

**Asia's New Institutional Architecture:  
Managing Trade and Security Relations in a  
Post-September 11 World**

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## I. INTRODUCTION

Can regional and interregional institutions better manage the increasing complexity of economic and security ties among the states in Northeast, Southeast, and South Asia? As the international state system undergoes dramatic changes in both security and trade relations in the wake of the end of the Cold War, the Asian financial crisis, and the September 11 attacks, this question is now at the forefront of the minds of both academics and policymakers.

In investigating the origins and evolution of Asia's new institutional architecture in trade and security, we focus on three sets of distinct but related issues. The first concerns the evolution of a new institutional equilibrium in the trade issue area. The second examines the changing path toward security cooperation. The final set of issues addresses the strategic interaction between trade and security arrangements. Each set of questions will be investigated along sub-regional lines, namely Northeast, Southeast, and South Asia, with attention to possible linkages among regions through interregional arrangements.

In this paper, we attempt to theorize about the emerging institutional architecture by systematically taking into account the role of non-state and state actors across the Asian region. Falling communication costs due to globalization have increased the number of participating actors and increased the relevance of "complex interdependence." Besides the traditional actors at the sub-national and national level, transnational actors (TNAs) are increasingly leaving their mark on the international system. Still, increased participation at a distance and a move toward complex interdependence does not necessarily imply the end of politics among "territorial" states. Globalization shrinks distance, but it does not make geography irrelevant. And the filters provided by domestic politics and political institutions play a major role in determining what effects globalization really has and how well various countries adapt to it. Therefore, we seek to

strike a balance between national and transitional actors in forming intergovernmental—if not supranational—institutions in Asia.

As products of culture, economics, history, and politics, geographically defined regions change over time.<sup>1</sup> This is also true of Asia. From one perspective, the Asian region is too heterogeneous to permit the invocation of a “real,” “natural,” or “essential” Asian identity as of yet. Southeast Asia is divided deeply along ethnic, linguistic, and religious lines. In Northeast Asia, the effects of Japanese colonialism and imperialism have left sharply diverging historical memories and interpretations. And conventional analysis has separated South Asia from its “East Asian” counterpart due to geography, economics, politics, history and culture. Such divisions and heterogeneity have inhibited the emergence of a common Asian identity, let alone broad-based, effective Asian institutions.

As we discuss below, the traditional institutional equilibrium in Asia has come under heavy strain in the “triple post” period—the post-Cold War, the post-Asian financial crisis of 1997-98, and the post-September 11 attacks. The new dynamics of rivalry and cooperation among states at both the intraregional and transregional levels is now shaping a new institutional architecture. Political and business leaders from Northeast and Southeast Asia interact with each other more frequently. South Asia’s participation with the rest of Asia in recent years is truly impressive. The future institutional trajectory of Asia is still open, but we believe that it is now timely to examine the shift. We believe that an academically informed approach to the links between trade and security institutions and issues will give us a unique perspective on the types

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<sup>1</sup> For instance, Tsunekawa (2005, p. 103) notes that “Asia” meant not only Northeast and Southeast Asia but also the Indian subcontinent within Japan during the 1940s and 1950s; in the 1960s, however, Asia, as Japan’s partner of regional cooperation, came to refer to Northeast and Southeast Asia, excluding the Indian subcontinent.

of institutional solutions that may be feasible in Asia. In doing so, our hope is to provide policymakers and analysts with an institutional road map for the future.

In what follows, this paper proceeds in five sections. Section II presents an overview of conventional explanations for the lack of institutionalization in Asia. Section III provides a conceptual approach to categorizing types of arrangements, and then presents an empirical overview of developments in Northeast Asia, Southeast Asia, and South Asia. Section IV develops an institutional bargaining game approach and analyzes the process by which various types of trade and security arrangements have been pursued in Asia. Section V summarizes the argument and draws policy implications.

## **II. CONVENTIONAL EXPLANATIONS AND SHIFTING INSTITUTIONAL BALANCE IN ASIA**

At the outset of the Cold War, hostile geo-strategic circumstances and historical animosities shaped a unique institutional path for Asian countries to manage their economic and security ties. In the virtual absence of an alternative mechanism at the regional level, economic and security relations were governed through a combination of U.S. focused bilateral and multilateral arrangements, supplemented by an informal network based on corporate and ethnic connections in the economic arena.<sup>2</sup>

The so-called “San Francisco System,” codified largely through the 1951 San Francisco Peace Treaty between the Allies and Japan, provided Asian countries with a unique institutional mix of bilateralism and multilateralism.<sup>3</sup> It offered America’s Asian allies access to the U.S.

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<sup>2</sup> Cumings (1997); Grieco (1997); Katzenstein (1997).

<sup>3</sup> In the immediate aftermath of World War II, U.S.-Soviet antagonism was heating up to a boiling point, and with the ebb and flow of various situations within the U.S. and overseas, the task of concluding a peace treaty with Japan had been put off. Yet the outbreak of the Korean War on June 25, 1950 pressed the U.S. to conclude a peace treaty promptly and effectively so that it could reconfigure Japan’s role to become a lynchpin of America’s

market in return for a bilateral security alliance with the U.S. It also encouraged Asian countries to participate in broad-based, multilateral forums in both areas of security—e.g., the United Nations (UN)—and trade—e.g., the General Agreement on Tariffs and Trade (GATT) and World Trade Organization (WTO).<sup>4</sup> This system, which proved relatively beneficial for most Asian countries, created few incentives for them to develop regional arrangements until the mid-1990s. At the same time, bitter memories of Japanese and Western colonialism, heterogeneous policy preferences and strategies, and cultural diversity have all been adduced as reasons as to why regionalism was not the preferred path.<sup>5</sup>

For example, since its creation in 1967, the Association of Southeast Asian Nations (ASEAN) has shown a certain degree of institutional capacity in both security and trade matters. Yet ASEAN remains a remarkably modest organization with only scattered signs of institutional deepening and widening. The ASEAN Free Trade Area (AFTA) is a collective effort by ASEAN members to eliminate tariffs on intra-ASEAN trade on a voluntary basis, but no concrete steps have been taken since the idea was first formulated in 1991. Asia-Pacific

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anti-communist front in the Asia-Pacific. In Europe, the U.S.-U.K.-USSR Yalta Agreement of February 1945 had survived as the basis of the Cold War structure until it collapsed in the early 1990s, accompanied by the democratization of Eastern Europe, the demolition of the Berlin Wall, the achievement of independence by the Baltic nations, the reunification of Germany, and the demise of the Soviet Union. In December 1989, when Presidents Gorbachev and Bush released the “end of the Cold War” declaration in Malta, the expression “from Yalta to Malta” was often employed in the mass media as symbolizing the advent of a new era. Conversely, the Yalta system was never established as an actual international order in Asia. By 1951, when the San Francisco Treaty was signed, the Yalta Agreements had been distorted or made equivocal. By contrast, the San Francisco system served as the backbone of the Cold War system in Asia (Calder and Ye (2003) pp. 1-2; Hara (2001) pp. 361-362).

<sup>4</sup> Calder (2004, pp. 138-140) outlines the key defining features of the San Francisco System: (1) a dense network of bilateral security alliances; (2) an absence of multilateral security structures; (3) strong asymmetry in alliance relations, both in security and economics; (4) special precedence to Japan; and (5) liberal trade access to American markets, coupled with relatively limited development assistance.

Economic Cooperation (APEC), a transregional agreement and Asia Pacific's most ambitious institutional experiment, remains an essentially consultative forum—even after fifteen years since its birth, with most members continuing to prefer “loose family-type linkages” to “a formal institution.”<sup>6</sup> Several proposals for a more exclusive Asian club failed throughout the 1990s.<sup>7</sup>

On the security front, Asia lacks the equivalent of the North Atlantic Treaty Organization (NATO) for Europe and the U.S., and alliance relationships in Asia tend to be bilateral, leaving security coordination at the minilateral level under-institutionalized. As Tsunekawa notes (2005: 108), together with large U.S. military forces stationed in Japan, South Korea, the Philippines, South Vietnam, and Guam, these bilateral security treaties became the backbone of the U.S. strategy of a “hub and spoke” network to contain Communist forces in Asia. The ASEAN Regional Forum (ARF), which was launched in 1994, is virtually the only intergovernmental forum for security dialogue in Asia. Yet Asian countries have failed to put their full weight behind ARF.<sup>8</sup>

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<sup>5</sup> Cumings (1997); Grieco (1997); Katzenstein (1997).

<sup>6</sup> Aggarwal and Morrison (1998); Ravenhill (2002); Tsunekawa (2005).

<sup>7</sup> The most oft-cited example is the fate of the East Asian Economic Group (EAEG), proposed by Former Malaysian Prime Minister Mahathir. Strong U.S. opposition, Japan's hesitation, and lukewarm support from most East Asian neighbors led to a downgrading of his idea to the creation of an East Asian Economic Caucus (EAEC) in 1993.

<sup>8</sup> The idea for such a forum originally came from Japan in 1992 as part of its effort to promote region-wide dialogues and cooperation through the ASEAN Post-Ministerial Conference as well as APEC. Although support for such a multinational forum to discuss political and security issues was lukewarm at first, the Japanese initiative bore fruit when the members of ASEAN decided to take the lead. ARF has formed several working groups for intensive discussions on confidence-building measures, preventive diplomacy, and the management and resolution of regional conflicts (Foot, 1998; Leifer, 1996). The weakness of both APEC and ARF as security forums has led to regional effort at launching an unofficial “Track-Two” dialogue such as the Northeast Asia Cooperation Dialogue (NEACD) specifically designed to provide a non-governmental forum for experts from the academic and policy analysis communities as well as government officials. Like ARF, NEACD is a consensus-building enterprise, not a formal negotiating body. In the meantime, some analysts such as Brian Job (2003), classify the NEACD as a Track 1.5 dialogue mechanism since it avowedly seeks to advance a Track 1 forum.

The U.S. was relatively passive and more concerned about how such a transregional security dialogue might constrain U.S. military forces and weaken bilateral alliances in the region. For its part, although an early proponent of multilateral security dialogues, Japan shied away from pushing hard for more substantive discussions and negotiations. China obstructed any moves in this direction for fear of international intervention and pressure on its domestic affairs such as human rights and civil justice. The two South Asian giants, India and Pakistan, were out of the regional scene. As a result, the conventional wisdom was that the development of cooperative security norms among Asian countries would likely have to rely on so-called “concerted bilateralism”—the structuring of a formal bilateral summit process in which major regional powers interact systematically with each other—rather than explicit multilateralism.<sup>9</sup>

Although one might argue that the San Francisco System well-served much of East Asia—if not Asia as a whole—for the postwar era by obviating the need for any significant regional arrangements to manage security and economic relations, this mix of institutions now faces severe challenges. We argue that the traditional institutional equilibrium in Asia, a combination of bilateral and multilateral approaches to both security and trade issues, has come under heavy strain.

Many Asian countries’ long-time commitment to a broad-based, multilateral trade regime is currently in question. Although the July 2004 Geneva meetings restarted the Doha Round of WTO negotiations, the debacle in Seattle in 1999 and the failed 2003 ministerial meeting in Cancun continue to cast their shadow over global multilateral negotiations. At the transregional level, APEC, as a formal mechanism to facilitate economic integration, has been unsuccessful.<sup>10</sup> With respect to informal market integration, the unprecedented economic shocks at the end of

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<sup>9</sup> Evans and Fukushima (1999); Mochizuki (1998).

<sup>10</sup> Aggarwal (2000).

1990s have shown that the seemingly dense networks of Japanese and overseas Chinese business are quite vulnerable.<sup>11</sup> A growing number of Asian countries are now actively pursuing greater institutionalization at the sub-multilateral level, actively weaving a web of preferential arrangements with each other.<sup>12</sup>

With respect to security, the San Francisco system has been gradually modified since the early 1970s by the inclusion of China and other communist countries, but has retained to a remarkable degree the Japan-centric, Washington-dominated form until recently.<sup>13</sup> In the post-September 11 era, however, the fissure in the system is increasingly visible, primarily due to changes in America's alliance policy. With its counterterrorism initiatives, the U.S. is now reconfiguring its traditional security policy in Asia for strategic and logistical reasons, while soliciting multilateral cooperation against terrorism and down-scaling its forward deployment. In order to maintain its strategic strength with less physical presence, Washington has begun to urge its Asian allies to expand their mission to contribute to broader regional security. Attempts to cope with the challenge have shaped regional cooperation. The APEC and ARF, encouraged by the U.S., have adopted a series of counter-terrorism measures. Although anti-terrorism cooperation undertaken by Asian regional organizations focuses on intelligence and information exchanges rather than substantive measures, a more rigorous effort to institutionalize security affairs at the regional level is increasingly becoming a strong possibility.

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<sup>11</sup> Aggarwal and Koo (2005).

<sup>12</sup> The conclusion of Japan's first post-World War II FTA, the Japan-Singapore Economic Partnership Agreement (JSEPA), came at this critical juncture in October 2001. The other economic giant in Asia, China, also signed a framework free trade agreement (FTA) with its neighbors in Southeast Asia in February 2003. In addition, other Asian nations have wasted no time in moving toward preferential agreements, departing from their traditional commitment to the WTO. For the details of East Asian countries' shift toward preferential trade arrangements, see Aggarwal and Urata (2005).

<sup>13</sup> Calder and Ye (2003).

What might these developments imply for Asia? How are U.S. relations with Japan and China likely to be affected? Will new developments undermine or enhance the WTO and efforts to manage security concerns on a broader basis? To examine these questions, we first begin by examining the institutional landscape in the region.

### **III. MODES OF TRADE AND SECURITY ARRANGEMENTS IN ASIA**

The literature on Asian regionalism fails to distinguish between various modes of governance of trade and security issues. Lacking well-institutionalized organizations like the European Union (EU) and the NATO, Asian countries have relied on official and unofficial, formal and informal, bilateral and multilateral dialogues to manage their economic and security relations. In this section, we explore different types of trading and security arrangements by classifying them according to the number of participants and the degree to which accords are geographically concentrated or dispersed. The first part of this section provides a conceptual approach to categorizing types of arrangements based on these dimensions. The second section then presents an empirical overview of developments in Northeast Asia, Southeast Asia, and South Asia.

#### **Categorizing Institutional Arrangements in Trade and Security**

Asian countries have utilized a host of measures to regulate trade flows and to assure security in an anarchic world. In terms of the number of participants, these include unilateral, bilateral, minilateral, and multilateral strategies; in terms of coverage, the range has been narrow in scope or quite broad. In addition, some arrangements tend to be focused geographically, while others bind states across long distances. Finally, other characteristics one might examine include the strength and institutionalization of accords, their timing, and the like. Of these many possible dimensions that one might use to classify trade and security arrangements, we focus on two

particular dimensions to simplify this narrative description, namely *actor scope* and *geography*. This approach will allow us to systematically classify the types of arrangements that have been pursued in Asia as a basis for further analysis. For sake of presentation, we do not illustrate issue/product coverage and the strength or level of institutionalization of agreements, although we will discuss these elements in our in-depth analyses in the future.

**Table 1: Modes of Trade and Security Arrangements in Asia\***

<i>Number of Actors</i>						
<i>Arrangements</i>	<b>Unilateral</b>	<b>Bilateral</b>		<b>Minilateral</b>		<b>Multilateral</b>
		<i>Geographically concentrated</i>	<i>Geographically dispersed</i>	<i>Geographically concentrated</i>	<i>Geographically dispersed</i>	
	(1)	(2)	(3)	(4)	(5)	(6)
	Various trade liberalization measures taken by Singapore and Hong Kong	Japan-South Korea FTA (under negotiation)	Singapore-New Zealand CEP (2000)	ASEAN (1967)	PAFTAD (1968)	GATT/ WTO (1947/1995)
	APEC Individual Action Plans (IAPs)	China-South Korea FTA (under study)	Japan-Singapore EPA (2002)	AFTA (1991)	PBEC (1980)	ITA (1997)
	Unilateral use of force	Joint military exercises	Korea-Chile FTA (2002)	China-ASEAN FTA (2003)	APEC (1989)	BTA (1998)
			U.S.-Singapore FTA (2003)	Northeast Asian FTA (proposed)	EAEC (1994)	FSA (1999)
			Taiwan-Panama FTA (2003)		CSCAP (1993)	UN operations (1945)
			Japan-Mexico FTA (2004)		ARF (1994)	
			Korea-Singapore FTA (2005)		ASEM (1996)	
			U.S. military treaties with Japan, South Korea, and others in Asia		ASEAN Plus Three (1998)	
					ASEAN-Japan Closer Economic Partnership (proposed)	

\*Adapted from Aggarwal (2001); Updated as of December 2005 with illustrative examples.

(1) Unilateral trade liberalization includes measures such as those by Singapore and Hong Kong, as well as APEC-fostered efforts, such as Individual Action Plans (IAPs). Other than these few cases, however, unilateral trade liberalization efforts have been as relatively rare in Asia as in other regions. Unilateral security management often involves actions that are detrimental to overall regional security. For example, China's occasional use of threat and/or force in the South China Sea and the Taiwan Straits has frustrated its neighbors as well as the U.S., destabilizing relations in the region. In contrast, as a floating arm of the U.S. military in the Asian region, the Seventh Fleet seems to stabilize the area simply by making its presence known. For example, the occasional appearance of the Seventh Fleet in the Taiwan Straits has usually coincided with heightened tensions between China and Taiwan.

(2) The prospective Japan-South Korea and South Korea-China FTAs fall into the category of geographically concentrated *bilateral subregionalism* in trade issue area. More often than not, such agreements indicate not only geographic, historic, and cultural affinity but also complementary industrial structures. Their counterpart in the security realm can be found in a "spider-web" of bilateral military ties that links together the states of Southeast Asia, with the majority of joint military exercises taking place between Indonesia, Malaysia, and Singapore.<sup>14</sup>

(3) The category of geographically dispersed *bilateral transregionalism* in trade issue areas includes the bilateral FTAs between Singapore-New Zealand (2000), Japan-Singapore (2002), South Korea and Chile (2002), Singapore-U.S. (2003), Japan-Mexico (2004), to name just a few. Meanwhile, the most significant transregional-bilateral defense ties exist between Asian

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<sup>14</sup> Acharya (1993).

countries and the U.S. The post-war U.S. grand strategy has revolved around bilateral security and economic ties with its allies in the region.

(4) The next category is geographically focused minilateral agreements. In the trade realm, Southeast Asian initiatives at the minilateral level—such as the AFTA, and the ASEAN-China FTA (ACFTA) framework agreement of 2002—fall in this category. In the Northeast Asian region, Japan, China, and South Korea are increasingly discussing the potential benefits of institutionalizing economic—and, though with less enthusiasm, security—relations among themselves. In the security area, the ASEAN as a geographically focused body was originally created in 1967 in order to promote peace and stability in the region in the wake of the Vietnam War. At their summit in Phnom Penh on November 4, 2002, the ten member-states of ASEAN and China signed a Declaration on the Conduct of Parties in the South China Sea, with the aim of preventing conflict and promoting cooperation in the region. In the sub-continent, the South Asian Association for Regional Cooperation (SAARC) aims to promote cooperation not only on security, but also on soft issue areas like tourism and agriculture. A prominent example of participation in security matters by NGOs is the ASEAN Institutes for Strategic and International Studies (ASEAN ISIS).

(5) The next category refers to geographically dispersed transregional/interregional arrangements. Transregional/interregional trade arrangements include the East Asian Economic Caucus (EAEC, 1994), APEC (1989), the Asia-Europe Meeting (ASEM, 1996), the ASEAN-Japan Closer Economic Partnership agreement (proposed in 2002), and the ASEAN Plus Three (APT, 1998). The setting up of semi-institutionalized, non-governmental institutions as confidence-building instruments and groundbreakers prior to the founding of official

transregional/interregional institutions has become an established practice in the Asian region. For instance, the Pacific Trade and Development Conference (PAFTAD), Pacific Economic Cooperation Council (PECC), and Pacific Basin Economic Council (PBEC) preceded the establishment of APEC.

The best example of transregional security forum is ARF, consisting of twenty-four countries including ASEAN member countries, China, Japan, South Korea, and the U.S. ARF follows ASEAN's pattern of gradual institutionalization and provides a setting for preventive diplomacy, confidence building measures, and conflict resolution. Though an economic forum, APEC as a transregional forum has also been used recently as an arena in which to discuss security matters, particularly since the September 11 terrorist attacks. Also, NGOs are increasingly becoming active at the transregional level—the Council for Security Cooperation in the Asia-Pacific (CSCAP) and the Council for Asia-Europe Cooperation (CAEC), for instance.

(6) The final category includes global trading arrangements, such as the multilateral broad-based arrangement of the GATT of 1947 and its successor organization, the WTO of 1995. East Asian countries have also been participants in multilateral sectoral market opening agreements such as the Information Technology Agreement (ITA), the Basic Telecom Agreement (BTA), and the Financial Services Agreement (FSA).

In pursuit of security assurances, all the South, Southeast, and Northeast Asian countries—with the exception of Taiwan—have become UN members in the postwar period. From one perspective, the UN has never been a prominent place for mediating, managing, or resolving some of the major conflicts that have wracked the Asian region. The continuing tension between North and South Korea and between China and Taiwan, the earlier wars between North and South Vietnam, China and India, and India and Pakistan—to name but a few

of the most serious instances of violence—have been dealt with largely in the absence of major UN initiatives. Nevertheless, the UN has often provided vital support, acting sometimes as a third-party facilitator or neutral mediator, and sometimes it has operated in important ways behind the scenes.<sup>15</sup>

## **Regional Overview**

*Northeast Asia.* In Northeast Asia, the Sino-Soviet-American “strategic triangle” during the Cold War has been superseded by a new triangular relationship between the U.S, Japan, and China, while the influence of Russia on regional matters has significantly receded. The complex balance of power in the region does not allow for a single pacesetter. In a region with an already awkward balance between the U.S., China, and Japan, the current nuclear standoff originating from the Korean peninsula has set everyone scrambling. As Calder and Ye (2003) note, some crises, catalyzed by developments in North Korea, may drive the other countries in the region together. Yet one might also argue that such a crisis is likely to exacerbate incipient conflicts among these actors.

For all the power of the U.S. and Japan, the past two decades have been most notable for the regional surge of China, which is at the heart of the political-strategic realignment of Asia. Economic development has enabled China to increase defense spending, upgrading military equipment and training, strengthening its capabilities, and investing in more strategic planning for future warfare in the process. China is unhappy with the political and territorial *status quo* in the region. It occasionally attempts to challenge the balance in the South China Sea and over

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<sup>15</sup> Foot (2003).

Taiwan. It seeks respect as a great power, and tends to see the U.S. and Japan as the chief threats to its ambitions.<sup>16</sup>

The contemporary concern is whether China's strengthened military capability could present itself as a threat to regional stability. Power transition theories would cast a relatively pessimistic outlook regarding the future of regional stability, because the dissatisfied rising power (i.e., China) would challenge the existing order, typically by fighting a major war.<sup>17</sup> China's constant complaints about the U.S. imposition of Western values on its sovereignty are one clear sign of dissatisfaction, and its claims and actions in the South and East China Sea are harbingers of further instability.<sup>18</sup>

From one perspective, the democratic transition of Taiwan is driving the Taiwan Strait issue and exacerbating it. Given China's view of Taiwan as an essential element of its national identity and its willingness to bear the serious costs of aggressive actions, the periodic tension across the Taiwan Strait in the recent past is not puzzling. Despite the increasing conflict over the issue of identity, the balance of power remains salient. Above all, a strong U.S. commitment to defend Taiwan has precluded China from imposing a solution against Taiwan's wishes. In contrast to the situation in the Korean peninsula, the dramatic changes in China-Taiwan relations over the past two decades have therefore implied less likelihood of militarized conflict between two Chinas. Indeed the issue of identity is consequential in large part because of American support, which prevents Beijing from overwhelming Taiwan through coercion or force.<sup>19</sup>

Despite simmering tensions, there have been various official and unofficial, formal and informal, bilateral and multilateral dialogues to resolve regional security issues. Although their

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<sup>16</sup> Shambaugh (1995, 2004/05); Xie and Wyner (1998).

<sup>17</sup> Organski (1968); Organski and Kugler (1980).

<sup>18</sup> Huang (2003) p. 8.

strength and effectiveness remains unclear, the variety of channels for security interactions in Northeast Asia indicate positive and dynamic processes in exchanging information and opinions, which should be promising signs for regional peace and stability. In particular, the current nuclear crisis on the Korean peninsula and the formation of the six party process to deal with the issue has given rise to the possibility that a more formal organizational framework for multilateral cooperation in Northeast Asia could be established, likely in the form of a Northeast Asian Security Dialogue (NEASD).<sup>20</sup> The recent breakthrough gives rise to the promise of a more permanent minilateral dialogue mechanism in Northeast Asia.<sup>21</sup>

In addition the burgeoning Northeast Asian regional institutional framework in trade has generated positive expectations for the region's institutional future. The dynamics between two regional rivals—Japan and China—and South Korea as a bridge between them are of great importance not only to the Northeast Asian region itself but also to the rest of Asia. In the triple post period, the new dynamics of rivalry between Japan and China is playing a critical part in shaping the newfound rush to preferential trade arrangements. Besides standard welfare calculations, for both Japan and China, emerging interest in preferential trade arrangements provides a convenient venue in which to vie for regional economic leadership. In the regional context of the growing Sino-Japanese rivalry, South Korea pursues preferential arrangements in order to strengthen its bargaining position and diplomatic weight.<sup>22</sup>

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<sup>19</sup> Kang (2003) pp.361-366.

<sup>20</sup> Pritchard (2004) pp. 1-3.

<sup>21</sup> On September 19, 2005, North Korea pledged to abandon its entire nuclear program in return for security and energy guarantee. The agreement, although vague, was the first real achievement of the six-party negotiating process (*The Washington Post*, September 19, 2005).

<sup>22</sup> Aggarwal and Koo (2005), pp. 202-210.

*Southeast Asia*. ASEAN has shown a certain degree of institutional capacity in both security and trade matters. In particular, AFTA is a collective effort by ASEAN members to eliminate tariffs on intra-ASEAN trade on a voluntary basis; however, no concrete progress has been made since the idea was first formulated in 1991. Among others, Singapore's search for sub-multilateral alternatives beyond ASEAN is motivated by dismal prospects for the progress of AFTA. To a large extent, Singapore's efforts at bilateral FTAs clearly marked a fundamental shift in its trade policy, which had hinged upon multilateralism and close ties with ASEAN members for the last four decades.<sup>23</sup>

Former Malaysian Prime Minister Mohammed Mahathir had looked warily upon the FTA forays of fellow ASEAN members, criticizing their actions as “worrisome” and “damaging to the unity of regional groupings such as ASEAN.” Malaysia was frustrated by the possible erosion of FDI inflows resulting from bilateral FTAs with non-ASEAN countries. In December 2002, however, for the first time Mahathir showed an interest in promoting trade and investment through bilateral talks with Japan. Among ASEAN members, Thailand presents an intermediate position between Singapore and Malaysia, as it is neither a vocal supporter nor a strong opponent of Asian bilateralism.<sup>24</sup> Most importantly, at the Phnom Penh summit in November 2002, China and ASEAN signed the ACFTA framework agreement, intending to create the world's largest FTA, with a market of 1.7 billion people, almost \$2 trillion in GDP, and trade totaling \$1.2 trillion annually.<sup>25</sup>

On the security front, the picture in Southeast Asia has become complicated by the growing presence of China. Most significantly, the end of the Cold War created a strategic

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<sup>23</sup> Lee (2005).

<sup>24</sup> Kiyota (2005); Okamoto (2005).

<sup>25</sup> Kwei (2005).

vacuum in the South China Sea. The changes include the collapse of the Soviet Union and its departure from Cam Ranh Bay; the closure of U.S. naval bases in the Philippines; and Vietnam's withdrawal from Cambodia. These events also prompted several Southeast Asian littoral governments to re-calculate the strategic and national security implications of sovereignty claims made to islands in the South China Sea. During the 1990s, incidents related to fisheries, oil exploration and military occupation of islands and reefs in the South China Sea were major irritants in China's relations with the Southeast Asian countries.<sup>26</sup>

Many ASEAN members worry that China has been working to acquire a blue-water navy and other offensive force projection capabilities, such as longer-range aircraft, aerial refueling capabilities, and more modern, harder-to-detect submarine technology. Although the Chinese navy is currently limited in its offshore capabilities and although development of indigenous production capability is taking place at a rather slow pace, concerns among Southeast Asian countries may be legitimate. In response, some Southeast Asian countries have begun to take limited but significant military modernization steps of their own, meant to enhance their command and control capabilities, thereby creating the potential for a regional arms race around the South China Sea.<sup>27</sup>

Nevertheless, the disputes over offshore islands have prompted many multilateral dialogues and confidence building measures to facilitate peaceful solutions in the South China Sea. Notable examples of more systemic efforts include the ARF, CSCAP, and a series of workshops on "Managing Potential Conflicts in the South China Sea."<sup>28</sup> More positive progress was made at the ASEAN summit in Phnom Penh on November 4, 2002, when the ten member-

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<sup>26</sup> Koo (2005b) pp. 196-238.

<sup>27</sup> Snyder (1996).

<sup>28</sup> Djalal (1998).

states of ASEAN and China signed a Declaration on the Conduct of Parties in the South China Sea, with the aim of preventing conflict and promoting cooperation in the region. The recent declaration does not establish a legally binding code of conduct: it is simply a political statement. Nevertheless, if its terms are respected and further incidents are avoided, this will mark a significant change.<sup>29</sup>

*South Asia.* South Asia has remained essentially inhospitable to official and unofficial, formal and informal, bilateral and multilateral dialogues to resolve regional security and trade issues. By and large, subregional conditions fail to meet the minimal levels of trust and incentives for official and unofficial interaction. The geopolitical asymmetry of South Asia has yet to be overcome. India's dominance of economic, political, and security matters has increased in the post-Cold War period. Hostility between the key actors, India and Pakistan, is sustained by ongoing conflict and inflamed by domestic political actors. Furthermore, practical barriers to communication, caused by technological problems or imposed by rigid government regulations and influence over the media, inhibit people-to-people interaction across the borders.<sup>30</sup>

At minimum, the South Asian Association for Regional Cooperation (SAARC) was established on December 8, 1985 by the heads of states or governments of Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka. SAARC aims to accelerate the process of economic and social development among member states. Institutionalization, no matter how loose, was needed to stabilize the awkward balance of power in the Sub-Continent. The next phase of SAARC came about after the dissolution of the USSR. In the post-Cold War climate, economic issues began to move to the forefront of discussions, becoming the vehicle for

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<sup>29</sup> Tønnesson (2003) pp.55-56.

<sup>30</sup> Job (2003).

cooperation in the region. However, the institutional capacity of SAARC fell short of resolving prominent security issues in the region such as the territorial dispute over Kashmir and the establishment of Khalistan in Punjab.<sup>31</sup>

In 2003, diplomatic links were resumed between the two countries and the two sides agreed to a ceasefire along the unofficial border surrounding Kashmir. Since the Indian National Congress (INC)-led coalition came to power in May 2004, India has pledged to seek friendly relations with Pakistan and the two parties renewed a ban on nuclear weapons tests that was set to expire. In September 2004, the foreign ministers from both countries met in Delhi—the first meeting at such a high level in years. Yet no concrete results have been produced thus far.<sup>32</sup>

America's "war on terror" has driven both India and Pakistan to a unique type of political brinksmanship. In the current international climate, both India and Pakistan want to curry America's favor, and see peacemaking as a way to do this. Thus, both parties try to outdo each other, and offer even more generous offers, extending the scope of the 2003 ceasefire even past the Line of Control all the way to the Siachen glacier. Thus, competition has developed within the region to please external actors.<sup>33</sup>

In addition, South Asian countries' external relations have significantly changed in the post-September 11 era. Since the 1962 Sino-India War, the two regional giants remained suspicious about each other's military intent. In particular, China's support of nuclear development programs in Pakistan infuriated India and forced the two nuclear powers into a pseudo-arms race that has the potential of developing into a full-blown rivalry. Yet September

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<sup>31</sup> Paranjpe (2002).

<sup>32</sup> *BBC News World Edition*, "Modest Progress in Delhi Talks," September 6, 2004.

<sup>33</sup> McGivering (2003).

11 has created an *impromptu* triangular relationship between India, China, and the U.S., stabilizing the otherwise hostile Sino-India relationship.<sup>34</sup>

The improvement of South Asia's relationship with Southeast Asia is dramatic. Since India launched the 'Look East Policy' in the early 1990s, Indo-ASEAN ties have grown increasingly solid, from mere sectoral dialogues in 1992, to the 2002 ASEAN-India summit where the two parties agreed to create a Regional Trade and Investment Area (RTIA). The relationship has also widened its scope to address security issues, with India joining the ARF in 1996. In the past few years, the two parties have put into place institutional frameworks to facilitate cooperation, including the establishment of an ASEAN-Indian Business Council (AIBC) designed to assist efforts in the private sector.<sup>35</sup>

While the current volume of bilateral trade still remains relatively small (in 2003, for example, India accounted for less than 2 percent of ASEAN's total trade), it is expected to double by 2007. The benefits of a prospective RTIA go beyond the economic realm. Along with its new place on the ARF, India has taken an increased interest in security issues in Southeast Asia, and vice-versa, as evidenced by India's accession in October 2003 to the Treaty of Amity and Co-operation (TAC), a non-aggression pact that assures non-interference with the internal affairs of other signees, and anti-terrorism discussions held at the second ASEAN-India summit in 2003.<sup>36</sup> Pakistan has followed suit, and signed a TAC with ASEAN and joined the ARF as its 24th member in July 2004. If the trend that started in India continues in Pakistan, the

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<sup>34</sup> Garver (2002).

<sup>35</sup> Gaur (2003).

<sup>36</sup> Gaur (2003).

South Asian region will be tied together economically with the ASEAN region, perhaps paving the way for further intra-South Asian multilateral agreements.<sup>37</sup>

#### **IV. ANALYZING ASIA'S INSTITUTIONAL ARCHITECTURE**

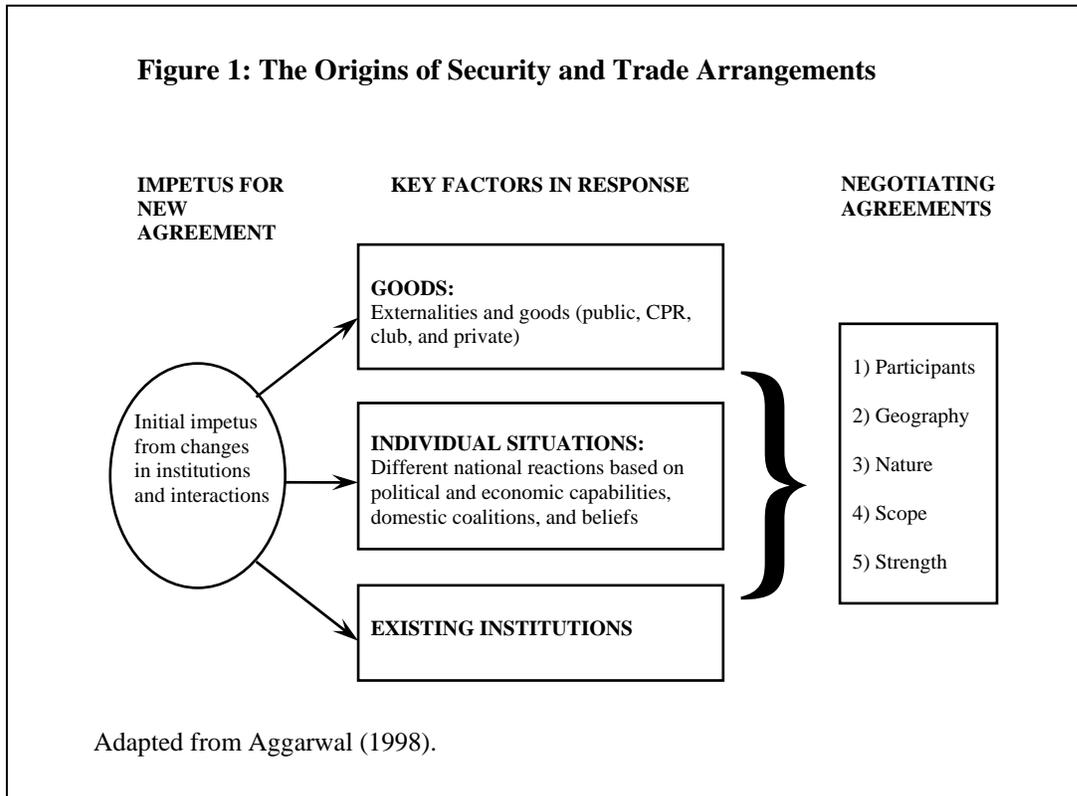
A number of factors have changed the institutional equilibrium in Asia. Much ink has been spilled over the uniqueness of Asian regionalism that has formed during the postwar period, but little progress has been made in our understanding of the shifting dynamic between trade and security ties among Asian countries in the triple post period. As a result, we offer an institutional bargaining game approach to more adequately analyze the process by which various types of trade and security arrangements have been pursued in Asia, with an aim to understand its emerging institutional architecture.

An institutional bargaining game approach begins by identifying the initial impetus for a new trade and security strategy. The process of a shift from an initial institutional equilibrium to a new one generally comes about with some external shocks that create pressure for change. Countries respond to such external shocks in various ways based on their individual political-economic situation. To systematically analyze why different countries respond in different ways, we focus on the interplay of three interrelated elements, namely goods, individual bargaining situations, and the existing institutional context. As countries attempt to meet their trade and security needs in a new environment, they negotiate new arrangements or modify existing ones, while interacting strategically within the context of broader institutional arrangements such as the UN and the WTO. In so doing, countries are likely to bring lower-level arrangements into conformity with broader level trade agreements, or nest their arrangements, both for strategic

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<sup>37</sup> ASEAN, "The Islamic Republic of Pakistan Instrument of Accession to the Treaty of Amity and Cooperation in Southeast Asia," July 2, 2004.

reasons and due to institutional constraints. Whether such nesting actually is possible for sub-multilateral accords is critical for understanding the interaction of different types of trade and security accords. Figure 1 illustrates the key elements and process of our institutional bargaining game approach.



### **Initial Impetus for a New Trade and Security Strategies**

The pressure for a shift from the traditional institutional path to a new equilibrium in Asia came about through three major external shocks in the past fifteen years.

First, the end of the Cold War has made it politically easier for Asian countries to consider regional institutionalization. The end of bipolarity has reduced the significance of Cold War perceptions and divisions, breaking down barriers that had previously precluded regional

economic and security cooperation between capitalist and communist blocs. Relatedly, the U.S. has adopted a less antithetical position towards regional organizations.<sup>38</sup>

The second (and primarily economic) turning point was the Asian financial crisis of 1997-98. This crisis revealed a number of institutional weaknesses that Asian countries shared. Most importantly, Asian economies continued to export to the U.S. and other developed country markets where they could sell the investment-fueled output that vastly exceeded the absorption capacity of domestic consumers. It was not until the financial crisis, which exacted heavy tolls, that many in Asia came to recognize that tighter institutionalization of intraregional commercial and financial ties might be a better commitment mechanism for providing economic security, and thus began to actively weave a web of preferential arrangements, targeting countries both within and outside the region.<sup>39</sup>

The third and critical turning point is the September 11 terrorist attacks. Among the more fundamental shifts produced by the September 11 attacks, the American global war on terror has called into question the fate of the Asian balance of power system, which has been long credited by conventional strategic thinking for the maintenance of the region's peace and prosperity.<sup>40</sup> As will be discussed below in more detail, the post-September 11 development puts unpredictable pressure on the emerging strategic triangle between the U.S., China, and Japan.

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<sup>38</sup> Breslin and Higgott (2000).

<sup>39</sup> Aggarwal and Urata (2005).

<sup>40</sup> Acharya (2003).

## **Key Factors in Response: Goods, Individual Situations, and Institutional Context**

Given the initial impetus for a new trade and security strategy, the three elements of the institutional bargaining game—goods, individual bargaining situations, and existing institutional context—determine how different countries respond in different ways to external shocks.

*Goods.* Asia's new appetite for preferential trading arrangements reflects a convergence of interests in securing inclusive "club goods" in the face of anemic, if not shrinking, economic prospects.<sup>41</sup> For Asian countries, with the exception of China, the seemingly endless export boom of the 1980s and early 1990s began to face problems in the mid-1990s. At the end of 1995 the "trade triangle" that had linked Japanese (and overseas Chinese) capital, developing Asian manufacturing capacities, and Western markets appeared to be in trouble. For example, Thailand experienced a drastic drop in its export market growth rate—from 31.6 percent in 1995 to 4.1 percent in 1996. As a result, its current account deficit reached 8.1 percent of GDP, and remained at that high level in 1996. Other Southeast Asian economies faced a similar threat.<sup>42</sup>

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<sup>41</sup> There is significant debate, reflecting different ideas, about how to characterize trade liberalization and international security. From one perspective, both international security and trade liberalization are seen as a public good since they are non-rival and non-excludable in consumption. Others, such as neoliberal institutionalists, see the game of liberalization and peace as a Prisoner's Dilemma (PD) game, where everyone could be better off if cooperation is achieved, but where the dominant strategy is to defect. In this view, international regimes provide an institutional basis for fostering cooperation and peace. Trade and security arrangements that have fewer participants reduce the possibility of free riders (by definition) and ensure that gains from trade liberalization and security cooperation are an inclusive club good that accrues only to the participants to the agreement.

<sup>42</sup> For example, Malaysia reached an even higher deficit level of 9.7 percent of GDP in 1995. Beginning in 1993, Indonesia's and South Korea's deficits increased steadily, reaching 3.37 percent and 4.75 percent of GDP in 1996, respectively. Behind these figures was a dramatic slowdown in the growth of exports (Asian Development Bank, *Key Indicators of Developing Asian and Pacific Countries*; World Bank, *World Development Indicators*). Two events precipitated the end. First, in 1994 China devalued its currency, making its labor-intensive exports highly

One major option for the crisis-ridden countries and their affected neighbors was to secure preferential access and create a more diversified export market. With traditional mechanisms within WTO and APEC offering no salient solutions, these countries quickly turned toward preferential trading arrangements to assure a market for their products.

In the security realm, the San Francisco system has provided Asian countries with security as a club good made available from their alliance with the U.S., with the U.S.-Soviet balance of power standoff having elements of a public good for other' security. In the post-Cold War and post-September 11 era, however, the provision of this particular type of club good and its associated public aspects is not likely to continue. As such, ways of regional provision are now being considered, though falling short of a collective security mechanism, mainly due to the unresolved antagonism and rivalry between the two regional giants, China and Japan. The Six Party Talks to resolve the North Korean nuclear crisis offers an early indication of a multilateral mechanism to settle security problems in Northeast Asia and beyond.

Indeed, whether or not security relations in Asia evolve in a cooperative or conflictual direction will depend to a large extent on how the North Korean nuclear questions are managed. Furthermore, a resolution of the Korean conflict will inevitably lead to some reduction of U.S. military forces in the Korean peninsula and perhaps even in Japan. Americans may be eager to bring troops home, Koreans, for nationalistic reasons, may seek at least a partial U.S. military withdrawal, and China is likely to oppose a robust U.S. presence on the peninsula without the

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competitive relative to those from its East Asian competitors. In response, many Japanese manufacturers and overseas Chinese businesses shifted export-oriented FDI to coastal China. Second, the yen lost 18 percent of its value against the dollar between 1995 and 1996; a sharp depreciation that, for Japanese manufacturers, removed much of the competitive advantage of exporting from Southeast Asian countries, most of whom still pegged their currency to the rising U.S. dollar, which, in turn, made Japanese multinationals less attracted to Southeast Asia as the destination of their capital (Hatch, 1998).

existence of the North Korean buffer. All of this does not mean that the U.S.-South Korea alliance will be terminated in the near future; nor does it mean that the alliance might become looser and strategic alignments more fluid.<sup>43</sup>

*Individual Situations.* While there are many factors that might affect state actors' individual preferences and situations, the most significant elements that determine national responses to an external shock include: (a) an actor's international position<sup>44</sup>; (b) the makeup of its domestic coalitions and regime types<sup>45</sup>; and (c) elite beliefs and ideologies.<sup>46</sup>

International positions: Among others, two aspects of the international context have been the basis for theorizing about trade and security relationships. The first international factor concerns a nation's relative position within the international continuum of economic development. For instance, a country with a large market—either actual or potential—is more likely to entice others to seek it out as a trading partner rather than the other way around. Many Asian countries' approach to China as an FTA partner illustrates the point. In turn, this attractiveness may provide the larger country with greater political leverage.

As to the second international factor, security concerns may also drive an interest in new trade and security agreements as a means of linking one's fate to other countries. Countries may prefer trade with their (potential) allies, avoiding trade with enemies because the relative gains realized from free trade can cause changes in the relative distribution of power in politics and military affairs. For example, the ACFTA is clearly driven by the security concerns as well as

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<sup>43</sup> Mochizuki (1998).

<sup>44</sup> Aggarwal (1985); Gowa (1995).

<sup>45</sup> Grossman and Helpman (1995); Milner (1997).

economic considerations held by both Chinese and ASEAN political leaders.<sup>47</sup> Therefore, one might hypothesize that trade accords are more likely to overlap with alliance relationships. Alternatively, allied relationships are more likely to be successful in realizing trade expansion.<sup>48</sup>

In theory, rapid shifts in major powers' relative position can complicate the task of balancing against threatening or rising countries. One danger is that the more advanced powers will not make the necessary adjustments fast enough to sustain a stable balance of power. This could then embolden the rising power to become more assertive, especially if it has a revisionist agenda of challenging the territorial status quo.<sup>49</sup> The other danger is that more advanced powers will, in paranoia, overreact. Rather than becoming inhibited by this response, a rising power may then devote more of its resources to building up its military, thus fueling an arms race that increases the possibility of military miscalculation. What emerges is a security dilemma under which efforts by countries to maximize their own security provoke hostile responses by others that ultimately make all the countries in the system more insecure.<sup>50</sup>

For these reasons, many countries in the region are increasingly concerned about the China threat and began to reformulate their security policy in accordance with that perception. From Japan's perspective, for example, the rise of China should reinforce its interest in the security relationship with the U.S. Not only does geographic proximity make China more threatening to Japan, but economic interests and shared democratic values make the U.S. by far the more attractive strategic partner. The greater uncertainty is America's willingness to sustain its defense commitment to Japan because the U.S. has the geopolitical luxury of disengaging

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<sup>46</sup> Haas (1992).

<sup>47</sup> Kwei (2005).

<sup>48</sup> Gowa (1995); Mansfield, Milner and Bronson (1997).

<sup>49</sup> Organski (1968); Organski and Kugler (1980).

<sup>50</sup> Jervis (1978).

from Asia with minimal negative security consequences. But if the U.S. did terminate its alliance with Japan and shift to what some have called an “offshore” balancing strategy, Japan would be inclined either to adopt an independent defense strategy that would include a nuclear arsenal as well as power projection capabilities or to bandwagon with China.<sup>51</sup>

Pressure groups and political regime type: In Asia, individual bargaining situations in terms of pressure groups and regime type have changed significantly as a result of the financial crisis and the end of the Cold War. State structures vary significantly in the region—ranging from highly democratic—e.g., Japan, South Korea, and India—to highly authoritarian—e.g., China, Vietnam, and Cambodia—regimes. Though with different degrees, many governments in the region experienced challenges to their political legitimacy and actual political turnover by groups and individuals who had previously tolerated cronyism and familism. Such a development in the regime structure as well as societal pressures have altered the economic and security payoffs confronting individual countries, as they move toward more liberal and democratic regimes, rendering cooperative outcomes at the inter-governmental level more likely and the requirements of institution-building less daunting.

As Papayouanou (1996) notes, the economic interests that Japan and the U.S. have in China might constrain these countries from standing up to China on security matters for fear of losing commercial opportunities. The democratic political systems of both countries will enable their respective business communities to persuade their governments to avoid antagonizing China. But an authoritarian Chinese state would be relatively immune from domestic economic interests that might have a stake in good relations with Japan and the U.S. One way to avoid the dangerous situation that flows from this situation is to help China to evolve into a democratic

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<sup>51</sup> Mochizuki (1998).

state in which international economic interests constrain security policy as much as they do in Japan and the U.S. This possibility is consistent with the insights of democratic peace theory that collaboration is more likely between stable democracies.<sup>52</sup>

Elite beliefs and ideologies: The third and last dimension of individual bargaining situations concerns elite beliefs and ideologies about the causal connections among issues and the need to handle problems on a multilateral, minilateral or bilateral basis. Besides the Asian financial crisis of 1997-98, the setback in Seattle has significantly eroded the traditional confidence in multilateral trade liberalization. The eroding confidence of Asian countries in America's military commitment to the region in the post-September 11 period has made everyone scramble in search of alternative security mechanisms. These changes have led to the construction of new ideational formulas that support "Asian" alternatives for trade and security.

In the development of the trade and security architecture of an avowedly state-centric regional order, the growing influence of nongovernmental institutions and unofficial processes is truly notable. Many experts in the region now are part of an "epistemic community" which shares the view that regional arrangements can be trade-enhancing and that a regional security institution is the right course to take in the face of a loosening San Francisco alliance system.<sup>53</sup> The informal security diplomacy through "Track 2" dialogues—such as the Northeast Asia Cooperation Dialogue (NEACD) and Council for Security Cooperation in the Asia-Pacific (CSCAP)—is a good example of the emerging epistemic community in Asia.<sup>54</sup> As Job (2002)

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<sup>52</sup> Doyle (1983); Maoz and Russett (1993); ONeal and Russett (1997).

<sup>53</sup> Tsunekawa (2005).

<sup>54</sup> Track 2, or nonofficial diplomacy refers to "unofficial, informal interactions between members of adversary groups or nations which aim to develop strategies, influence public opinion, and organize human and material resources in ways that might help to resolve their conflict" (Montville (1995), p. 9).

notes, ARF's formation followed shortly after CSCAP's establishment and the ASEAN ISIS played a key role in the establishment of ARF not only in actively promoting its establishment but also in seeking to ensure that ASEAN maintained a central role in ARF's direction and management. Advocates of Track 2 dialogues do not exclude government officials, but reject the notion that state officials should monopolize consideration of trade and security matters. They seek to engage participation of leaders from the academic, financial, social, and political sectors of society in order to bring expertise and new ideas to the table and, more importantly, to foster transnational understanding and confidence building.

*Institutional Context.* The political initiatives and intrinsic interest in creating regional trade and security arrangements reflect the growing need for an “insurance policy” to realize free trade and security sub-multilaterally when traditional mechanisms to provide trade liberalization and security stall or proceed slowly.

On the trade front, many of the recent preferential arrangements in Asia attempt to cover broader areas and elements like trade in services, factor mobility, investment rules, intellectual property rights, government procurement, and other trade facilitation measures such as mutual recognition of product standards and harmonization of customs and quarantine procedures. Furthermore, most Asian countries, stricken by the financial crisis, have a keen interest in accessing the financial resources that might accompany a preferential accord, especially with the region's financial giant, Japan.<sup>55</sup>

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<sup>55</sup> The regional attempt to create an “Asian Monetary Fund (AMF)” during the early stages of the 1997-98 financial crisis was immediately rejected by the U.S., owing to fears that an AMF could undermine the leadership role of the International Monetary Fund (IMF) and foster a split between East Asia and North America. Instead of directly confronting American opposition, the APT countries, therefore, set up a currency swap scheme in Chiang Mai, Thailand, in 2000 as a “firewall” against future financial crises. For more details, see Amyx (2003).

In post-Cold War Asia, an emerging strategic triangle between the U.S., China, and Japan has replaced the Cold War competition between the U.S. and the Soviet Union in the region. Furthermore, post-September 11 developments put additional pressure and strain on the new strategic triangle in Asia. With the collapse of the Soviet threat, the traditional security alliance between the U.S. and Japan seemed to have weakened. In the post-September 11 era, however, both countries recognize their bilateral security relationship as the lynchpin of their defense postures in Asia. Nevertheless, their recovering security tie cannot belie the unsettling reality of Asian security, mainly posed by the rise of China.

China currently acts as a conservative power with an interest in a peaceful international environment so that it can concentrate on economic development.<sup>56</sup> But among others, China has the greatest potential to become a revisionist power. It wants to overcome what it sees as centuries of humiliation by the Western powers. It desires international recognition and respect commensurate with its long history, great culture, and mammoth size. China still appears to have an irredentist agenda of aiming to regain control over Taiwan, the last piece of territory of the great Manchu empire that has yet to be recovered. And unlike postwar Japan, China lacks strong domestic constraints on the use of military force.<sup>57</sup>

### **Negotiating New Trade and Security Arrangements**

If a nation decides to create a new trade and/or security arrangement, it must decide on the participants, geography, strength, nature, and scope of the agreement. In Asia, the latest enthusiasm for preferential trade agreements seems to revolve around a “bilateral” FTA as a popular mode of participation, while there are also strong indications of “minilateral”

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<sup>56</sup> Ross (1997).

<sup>57</sup> Waldron (1996).

participation such as the APT and the ACFTA. Asia's new appetite for FTAs is geographically open. On the one hand, these FTAs go beyond the traditional concept of a region defined by geographical proximity.<sup>58</sup> On the other hand, other "transregional" initiatives have emerged that attempt to formalize the traditional concept of an "Asian economic community" with multiple cross-cutting linkages of trade and investment, as exemplified by the APT initiative.

The strength of these preferential agreements will reflect not only the power of different actors, but also the willingness of governments to give up some autonomy to their trading partners. Moreover, the nature and scope of coverage of such agreements will also be driven by economic concerns about trade competition, investment flow patterns, and the danger of rapid capital flows. Many of the recent FTAs in Asia attempt to cover broader areas and elements beyond trade, indicating their nature of WTO plus or institutional division of labor. At the same time, however, these agreements are potentially incompatible with WTO provisions, since some sensitive sectors are deliberately excluded.<sup>59</sup>

In theory, successful experience at regional economic institutionalization can spill over into the security arena. National leaders who learn how to compromise and cooperate on economic issues have a greater chance of doing the same on traditional security problems or preventing security disputes from escalating to actual military conflict. Over time, regional economic institutions can even transform national attitudes, preferences, and the definition of

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<sup>58</sup> These include FTAs between Singapore-New Zealand (2000), Japan-Singapore (2002), Japan-Mexico (2004), Korea-Chile (2002), Singapore-U.S. (2003), and many others.

<sup>59</sup> For example, the South Korea-Chile FTA is not all-inclusive; the two countries agreed to nominate a number of products that will be excluded from liberalization, including apples, pears, washing machines, and refrigerators. They have agreed to resume negotiations regarding 373 agricultural products after 2005. The issue of financial service investment has been left out of the pact and will not be revisited until 2006 (Koo, 2005a).

interests so that regional accommodation and cooperation become more likely in the security realm.<sup>60</sup> Ultimately, a collective security order might emerge to keep the peace.

## V. CONCLUSION

We began our analysis with the observation that the postwar trade and security order in Asia remained multilayered under the San Francisco System, involving elements of bilateral alliance structures, global institutions for managing economic and security problems, and long-standing informal alternatives. In the wake of the three major external shocks in the past fifteen plus years, however, the traditional institutional equilibrium in Asia has come under heavy strain. As a result, principal actors are now pursuing greater institutionalization at the regional level, actively weaving a web of FTAs and security dialogues.

Explaining the emerging institutional architecture in Asia poses a challenge. In an effort to understand the shifting institutional dynamics, we examined external shocks, goods, countries' individual bargaining situations, and the fit with existing arrangements. We focused on the triple post shocks: the post-Cold War, the post-Asian financial crisis of 1997-98, and the post-September 11 attacks. With respect to goods, we noted that the disturbances in the tradition mechanism to provide trade liberalization and regional security motivate countries to seek for club goods as a viable alternative. In looking at countries' individual bargaining situations, we focused on their international strategic and economic interests, domestic power dynamics, and elite beliefs about the value of pursuing regional alternatives. We also showed how the changing nature of broader institutions interacted with country characteristics to alter institutional payoffs in the region.

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<sup>60</sup> Nye (1988).

We argued that the pursuit of club goods replaced a more generalized commitment to public goods in the triple post period, thereby undermining the myth that the combination of bilateral and multilateral arrangements under the San Francisco System and loose-structured production networks could be a viable alternative to tighter, formal institutionalization at the regional level.

With respect to trade liberalization, the weakness of the WTO and APEC opens up institutional space for an Asian economic community by affecting the provision of public goods and thus the incentives for club goods. Yet much depends on the possibility of a Sino-Japanese entente as well as an Indo-Pakistan rapprochement. In the meantime, the establishment of a permanent security forum in Asia to address security issues may appear premature. Yet we argued that the current Six Party Talks as well as the ARF process have the potential to evolve into an Asian security dialogue, albeit through the unforeseen and unplanned spontaneous development of consultations among the countries involved. In the post-September 11 environment, the prospect of establishing a framework for multilateral cooperation is enticing in a region where no forum has previously existed.

We do not claim by any means that regional institutions are a magical formula for transforming power politics and economic competition into cooperative internationalism in Asia. Rather, we believe that they are becoming viable means for creating norms and rules of interstate behavior that are essential for establishing regional institutional architecture to manage collective trade and security issues, the process of which could possibly take at least a decade, if not decades.

In sum, Asia faces the uncertainty of a host of multiple institutional alternatives for regional trade and security cooperation. In view of the tremendous political and economic uncertainties in the contemporary period, the path to deeper and wider economic and security

integration in Asia is likely to be complex. Yet the burgeoning efforts to form FTAs and security dialogues will help to smooth it.

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