



U.S.-Korea Relations:
Unexpected Progress on All Fronts

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North Korea promised to shut down and seal its nuclear facilities at Yongbyon this quarter in a deal that implements the Six-Party Talks September 2005 Joint Statement, committing Pyongyang to dismantling its nuclear weapons program. To achieve this breakthrough, the Bush administration agreed to transfer back to North Korea approximately \$25 million in funds that were frozen since the fall of 2005 in a Macau bank for reported laundering of U.S. money.

Despite the political will on both sides, however, “technical issues” involving financial regulations prevented the funds from being transferred, as scheduled, by the mid-March round of Six-Party Talks, which was quickly adjourned. At the end of the quarter, U.S. diplomats expected to resolve the banking issues shortly so North Korea would move to shut down its reactor and allow inspectors from the International Atomic Energy Agency (IAEA) to reenter the country.

The U.S. and South Korea reached an historic free trade agreement (FTA) at the end of the quarter, which must now go to the U.S. Congress and South Korean National Assembly for ratification. The agreement would eliminate more than 90 percent of the tariffs currently applied in the two countries’ international trade. Reportedly, a “rice for beef” deal clinched the FTA. South Korea agreed to lift completely restrictions on U.S. beef that aim at preventing the spread of mad cow disease. In return, U.S. negotiators agreed to exclude rice from the FTA, effectively giving into demands from Korean rice farmers who had angrily demonstrated against the accord.

Senior U.S. and South Korean defense officials reached a tentative agreement in March on the timetable and funding to relocate U.S. forces in South Korea to a newly expanded base at Pyongtaek, south of Seoul. South Korea agreed to pay \$6 billion of the \$11 billion project and promised that base construction would be completed no later than 2012.

A critical meeting in Berlin

In mid-January, assistant secretary of state of the Bureau of East Asian and Pacific Affairs and chief U.S. negotiator to the Six-Party Talks, Ambassador Christopher Hill met in Berlin with North Korea’s chief delegate to the Six-Party Talks, Kim Gye-gwan, to resolve the dispute that bogged down the previous round of multilateral talks –

Pyongyang's unwillingness to negotiate on dismantling its nuclear weapons program until the U.S. ended financial sanctions for alleged counterfeiting. At stake was approximately \$25 million in North Korean funds that were frozen in a Macau bank Banco Delta Asia since the fall of 2005.

Both the White House and State Department spokesmen played down the significance of this meeting, though it represented the first time during the Bush administration that U.S. diplomats met bilaterally with North Korean officials outside the setting of the Six-Party Talks. That the meeting took place at all was something of a procedural concession to Pyongyang, which has long sought direct talks with the United States.

Details of discussions at the meeting did not emerge for approximately two weeks. Ambassador Hill initially commented that the talks were "substantive" and "useful," while the administration denied that anything unusual had occurred. White House press secretary Tony Snow said that "this is not an instance of bilateral negotiations," while State Department's Deputy Spokesman Tom Casey emphasized that the talks "certainly don't represent anything particularly new or different from what we've done before."

In fact, according to a story in early February by the Japanese *Asahi Shimbun*, the U.S. and North Korea signed a memorandum of understanding (MOU) in Berlin that laid the basis for the negotiating breakthrough at the mid-February round of the Six-Party Talks. Under the MOU, North Korea agreed to initially freeze the operation of its nuclear reactors in Yongbyon in exchange for energy and humanitarian assistance from the U.S. In concept, this agreement was similar to the Agreed Framework reached between Washington and Pyongyang in October 1994 that previously led to the shutdown of the Yongbyon nuclear reactor. Following the Berlin meeting, Treasury Deputy Assistant Secretary for Terrorist Financing and Financial Crimes Daniel Glaser hosted a three-hour session to discuss Banco Delta Asia and counterfeiting concerns with DPRK officials at the U.S. Embassy in Beijing.

A "joint agreement" at the Six-Party Talks

The Six-Party Talks reconvened in Beijing on Feb. 8, in an atmosphere of optimism engendered by the Berlin meeting. Despite the blueprint for progress in the U.S.-North Korea MOU, the talks proved more difficult than expected. One day before the successful conclusion of the round, *The New York Times* reported that the negotiations were on the verge of "collapse" due to differences over the amount of energy assistance Pyongyang would initially receive as compensation.

Nevertheless, on the last day of the round, the delegates announced their "joint agreement" for implementing the principles they previously agreed upon at the Six-Party Talks on Sept. 19, 2005. In the text of their "joint agreement," the U.S. and North Korea joined the other parties in reaffirming "their common goal and will to achieve early denuclearization of the Korean peninsula in a peaceful manner." The key points of the joint agreement were:

- Within 60 days, North Korea will shut down and seal its main nuclear facilities at Yongbyon. Inspectors from the IAEA will be allowed to return to North Korea to verify this process.
- In exchange for the complete accounting of its nuclear programs and the shutting down of its nuclear facilities, North Korea will receive energy, food, and other assistance up to an equivalent of 1 million tons of heavy fuel oil (HFO), including an initial shipment of 50,000 tons of HFO from the other five parties.
- The U.S. will begin bilateral talks with North Korea, at an unspecified future time, to discuss normalizing relations.
- The U.S. will, at an unspecified future time, begin the process of removing North Korea from the U.S. list of states that support terrorism. (This listing currently requires the U.S. to oppose any assistance by multilateral financial institutions, such as the World Bank and IMF, to North Korea).
- Japan will begin bilateral talks with North Korea to normalize their relations.
- After 60 days, the foreign ministers of all the countries involved in the Six-Party Talks will meet to confirm the implementation of the agreement and discuss creation of a peace and security mechanism in Northeast Asia.
- “Some countries” (presumably the U.S., China, North Korea, and South Korea – the “principal belligerents” in the Korean War) will hold a separate forum on negotiations for a permanent peace settlement to replace the 1953 Armistice, a ceasefire agreement that ended the Korean War.
- Five working groups will be created to discuss the following topics: denuclearization, U.S.-North Korea relations, Japan-North Korea relations, economic cooperation, and a peace and security mechanism in Northeast Asia.
- The parties will meet for their next round of talks on March 19.

Although unstated in the text of the Feb. 13 joint agreement, prior U.S. willingness (in the Berlin MOU) to release the \$25 million in North Korean funds frozen in a Macau bank for reported counterfeiting was the critical *quid pro quo* for North Korea to shut down its nuclear facilities at Yongbyon.

Reaction to the joint agreement

Following announcement of the joint agreement, President George W. Bush said that he was “pleased with the agreements reached today at the Six-Party Talks in Beijing. These talks represent the best opportunity to use diplomacy to address North Korea’s nuclear programs. They reflect the common commitment of the participants to a Korean Peninsula that is free of nuclear weapons.”

Bush tied the joint agreement closely to the joint statement of principles reached by the six countries on Sept. 19, 2005. He said that “today’s announcement represents the first step toward implementing that [September 2005] agreement.” Bush also acknowledged that the U.S. would participate in providing economic, humanitarian, and energy assistance to North Korea when he said that “such assistance will be provided as the North carries out its commitments to disable its nuclear facilities.”

Bush’s support for advancing nuclear negotiations with North Korea represented a victory for a moderate faction in the administration, now led by Secretary of State Condoleezza Rice, which seeks a diplomatic agreement with Pyongyang. Members of a more conservative faction, including former U.S. Representative to the United Nations John Bolton and Under Secretary of State Robert Joseph, made clear after the announcement that they preferred a tougher U.S. approach. In response to Bolton’s public comment that the agreement sets a bad example by rewarding North Korea for its nuclear activities, Bush said “I strongly disagree, strongly disagree with this assessment.”

South Korea’s President Roh Moo-hyun welcomed the six-party breakthrough and called for an agreement between North and South Korea on a permanent peace regime following a denuclearization agreement. He emphasized that a peace agreement to replace the 1953 Armistice and the formation of a multilateral security and cooperation framework in Northeast Asia would confer major economic benefits on South Korea.

Referring to this lower credit rating that South Korea receives because of security problems on the peninsula, Roh commented: “the successful settlement of negotiations between South and North Korea on lasting peace as well as the nuclear problem would eliminate non-economic hurdles to South Korea’s ascent to the top of the global credit rating ladder.”

“Technical problems” transferring North Korean funds

From mid-February until the new round of six-party process began March 19, events proceeded apace, in line with the outlines of the Feb. 13 joint agreement:

- On Feb. 26, U.S. Treasury official Glaser met with Macau authorities and told the press afterward “we’ve completed our investigation.... All of this work has put us in a position where we can begin to take steps to resolve the [Banco Delta Asia] matter.... We do intend to take steps to resolve the matter and we do intend to do that in a timely fashion and to do it as soon as possible.”
- On March 5, North Korean chief delegate to the Six-Party Talks Kim Gye-gwan met in New York with Ambassador Hill where they agreed to “normalize ties between North Korea and the U.S.” and resolve the issues of Pyongyang’s continued listing a state sponsor of terrorism and as an object of the U.S. Trading with the Enemy Act.

- On March 13, Mohamed ElBaradei, head of the IAEA, visited North Korea, meeting with high-level officials as well as nuclear experts to prepare for a return of IAEA inspectors and the process of verifying Pyongyang's shut-down and sealing of its Yongbyon nuclear facility.

At the March 19 round of Six-Party Talks, the momentum built during the prior month seemed to continue. Hill said that “we are very pleased to announce that we’ve been able to reach an understanding with the DPRK on the full return of funds [held by Banco Delta Asia].”

Treasury official Glaser confirmed that the frozen North Korean funds would be “transferred to an account “held by North Korea’s Foreign Trade Bank at the Bank of China in Beijing.” He added in his prepared statement in Beijing that “North Korea has pledged, within the framework of the Six-Party Talks, that these funds will be used solely for the betterment of the North Korean people, including for humanitarian and educational purposes.”

The hint of a possible problem arose, however, from Glaser’s comment that the transfer of funds would be arranged between Pyongyang and Macau “in conformity with Macanese procedures and regulations” and this would take some time. It soon became clear that because of technical issues – bearing on the formal permissions required for inter-bank transfers – the \$25 million in frozen funds could not be turned over to North Korea during the next several days of scheduled six-party negotiations.

Until the monies were transferred, North Korea refused to move ahead in implementing the Feb. 13 agreement. North Korean Chief Delegate Kim Gye-gwan, affirmed that only “if the Banco Delta Asia issue is completely resolved, [North Korea] will halt its nuclear activities at Yongbyon.” Given what amounted to a technical glitch, despite the political agreement of the parties, China decided to adjourn the Six-Party Talks March 22 with the intention of reconvening after the transfer of funds to North Korea occurred.

U.S. and South Korea complete free trade agreement

On April 1, the U.S. and South Korea reached a final deal on the Korea-U.S. Free Trade Agreement (KORUS) they had negotiated, at times with great difficulty, since early 2006. For the United States, the FTA is the biggest since the North American Free Trade Agreement with Canada and Mexico in 1994 and the first with a major Asian country.

The agreement, which still needs to be approved by the U.S. Congress and South Korea’s National Assembly, would eliminate more than 90 percent of the tariffs currently applied to products in the two countries’ international trade. South Korea is the 11th largest economy in the world, while the U.S. economy is the world’s largest.

Trade negotiators were working under a tight March 31 deadline for finishing their talks. They “declared” completion of the agreement by that time, which will allow the Bush administration to submit the agreement to the Congress under so-called “fast track”

negotiating authority. Using this procedure, Congress must give a “thumbs up or thumbs down” decision to the overall pact and cannot amend it in part.

Both President Bush and President Roh welcomed the agreement. According to Bush, “the United States-Korea Free Trade Agreement will generate export opportunities for U.S. farmers, ranchers, manufacturers and service suppliers, promote economic growth and the creation of better paying jobs in the United States, and help American consumers save money while offering them greater choices. The agreement will also further enhance the strong United States-Korea partnership, which has served as a force for stability and prosperity in Asia.”

Roh said in a special nation-wide address that “I expect the accord to be a stepping stone for our country to take a leap forward to becoming an advanced economy.” The South Korean president plans to lead a major effort to seek ratification of the pact in the National Assembly, where many of his former colleagues in the Uri Party oppose the FTA.

For the Bush administration, the agreement is a major victory in its drive to secure a number of new free trade agreements before leaving office in 2008. The U.S.-Korea FTA should help build support for other pending FTA negotiations with Peru, Columbia, and Panama, despite skepticism for free trade agreements, in general, from a Democrat-controlled Congress.

For South Korea, the FTA culminates its strategy of securing preferential access for South Korean products to the U.S. market, ahead of its primary Asia competitors, China and Japan. According to Fred Bergsten, director of the Peterson Institute for International Economics in Washington, the FTA gives Korea “a unique historic opportunity to achieve a preferred trade and indeed overall relationship with the United States that is unlikely to be available to any of its main competitors for a prolonged period of time.”

In 2006, the U.S. and South Korea had approximately \$78 billion in international trade. Studies by researchers at economic think-tanks have estimated that trade between the two countries may rise by as much as 20 percent as a result of the FTA.

Resolving tough final issues on the FTA

In the closing days of the negotiations, the most difficult issues were not surprisingly in the agricultural and automobile sectors. South Korea insisted on excluding rice from the FTA altogether to protect its vulnerable – and militant – rice farmers whose pleas for protection resonated with the Korean public. The U.S. on the other hand, demanded free access to the Korean market for U.S. beef, which the Korean government has severely restricted over the past several years due to the threat of mad cow disease.

Negotiators reportedly reached an agreement that South Korea would fully open its beef market under the FTA over 15 years, assuming that the World Organization for Animal Health classifies U.S. beef as relatively free from mad cow disease, a decision that is expected in mid-May. In return the U.S. would not press for opening Korea's rice market.

In the automobile sector, South Korea agreed to remove an 8 percent tariff on imported cars and to eliminate a domestic vehicle tax system, which U.S. trade negotiators said discriminates against U.S. made cars with bigger engines. In return, the U.S. agreed to immediately eliminate import tariffs on Korean-made auto parts and a 2.5 percent tariff on Korean-made autos with engines smaller than 3,000 cubic centimeters. The U.S. also said it would phase out a 25 percent duty on trucks over a 10-year period.

Other important measures in the FTA include:

- Over \$1 billion of U.S. agricultural exports will become duty-free in Korea, once the FTA is ratified.
- 95 percent of bilateral trade in consumer and industrial products will become duty-free within three years; most remaining tariffs will be removed in 10 years.
- South Korea will expand market-access for U.S. service providers in the fields of law, accounting, broadcasting, and e-commerce.
- U.S. tariffs on Korean textiles, averaging approximately 9 percent, will be removed on about 60 percent of textiles.
- The U.S. and South Korea will form a committee to discuss the creation of "outward processing zones" on the Korean Peninsula, which would potentially include the Kaesong industrial complex in North Korea.
- U.S. investors in South Korea will have the same rights and protections as Korean investors. These rights will be strengthened by a transparent, legal framework.
- South Korea will provide strong protection for intellectual property rights including patents, copyrights, and trademarks, at the level of U.S. standards.
- Both the U.S. and South Korea will enforce their labor and environmental laws to safeguard labor rights and protect the environment.

Relocation of U.S. Bases in South Korea

Senior U.S. and South Korean defense officials reached a tentative agreement in late March on the timetable and funding for relocating U.S. forces to a newly expanded base south of Seoul. Under the plan, South Korea would spend approximately \$6 billion for the \$11 billion project, with the U.S. picking up the rest. The new base construction, in

Pyongtaek, Gyeonggi province (about 70 km from Seoul) would be completed no later than 2012.

At the outset of the quarter, the commander of U.S. forces in Korea, Gen. B.B. Bell, strongly criticized the South Korean government for suggesting a delay of four to five years in the construction, beyond the previously agreed completion date of 2008. Bell argued that the new base expansion would “correct a wrong we have tolerated for years. That is, lousy living conditions and lousy facilities. So, I’m opposed to any decision to stretch this out for any reason, whether that is political or whether it’s fiscal, money or whatever it is.”

Despite the tentative agreement, differences still remain. For example, Washington wants South Korea to pay \$400 million for moving C4I (command, control, communications, computers, and intelligence) facilities, while Seoul has said that the most it is willing to pay is \$200 million.

The senior South Korean army official in charge of base relocation, Gen. H.K. Kwon, summed up the situation this way: “Despite 17 months of negotiations, there are still unresolved issues that we have failed to compromise on. We expect that such remaining problems will be solved after a consortium of firms to handle the relocation is picked in May... Total cost-sharing between the two sides is likely to [eventually] be 50-50.”

Prospects

U.S. relations with both South and North Korea lurched this quarter in unexpectedly positive directions. Merely four months after Pyongyang conducted a nuclear test and declared itself a nuclear weapons state, North Korea and the U.S. agreed on a concrete process for dismantling North Korea’s nuclear weapons program. In so doing, the U.S. reached its immediate diplomatic objective of starting to implement the Sept. 19, 2005 joint statement of principles at the Six Party Talks – in which North Korea, for the first time, committed itself to abandoning its nuclear weapons program.

The sudden adjournment of the round of Six-Party Talks that began March 19 reflected an underlying “technical problem” in the true sense. Despite the political decision of the U.S., China, and other parties to release North Korean funds, the banks involved would not implement a transfer unless certain financial regulatory requirements were met. At the end of the quarter, U.S. officials were optimistic that the North Korea funds would be released, and Pyongyang would proceed to shut down and seal its nuclear facilities at Yongbyon.

Once that shutdown occurs, Washington and Pyongyang will truly be charting new ground. With six-party working groups focusing on normalizing U.S.-North Korea bilateral relations as well as establishing a new multilateral “peace and security mechanism” for Northeast Asia, U.S. diplomats will need to ensure that movement in these areas spurs progress on the main issue – dismantling North Korea’s nuclear weapons program.

Despite months of pessimism that the U.S. and South Korea would ever agree on a free trade agreement, negotiators successfully achieved a deal at the end of the quarter. Considerable credit for this accomplishment should go to President Roh, who made an FTA a central objective of his last year in office.

Ultimately, the Bush administration gathered the political will to finalize an agreement, though its potential value to the U.S., both economically and politically, could not possibly match its importance to South Korea. Merely comparing the treatment of the issue in Korean newspapers – where the FTA negotiation has been front-page news for months – to its minor mention in U.S. media, bears out this point.

Although some members of Congress were critical of the final agreement, it is likely to be approved at the end of the 90-day fast-track review period. Once South Korea declares its decision to admit all U.S. beef, as is probable in mid-May, leading advocates for U.S. agriculture, including Montana Sen. Max Baucus, are likely to embrace the accord.

They and other members of Congress will find that U.S. trade negotiators gained considerable economic concessions from South Korea that benefit U.S. businesses in a variety of sectors. In retrospect, U.S. negotiators were able to achieve this impressive result because South Korea focused more on reaching its strategic goals – strengthening the Korea-U.S. political relationship and obtaining broad preferential access to the U.S. market vis-à-vis China and Japan – than on achieving narrow economic gains on most specific sectoral issues.

Chronology of U.S.-Korea Relations January-March 2007

Jan. 15, 2007: U.S. and South Korean trade negotiators meet in Seoul to continue discussions on a free trade agreement.

Jan. 16-18, 2007: U.S. and North Korean negotiators meet in Berlin to discuss the nuclear issue.

Jan. 30-Feb. 1, 2007: Treasury Deputy Assistant Secretary for Terrorist Financing and Financial Crimes Daniel Glaser hosts financial talks to discuss Banco Delta Asia and counterfeiting concerns with DPRK officials at the U.S. Embassy in Beijing.

Jan. 31, 2007: U.S. Congressman Michael Honda (D-Ca) introduces nonbinding resolution in the House of Representatives calling for the Japanese government to apologize unambiguously for its role in the “comfort women” issue during World War II.

Feb. 7-8, 2007: The U.S. and ROK hold Security Policy Initiative talks.

Feb. 8, 2007: U.S. and South Korean negotiators meet to resolve differences on the relocation of U.S. military bases in South Korea.

Feb. 8-13, 2007: The Six-Party Talks convene in Beijing. At the conclusion of the proceedings, a phased “action for action” agreement is reached.

Feb. 9, 2007: *Asahi Shimbun* reports that during the January Berlin U.S.-DPRK bilateral meeting the parties signed a memorandum of understanding under which North Korea agreed to freeze its Yongbyon nuclear reactors for energy and economic assistance.

Feb. 12, 2007: *The New York Times* reports that the North Korea demand for huge amount of oil and energy in exchange for its nuclear weapons program nearly stalls the talks.

Feb. 13, 2007: Diplomats reach agreement at the Six-Party Talks on phasing in a denuclearization agreement for North Korea.

Feb. 13, 2007: President Roh Moo-hyun tells South Korean residents in Spain that he welcomes the breakthrough agreement because a permanent peace regime will not only ease tensions in the region, but also strengthen South Korea’s global credit rating.

Feb. 23, 2007: Defense Secretary Robert Gates and ROK Defense Minister Kim Jang-soo meet in Washington to reaffirm and to look at the future of the U.S.-ROK alliance. They agree that the Joint Forces Command will be disestablished on April 17, 2012.

Feb. 26, 2007: U.S. Treasury official Glaser meets Macau authorities to discuss Treasury Department findings on Banco Delta Asia.

March 1, 2007: PM Abe says that there is no evidence or testimony that the Japanese military forced the so-called women to become sex slaves during World War II.

March 1-6, 2007: Newly appointed Deputy Secretary of State John Negroponte travels to Japan, South Korea, and China to discuss Iran, Iraq, Afghanistan, North Korea, regional security, the war on terrorism, and trade.

March 5-6, 2007: The U.S. and North Korea hold working group meetings in New York to discuss North Korean nuclear arms programs, removal of North Korea from the U.S. list of state sponsors of terrorism, and normalization of relations.

March 11, 2007: Prime Minister Abe reiterates “unfeigned apology” to the “comfort women” and that he stands by the Kono Statement – Japan’s acknowledgement and apology for Japan’s military direct involvement in the running of the “comfort stations” – on a Sunday morning NHK program

March 13, 2007: IAEA head Mohamed ElBaradei visits North Korea; President Roh calls for a new peace regime in Korea after the North Korea nuclear issue is settled.

March 14, 2007: U.S. Treasury finalizes a ruling against Banco Delta Asia that prohibits all U.S. financial institutions from maintaining correspondent accounts for BDA and prevents BDA from accessing the U.S. financial system. China expresses deep regret over Treasury's decision. It also announces that treatment of the North Korean BDA account will be left to the discretion of the Macau authority.

March 14, 2007: Assistant Secretary Hill arrives in Beijing to attend the denuclearization working group, Northeast Asia security working group, and the next round of Six-Party Talks.

March 16, 2007: IAEA head ElBaradei meets in Beijing with U.S., Japanese, and South Korean ambassadors in charge of North Korean nuclear issues to report on his visit to North Korea from March 13 to 14.

March 16, 2007: FM Song and Secretary Rice review the process of the Six-Party Talks working group discussions and the status of the KORUS FTA.

March 19, 2007: U.S. and North Korea agree on the release of \$25 million in frozen funds in a Macau bank; Six-Party Talks open in Beijing.

March 22, 2007: Six-Party Talks abruptly adjourn after technical problems prevent the transfer of frozen funds in a Macau bank to North Korea.

March 25-31, 2007: U.S. and ROK military hold 12th Reception, Staging, Onward Movement and Integration and Foal Eagle exercises in South Korea.

March 24, 2007: Deputy Assistant Secretary Glaser meets Chinese Foreign Ministry officials in Beijing to discuss the transfer of the frozen North Korean funds held at Banco Delta Asia to the Bank of China.

April 1, 2007: U.S. and South Korean trade negotiators announce conclusion of a free trade agreement.