter, the U.S. and South Korea also agreed to form a joint panel to consider the modalities of transferring wartime command of South Korean armed forces to the government of South Korea. At present, the commander of U.S. forces in South Korea would exercise operational control over the armed forces of South Korea, through the Combined Forces Command, during wartime.

Chairman Kim Jong-il confers with President Hu Jintao

As the New Year opened, North Korea declared it would boycott the Six-Party Talks until the U.S. lifted financial sanctions imposed for alleged counterfeiting of U.S. dollars: "We cannot sit down and discuss abandonment of our nuclear deterrent, designed to protect our system, with a counterpart that seeks to isolate and stifle us to death," stated a commentary in *Rodong Shinmun*, the official newspaper of North Korea's ruling party.

Facing new and severe financial pressure, North Korean leader Kim Jong-il sought support from China, making one of his periodic visits there on Jan. 10. After touring the booming cities of Guangzhou, Shenzhen, Wuhan, and Zhuhai, Kim met with Chinese President Hu Jintao on Jan. 17 and made two important announcements.

On the question of moving ahead with Chinese-style economic reform in North Korea, he took a more forward-leaning stance than ever before: "Rapid development in southern China left a deep and indelible impression on us. In a word, we are confident through our tour of southern China that the future of China is bright due to the *correct policy* of the Chinese Communist Party" (emphasis added). This was the first time Kim has given such a forthright political approval to China's internal economic reform policies.

On the most pressing security issue, Kim reaffirmed North Korea's interest in participating in the Six-Party Talks. He said: "There is no change in North Korea's basic stand of maintaining the goal of denuclearizing the Korean Peninsula, implementing the joint statement of principles issued at the fourth round of the Six-Party Talks in September and pursuing a negotiated peaceful settlement."

The same day as Kim made his public statements, Assistant Secretary of State Christopher Hill, head of the U.S. delegation to the Six-Party Talks, met with the heads of the North Korean and Chinese delegations in Beijing. (He had visited China just a week earlier to discuss "bilateral issues" as part of a scheduled tour of Asian capitals). In his Jan. 17 talks, Hill tried to defuse the impact of the counterfeiting controversy on the nuclear negotiations by stressing that illicit financial activities give rise to a purely "legal enforcement issue" that was separate from the nuclear question. Two days later, the Chinese put their weight behind an early resumption of the Six-Party Talks by proposing a meeting during the second week of February.

Although North Korea continued to resist fixing a date for the next meeting, it signaled a new policy direction on Feb. 9 when a Foreign Ministry official proclaimed that "the consistent policy of the [North Korean] government is to oppose all sorts of illegal acts in the financial field. We have the perfect legal mechanism to combat such illegal acts and any illegal acts are liable to severe punishment."

Soon after, U.S. Ambassador to South Korea Alexander Vershbow commented that "we hope that the statement reflects a decision by the North Korean government to stop its involvement in illicit activities." Vershbow said Pyongyang would have to offer

"convincing evidence" that it has destroyed all the counterfeiting equipment and printing plates allegedly used to manufacture the so-called counterfeit "supernotes."

U.S. and DPRK: "working level" discussion of financial issues

In mid-February, U.S. and North Korean diplomats finally agreed on a procedural approach to the issue of North Korean counterfeiting to help get the Six-Party Talks back on track. They decided that a North Korean official – deputy North Korean nuclear negotiator Ri Gun – would travel to New York in early March for "working level" discussions on the counterfeiting problem.

In November 2005, Assistant Secretary Hill offered a briefing of this kind to Pyongyang by U.S. Treasury and Secret Service officials. However, when North Korea proposed to send its chief nuclear negotiator, Ambassador Kim Gye-gwan, Washington refused to accept him. The U.S. was unwilling to enter into what it saw as "political level" negotiations with Pyongyang on an essentially law enforcement issue.

The U.S. position, at that time, was colored by the Bush administration's general view that it would not engage in *bilateral* talks with North Korea. President Bush has long criticized the Clinton administration for engaging in fruitless bilateral talks with Pyongyang and instead pursued the nuclear talks in a multilateral setting (drawing heavily on the assistance of China, in particular). Until the planned meeting with deputy negotiator Ri Gun, the only significant bilateral meetings between North Korea and the U.S. during the Bush administration have occurred on the margins of the Six-Party Talks.

An agreement by Washington and Pyongyang to meet March 7 apparently occurred because North Korea offered to send a diplomat of slightly lower rank than Ambassador Kim, the head of delegation. Ri Gun was well-known to U.S. officials from his many years at North Korea's mission to the UN, where he served as the North Korea end of the famous "New York channel." (During the 1990s, this diplomatic track played an important role in keeping open lines of communication between Washington and Pyongyang, despite the absence of formal diplomatic relations.) Even though Ri Gun's rank as deputy nuclear negotiator (as well as director general of the Foreign Ministry's North American Affairs Bureau) is roughly equivalent to that of Christopher Hill, the U.S. assistant secretary of state for East Asian affairs, Washington agreed to accept him in the interest of getting the Six-Party Talks back on track.

In retrospect, it appears that by attempting to align itself with countries combating counterfeiting and by agreeing to send deputy negotiator Ri Gun to the U.S., North Korea showed in February its desire to overcome the impasse in the Six-Party Talks. Similarly, by accepting a bilateral meeting with North Korea and by approaching the issue of counterfeiting in a low-key, matter-of-fact way, Washington also indicated its intent to avoid a long delay in the nuclear negotiations.

However, the results of the March 7 meeting by U.S. and North Korean diplomats were not terribly propitious. Washington clarified that the U.S. actions against a Macau bank in September as a "primary money laundering concern" under the Patriot Act were a "regulatory measure… not a sanction against North Korea" and were "separate and unrelated to the ongoing diplomatic negotiations of the Six-Party Talks." Fearing a backdoor effort to establish an unwanted bilateral channel, U.S. diplomats reacted coolly to the North Korean proposal that the two governments set up a "non-permanent" bilateral committee to exchange information about financial irregularities. U.S. diplomats countered that North Korea should join the Asia Pacific Group on Money Laundering, an organization that seeks to curb illicit financial activities by criminals and terrorist groups, and would require more transparency from Pyongyang in its financial transactions. Deputy negotiator Ri responded that "due to Washington's blockage of legitimate financial transactions, we are forced to use only cash now." So he asked permission for North Korea to open an account in a U.S. bank – an action currently prohibited under U.S. law.

The meeting ended inconclusively, with North Korea vowing to continue boycotting the Six-Party Talks unless its demands are met and the U.S. saying it would not "negotiate" the "law enforcement matter" of financial sanctions. A day after this meeting, North Korea made clear its displeasure by test launching short-range missiles near North Korea's border with China. South Korea downplayed the test as "not a big concern" while a U.S. spokesman said that North Korea's missile program "poses a threat to the region and the larger international community."

U.S. and DPRK: Financial discussions continued

In mid-March, Ambassador Vershbow effectively gave the U.S. response to North Korea's demand for a "semi-permanent" bilateral committee to discuss the issue of financial sanctions. Shifting from the previous U.S. position that regarded North Korea's nuclear program as separate from its illicit financial activities, Vershbow said "we are prepared to continue to discuss [with North Korea] the same issues discussed in New York. But there are plenty of opportunities to do that in the context of the Six-Party Talks, where many different contacts can take place."

In effect, Vershbow adopted the same position that Assistant Secretary Hill successfully used to out-flank Bush administration neo-conservatives who opposed direct, bilateral talks with North Korea. In Vershbow's formulation, bilateral talks on the counterfeiting issue could take place on the sidelines of the multilateral talks on North Korea's nuclear program. South Korea's Foreign Minister Ban Ki-moon endorsed this view a few days later in the apparent hope of bringing North Korea back to the Six-Party Talks.

At the end of the quarter, it appeared possible that the U.S. and North Korea could broker a compromise to resume the nuclear negotiations along the lines Vershbow suggested. North Korea would thereby strengthen its bilateral track with the U.S., though not through the new forum on financial issues it originally desired. The U.S. would give

impetus to diplomatic efforts for resolving the nuclear issue, while expanding the Six-Party Talks beyond their original format.

U.S. and ROK: launching FTA negotiations

On Feb. 2, USTR Portman and Korean Trade Minister Kim Hyun-chong announced the launch of negotiations on a Korea-U.S. Free Trade Agreement. Portman called the talks the "most commercially significant free trade negotiations we have embarked on in 15 years." Kim said the initiation of FTA negotiations "is the most important event [in U.S.-Korea relations] since the signing of the military alliance in 1953." President Bush stated that a deal would "provide important economic, political and strategic benefits to both countries and build on America's engagement in Asia."

The South Korean government, in particular, took great pains to begin these talks by meeting the conditions laid down by USTR to initiate the FTA negotiations: in late January, much to the chagrin of the Korean film industry, Seoul cut in half the "screen quota" that had guaranteed the showing of Korean movies 146 days each year. Accusing the film industry of "collective selfishness," Seoul acted decisively, after wrestling with this issue for almost 10 years.

Korea also agreed to resume the import of U.S. beef aged under 30 months, after prohibiting all U.S. beef imports since the discovery of mad cow disease in U.S. cattle in 2003. In public statements, ROK President Roh Moo-hyun indicated that achieving an FTA was a top policy goal during the remainder of his term in office.

The FTA negotiations will have to be completed no later than spring of 2007 since President Bush's Trade Promotion Authority, which allows him to negotiate a trade agreement and then bring it before the U.S. Congress through an expedited procedure, expires in June 2007. There is little chance the U.S. Congress would extend the president's negotiating authority beyond that time.

According to a study by the U.S. International Trade Commission, a U.S.-Korea FTA would bring about a more than 21 percent increase in Korean exports to the U.S. and more than a 53 percent increase in U.S. exports to Korea.

For Seoul, the potential growth of major exporting firms and increased U.S. direct investment accompanying an FTA would close the apparent "benefit gap" between the two countries. Overall, the Korean Institute for International Economic Policy calculates that, following an FTA, Korea's real gross domestic product would increase by more than 7.5 percent or $35.2 billion, leading to the creation of approximately 670,000 jobs.

More than the normal benefits of increased trade lay behind the two governments' calculations, however. Seoul fears being overwhelmed by the rapid growth of China's economy and seeks to lock in preferential trading arrangements with the U.S. to maintain its "qualitative edge" in technology and export products. At the same time, Seoul wants

to strengthen and deepen its alliance with the U.S. so it goes well beyond military cooperation.

For the U.S., striking bilateral trade agreements with Asian countries is also a way of countering China's aggressive economic diplomacy in the region and ensuring that U.S. companies will have optimal access to important Asian markets. Washington has an equally important motivation for strengthening the U.S.-Korea alliance, broadening its rationale beyond cooperation against a common military threat. In the last year, especially, the alliance has suffered major strains due to differences in the U.S. and South Korean approaches toward North Korea.

U.S. and ROK: new strategic consultations

South Korea and the U.S. conducted their first "Strategic Consultation for Allied Partnership" in Washington on Jan. 18-19. Foreign Minister Ban and Secretary of State Rice led their delegations at meetings designed to broaden the alliance relationship. Among the subjects for discussion were global terrorism and political relations in Northeast Asia as well as the current security threat from North Korea and the state of the alliance.

The U.S. and South Korea agreed during the consultation to coordinate closely in promoting democratic institutions and human rights, fighting terrorism, countering the spread of weapons of mass destruction, combating pandemic diseases, supporting multilateral peacekeeping, responding to crises, and managing disasters.

The most sensitive issue taken up in the consultation was the question of the "strategic flexibility" of U.S. forces stationed on the Korean Peninsula. The U.S. has long sought acknowledgement from South Korea that these troops could be deployed elsewhere in the event of a crisis, particularly a military contingency involving China in the Taiwan Straits. The joint statement released at the end of the meeting tried to balance the two governments' positions:

"The ROK, as an ally, fully understands the rationale for the transformation of the U.S. global military strategy, and respects the necessity for strategic flexibility of the U.S. forces in the ROK… In the implementation of strategic flexibility, the United States respects the ROK position that it shall not be involved in a regional conflict in Northeast Asia against the will of the Korean people."

In the statement, Seoul essentially accepted the reality that the U.S. could redeploy forces from the Peninsula for a Taiwan contingency regardless of the views of the Korean government. But the statement also put Washington on notice that it could not expect Korean support for any operation that would disrupt South Korea's harmonious relations with China.

Not long after this new round of talks ended, negotiators from the Defense Department and Defense Ministry, in mid-February, discussed the question of whether South Korea should be allowed to exercise control over its own armed forces during wartime. In 1994, Seoul acquired the authority, within the Combined [U.S.-ROK] Forces Command, to control its military during peacetime. But the control of South Korean armed forces has remained until now with the commander of U.S. Forces in Korea.

These talks led to an accord at the end of March to form a joint panel to study and develop detailed measures for the transfer of wartime command. The joint panel will report its results to the next meeting of the U.S. defense secretary and the South Korean defense minister at their "ROK-U.S. Security Consultative Meeting" scheduled for October 2006.

Commenting on this issue, President Roh said: "If South Korea and the U.S. agree within the year on the return of the military command [and to] implement the agreement step by step in the coming years, a more mature form of comprehensive security cooperation would become possible."

Prospects

The good news this quarter is that the U.S. and North Korea are striving to overcome the impasse in the Six-Party Talks. The not-so-good news is that, at quarter's end, their efforts show few signs of success. If the Six-Party Talks never reconvene, neo-conservatives in the Bush administration can take heart that an issue entirely unrelated to North Korea's nuclear weapons program – counterfeiting of U.S. dollars – led to the demise of the nuclear negotiations. If, however, the two sides can reach a compromise to end the impasse, professional U.S. diplomats will deserve considerable credit for rescuing this all-important diplomatic track from oblivion.

The launch of negotiations on an FTA holds much promise for both South Korea and the United States. It offers a way to expand trade and investment between the two countries while strengthening the Korea-U.S. alliance. Given the strong commitment of both the Bush and Roh administrations to this historic measure, agreement on an FTA will likely be reached next spring, though only after a number of difficult negotiating sessions on some tough sectoral issues including automobiles, agriculture, intellectual property rights, pharmaceuticals, and steel.

Chronology of U.S.-Korea Relations
January-March 2006

Jan. 3, 2006: North Korea says it will not attend the Six-Party Talks as long as U.S. financial sanctions remain in place.

Jan. 5, 2006: U.S. Secretary of State Condoleezza Rice calls North Korea a "dangerous regime."

Jan. 8, 2006: Last of KEDO workers withdraw from the light-water reactor construction site in Kumho, North Korea.

Jan. 9, 2006: North Korea officially denies U.S. claims of DPRK counterfeiting.

Jan. 10, 2006: North Korean leader Kim Jong-il begins visit to China.

Jan. 17, 2006: U.S. Ambassador Vershbow says all South Koreans should be worried about North Korea.

Jan. 18, 2006: U.S., Chinese, and North Korean Six-Party Talks negotiators meet in Beijing; North Korean leader Kim Jong-il meets Chinese President Hu Jintao.

Jan. 19, 2006: The U.S. and South Korea issue a joint statement, after first Strategic Consultation for Allied Partnership talks, on the "strategic flexibility" of U.S. forces in South Korea.

Jan. 23, 2006: U.S. Treasury team briefs South Korea on alleged North Korean counterfeiting.

Jan. 26, 2006: South Korean court orders two U.S. manufacturers of Agent Orange defoliant used during the Vietnam War to compensate 6,800 affected Korean nationals.

Feb. 2, 2006: U.S. and ROK announce plans to open FTA talks in May.

Feb. 3, 2006: In the *Quadrennial Defense Review*, the U.S. Defense Department calls North Korea a "potentially hostile state."

Feb. 14, 2006: South Korea and the U.S. begin Security Policy Initiative (SPI) talks in Guam to discuss further development of the military alliance, including operational wartime control by South Korea.

Feb. 22, 2006: U.S. embassy official reveals the U.S. has provided the ROK government physical evidence of DPRK counterfeiting activity.

Feb. 28, 2006: North Korea claims it is also a victim of counterfeiting.

March 1, 2006: State Department reports it has "substantial evidence" of North Korean counterfeiting of U.S. currency.

March 6, 2006: U.S. and South Korea conduct a procedural meeting in Seoul for their upcoming FTA negotiation.

March 7, 2006: U.S. and North Korean officials meet in New York to discuss U.S. financial sanctions.

March 8, 2006: North Korea tests two short-range missiles.

March 11-19, 2006: Seoul Mayor Lee Myung-bak travels to Washington, New York, and Los Angeles, meets Deputy Secretary Zoellick, Sen. Richard Lugar among many others. ROK opinion polls put Mayor Lee as the leading presidential contender.

March 16, 2006: The White House releases *National Security Strategy of the United States of America* that reasserts the administration's belief in the doctrine of preemption and describes the DPRK as one of the seven "despotic systems."

March 16, 2006: Ambassador Vershbow says there are "plenty of opportunities" to discuss North Korea's alleged illicit financial activities in the Six-Party Talks.

March 21, 2006: U.S. and South Korea continue SPI talks in Seoul.

March 22, 2006: FM Ban says North Korea could possibly discuss the counterfeiting issue within the framework of the Six-Party Talks.

March 23, 2006: Defense Secretary Donald Rumsfeld states that ROK and U.S. generally agree on a transfer of wartime command of ROK forces to the ROK and are discussing a time table.

March 25, 2006: U.S. and South Korean forces begin annual military excercises – *RSOI (Reception, Staging, Onward Movement and Integration)* and *Foal Eagle*.

March 29, 2006: U.S. and South Korea agree to form a joint panel to study South Korea retaining operational command of its armed forces during wartime.

March 30, 2006: U.S. Treasury freezes U.S. assets of a Swiss company allegedly supporting North Korea's WMD proliferation activities.