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Introduction / Interest in Asia

I am very pleased to be here today to address this distinguished gathering. The Asia Pacific region is a dynamic and thriving arena within the expanding global economy – and the potential benefits to developing and developed nations within the region is giving rise to tremendous regional economic cooperation. As host to this year’s APEC forum, Australia is uniquely positioned to lead the region toward closer cooperation and greater growth. We look forward to working with Australia to achieve real progress toward our shared goals.

I have found it distressing that local pundits continue to claim that U.S. interest in Asia is waning. There is no doubt that America faces many great challenges across the globe, and we are working hard to meet those challenges. But the notion that we are distracted and will be uninvolved in Asia is simply wrong.

Simply put, many in the U.S. recognize that the economic center of gravity in the global economy in the coming years will be in Asia. The United States has been – and will continue to be – a major force for promoting economic growth through trade liberalization and market principles around the globe. And this promotion of growth through increased trade liberalization is particularly true in Asia. Not only is this growth policy good for nations in Asia, our economic engagement in Asia has been a strong driver for the United States own economic growth.

With that in mind, I would like to discuss with you some thoughts on America’s economic position in the region and how our economic engagement, including our membership and active participation in APEC, impacts our overall interests in Asia. America’s evolving relationship with China is, of course, an important element of that engagement as are regional security issues that demand our attention because stability is critical in encouraging and facilitating economic activity.

U.S. Economic Situation

I begin with the general consensus that the outlook for the U.S. economy in 2007 is positive – reflecting high employment, firm wage growth, and the recent and welcome moderation in oil prices. Business investment is expected to remain firm in 2007, with corporate profits currently strong and capital goods orders remaining robust.

While U.S. output growth slowed somewhat in 2006 as a result of the cooling housing sector, talk of recession proved overly pessimistic as non-residential investment and consumption continued to expand. The resilience of the American consumer in 2006 was aided by strong employment growth and a fall in energy prices from the record highs of the previous year. As President Bush noted in his State of the Union address just 2 weeks ago, the U.S. economy has now achieved 41 months of consecutive employment growth. This is, of course, excellent news for global growth, particularly in Asia.

The United States economy can still be rightly identified as the engine room of global growth. U.S. GDP accounts for around one-quarter of global output, and it is the foundation of the growth of Asian economies, particularly China. It is important to note that this growth could not have happened if China and other Asian economies before it, such as Japan, had not integrated into the world's marketplace – through fora such as the WTO and APEC.

Asia is of central importance to the United States and to the global economy. In fact, five of our ten largest trading partners are in Asia. On a purchasing power parity basis, over one third of global GDP is contributed by Asian countries and three of the world's four largest economies are in Asia. Asia is the most dynamic region of the world and its importance to the United States now and in the future is clear

From India to Japan – and from Singapore to China – this region has shaken off the Asian financial crisis and stands at a moment of tremendous opportunity. The decisions in the next few years by the engaged nations of this region on their bilateral and multilateral economic relationships with each other and global economies like the U.S. will determine the shape and pace of global growth for years to come. It is important that we all manage our relations with this region in a way that preserves global economic growth and maintains broad support on both sides of the Pacific.

APEC

APEC will and should play a central part in these decisions. Three months ago in Hanoi at the APEC Leaders' Summit, President Bush and Secretary Rice made clear that APEC remains America's pre-eminent channel for engagement in the region. In every meeting and public event, they explained that the U.S. vision for APEC transcends simple cooperation, and looks to the emergence of a true Asia-Pacific Economic Community, spanning the public sphere, the private sector, NGOs, academia, and civil society.

Australia has already kicked off its year of leading APEC with a highly successful series of senior officials' meeting in Canberra last month. And because of Australia's compressed calendar, less than nine months after that first meeting, we will close out the year with the 2007 Leaders' Summit in Sydney in early September.

As those of you who are old hands at APEC know, Australia's hosting of APEC is both a milestone and a homecoming. When ministers from a dozen countries, including the United States, gathered for their first informal meeting in Canberra more than seventeen years ago in November 1989 to ponder how to advance the process of Asia Pacific Economic Cooperation, few could have known that APEC would evolve to become the premiere economic forum for the region – today encompassing the membership of 21 APEC economies, spanning four continents,

and representing 60% of global GDP and roughly 50% of world trade. Nor could those founding ministers have predicted that APEC would grow to include a Secretariat and a process of over 100 meetings each year involving literally thousands of participants from both the public and private sectors and other interested stakeholders.

Institutional Agenda -- Making APEC Stronger

Given the real advantages and scope of this forum, the United States is working hard to ensure that APEC remains strong and vital – while keeping APEC’s agenda true to its original focus on trade and investment liberalization, regional cooperation, capacity building, and providing a forum to discuss world and regional developments. We are working hard to make sure that as an institution, APEC measures up to the aspirations and accomplishments of its member economies while advancing the causes of prosperity and security for the benefit of all.

During the Leaders’ meeting in Hanoi and in recognition of APEC’s role as the premier economic forum in the Asia-Pacific, President Bush also announced that the United States would commit to doubling our support of APEC activities to roughly \$5 million per year, starting in 2007.

The President and the other leaders also welcomed plans for the strengthening of the APEC Secretariat and the streamlining of APEC’s operations. The U.S. has been working closely with partners to ensure that APEC remains a vital multilateral organization within which the U.S. can engage broadly and effectively throughout the region.

U.S. Goals in APEC

Our four key goals in APEC are:

- Trade and investment liberalization
- Enhancing security
- Preparing for and preventing pandemic diseases, and
- Improving the region’s business environment.

I don’t have time today to address each of these areas, but I would like to briefly touch on what we view as the most important – trade and investment liberalization.

In Hanoi, the U.S. gained agreement that APEC needs to be at the forefront of the regional economic integration trend and should be seriously considering a Free Trade Area of the Asia-Pacific as a long term prospect. Importantly, the Leaders endorsed this valuable outcome.

In the coming year, we will work with Australia and other APEC members to develop concrete initiatives to advance this commitment.

On WTO Doha, the Leaders also issued a strong stand-alone statement urging APEC members and others to renew efforts to complete the Doha Development Agenda round of negotiations. One of the strongest passages in that pointed, one-page document was this:

“We are ready to break the current deadlock: each of us is committed to moving beyond our current positions in key areas of the Round.”

Make no mistake about it, the Doha Development Agenda remains our number one trade priority – and USTR Susan Schwab and Minister Truss have been working hard to keep the WTO talks on track.

On the economic policy front, Australia has promised to make structural economic reforms a cross-cutting theme for its year, with initiatives such as an extensive study of behind-the-borders barriers to investment within selected APEC economies. This is an effort that the U.S. firmly supports.

China

As I’ve said, U.S. interest in Asia is not waning – Asia is crucial to the U.S. economy – and vice-versa. APEC helps to ensure economic development through cooperation and agreement on important aspects of trade, financial integration and harmonization. So it is clear that the increasing prosperity of the entire region is enhanced by strong international and national economic institutions which support free and open trade. This is especially true for the fastest growing economy in the region and the world – China.

Growth in the Chinese economy continues apace. The economy is expected to again grow by over 10% in 2007. GDP growth is expected to remain strong, underpinned by high rates of national saving, widespread urbanization, and the availability of a large pool of low-cost labor.

The importance of China’s economic growth to the region is no surprise to anyone in this room. An important component of Australia’s ongoing economic success is its deepening economic relationship with China. So too for the United States.

The U.S. relationship with China may become the single most important economic relationship of the 21st century. More than twenty-five years have passed since China began its transition to a market economy, and China has seen its standard of living surge. The growth of China's income per capita is much faster than that of any region in the world, and especially noteworthy considering the country's size and extreme regional differences. These economic reforms, including China’s participation in the WTO, have lifted many millions out of poverty. China is now

the world's 2nd largest economy on a purchasing power parity basis and the 3rd largest trading nation.

The United States has clearly benefited from China's growth: U.S. exports to China have grown at four times the rate of our exports to the rest of the world since China joined the WTO, and China has risen to become our fourth largest export market after our NAFTA neighbors and Japan.

However, China's rapid growth and the character of that growth pose challenges – for China itself, and for the rest of the world.

One important issue is China's balance of payments situation with the rest of the world. China's overall current account surplus has risen sharply, from \$46 billion in 2003 to \$184 billion in 2006. Estimates for 2007 are near \$206 billion, or 7.2% of China's GDP. In the process, China has accumulated massive amounts of foreign currencies. China's holdings are now estimated to total over one trillion dollars, surpassing Japan as the world's largest holder of foreign exchange reserves.

While China's rapid growth has benefited many of its trading partners, its current account surplus is now a major component of global imbalances, and if that surplus continues, it risks undermining support for the open trade policies that have contributed so much to global growth and to China's development.

The United States has been engaging China in these areas for several years. We have articulated three pillars on which we consider China's integration into the global economy can maximize growth and minimize possible disruptions.

China should adopt a more market-based, flexible exchange rate.

It should shift from an investment and export-oriented economy to a more consumption-based economy.

And China should reform and open up its financial sector, including its capital markets.

This strategy is receiving widespread support, and there is an emerging global consensus that it is the appropriate policy agenda. In fact, the Chinese have embraced this agenda; for example, the People's Bank of China revalued and partially floated the currency in early 2006, but they still have much to do.

Full exchange rate flexibility, which garners most of the attention, is first and foremost in China's interest. Greater exchange rate flexibility will strengthen the ability of Chinese monetary policy to assure sustained growth, avoiding the boom-bust cycles that have characterized Chinese growth to date. Greater ability to control domestic interest rates will also lead to more efficient and prudent financial

intermediation, and help avoid credit-fueled investment booms and resulting buildups of non-performing loans.

In fact, the Chinese leadership have publicly committed to greater exchange rate flexibility. Our engagement with China on exchange rate policy is now not about "whether" but about "how quickly" and to date China's progress has, in our view, been too cautious.

The second pillar of this sound economic policy is achieving a better balance among sources of Chinese growth. This is critical to sustaining China's growth in the future and avoiding huge imbalances in trade. While China's growth has been rapid, it has depended too heavily on investment growth and the export sector of the economy. Since the early 1990s increased capital and labor input, rather than greater productivity, has accounted for the bulk of China's growth. While China has a virtually unlimited supply of rural labor entering the cities in search of higher-paid manufacturing jobs, demographics will eventually turn against this trend. And with an undervalued exchange rate, China is very much dependent on exports for growth. As a percentage of GDP, goods and services exports have risen sharply from 23% in 2001 to almost 40% in 2006.

China's leaders recognize that achieving more balanced growth is central to current Chinese policy. To spur consumption, China has placed strong emphasis on rural development in its most recent Five-Year Plan, deciding to cut agricultural taxes and eliminate fees for rural primary education. It also plans to direct more capital and social spending to the rural sector. Household savings could be reduced by working towards the establishment of a universal pension system.

This brings me to the third pillar of reform for China's successful global integration – financial sector and capital markets reform. Inefficient financial intermediation remains the Achilles heel of the Chinese economy. To help modernize China's financial system and capital markets, the U.S. and others have pointed out a number of priorities.

First, we believe it would be in China's best interest to allow more competition and market forces into the sector, in particular, by eliminating ownership caps on foreign stakes and expanding the scope of products they can offer. We are also pressing China to make substantial new commitments in financial services as an essential element of any Doha agreement.

Second, China's regulators and firms need to improve capacity for risk management.

Third, China needs to improve opportunities for private companies to obtain finance so that capital can be channeled to its most productive uses. They need to develop corporate bond and equity markets and continue to privatize their state-owned enterprises.

Finally, I should note that China's growth is earning it more influence with more governments than ever before. We constantly encourage China to be mindful of this growing influence and leverage it as a responsible stakeholder of the international order. This responsibility includes being more transparent regarding its military intentions. We continue to be concerned about the lack of transparency in China's military modernization, especially with respect to military doctrine, budgets, and military acquisitions. Recently, for example, China fired an anti-satellite missile into space, destroying a weather satellite, without explanation or advance notice. We believe China should respond to international calls for a full explanation of the test and China's intentions, including how China's development of anti-satellite weapons squares with its claims to be opposed to the militarization of space.

Regional Peace and Security

Which brings me to stability and security concerns. Terrorism and nuclear proliferation are the two gravest threats to security in the region. The Asia Pacific region remains an important theater in the global war on terror. Terrorist organizations operate networks in Indonesia and the Philippines, and they are establishing cells in other countries. Sadly, as we have witnessed in Bali, Jakarta, Mindanao and elsewhere, the terrorists have not hesitated to attack civilian targets.

We are making important progress in diminishing the terrorists' strength and reach. As President Bush noted in his recent State of the Union address, "The enemy knows that the days of comfortable sanctuary, easy movement, steady financing, and free flowing communications are long over."

In the Asia Pacific, strong regional cooperation is beginning to pay off. U.S. and Australian cooperation with Indonesian authorities has contributed to Indonesia's success in apprehending hundreds of terrorist suspects. The recent demise of one of the region's most dangerous terrorists, Abu Sayyaf leader Janjalani, was achieved through close cooperation with the government of the Philippines.

The U.S and Australia's strong alliance has resulted in ongoing intelligence sharing and joint counter-terrorism operations in the region. Japan is partnering with our two countries to advance trilateral counterterrorism cooperation. Our two countries also work together to enforce financial sanctions against terrorist organizations. The U.S. will continue to employ the full range of tools – law enforcement, diplomacy, and intelligence – to end the threat of terrorism in the Asia Pacific.

North Korea's nuclear weapons ambition is another serious security threat to the region. North Korea's reluctance to discuss its intentions, while at the same time performing unannounced missile and nuclear tests, is only escalating tensions and security concerns in the region.

The North Koreans must heed the virtually unanimous opposition of the world community and end its threat to global security by returning to the Six-Party Talks, by implementing the provisions of the Joint Statement that it agreed to with the other Six-Party members states in September 2005, and by respecting the obligations of the parties to the Nuclear Nonproliferation Treaty and the International Atomic Energy safeguards regime. As Assistant Secretary of State Chris Hill put it a few months back, North Korea “can have a future or it can have these weapons. It cannot have both.”

Political instability can be just as detrimental to foreign trade as regional insecurity. Fiji, the Solomon Islands, East Timor and Tonga are the most recent examples of countries whose economies have taken suffered serious setbacks as a result of a military coups or political turmoil. Corruption and weak democratic institutions in some of these countries drive away foreign investment, adding to the downward spiral.

Closing

The Asia Pacific region represents tremendous potential – and hope – for a peaceful and prosperous world. As long as the great economies of our region continue to grow together, based on liberal trade, market principles, constructive engagement in regional bodies like APEC, good governance, and political stability, the entire region will realize a bright future. Challenges lay ahead, and our work is cut out for us, but I am optimistic that we are on the right path.

Thank you for this opportunity and I look forward to a continued rich exchange of ideas.