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THE DYNAMICS OF TRADE LIBERALIZATION

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I. INTRODUCTION

In 1999, World Trade Organization (WTO) participants in Seattle unsuccessfully attempted to launch a new trade round. Many commentators saw this as the swan song of the global approach to negotiations and began to call for alternative paths to liberalize trade. Suggestions for coping with the perceived complexity of the WTO included negotiating among a more restricted set of actors and limiting the set of issues discussed.² But the success of the November 2001 Doha meeting of the WTO in setting a timetable for negotiations seemed to once again restore faith in the global approach. Yet the seesaw continued. First came the dramatic collapse of the Cancún negotiations in September 2003, followed shortly thereafter by the success of the July 2004 WTO meeting in Geneva. Since then, the WTO members have missed the January 2005 deadline for concluding the Doha Round and disagreements over trade concessions, particularly between developed and developing countries continue. Efforts to revive the Doha Round in 2007 have foundered, and President's George W. Bush's expiration of Trade Promotion Authority (allowing up or down votes of trade bills in Congress without amendment) signal a very bleak

¹ I am especially grateful to Min Gyo Koo for his insights and research assistance. Edward Fogarty provided valuable comments and Vivek Narayanadas and Rene Schneeberger helped with background research.

² For an example of restricting participants, see the Business Roundtable 2001; for an example of restricting issues, see Tyson 2000.

prospect for any imminent conclusion of the multilateral round. In this environment, many countries continue to look for other trade options, in particular the active pursuit of bilateral preferential trade agreements.

In the post-World War II era until the early 1990s, the General Agreement on Tariffs and Trade (GATT) was the primary vehicle to foster trade liberalization, with the most significant exception being the formation and evolution of a customs union in Europe. By contrast, trade protection has taken a variety of forms, with unilateral, bilateral, minilateral, and multilateral restrictions—both on a sector specific and multiproduct basis. Robert Keohane’s work has been particularly illuminating in developing an explanation for the persistence of trade liberalization in the face of these protectionist measures. Drawing on the seminal work of Ronald Coase and Oliver Williamson, Keohane applied a transaction cost approach to understand the persistence of the GATT regime in promoting openness in the face of declining U.S. hegemony.³ Keohane’s work, as highlighted by Helen Milner in the introduction to this volume, developed several themes, including the role and evolution of institutions in fostering cooperation, constraints on the provision of public goods, the role of reciprocity, the use of non-military power in negotiations, and the importance of institutional design. This work has inspired research on the dynamics of trade liberalization and protection.⁴

My objective in this chapter is to build in the tradition of this research program on trade cooperation and conflict. In earlier work with Robert Keohane and David Yoffie,⁵ we focused on the evolution of different forms of trade protectionism. Here, drawing on Keohane’s work, the work of his other students, and other scholars who have focused on trade issues, I focus on

³ Coase 1960, Williamson 1975, and Keohane 1984.

⁴ Yarbrough and Yarbrough 1992, Mansfield and Milner 1999, Oye 1992, McKeown 1983 and 1991

⁵ Aggarwal, Keohane, and Yoffie 1987.

forms of trade liberalization.⁶ To this end, Section II of this chapter begins by summarizing the general problem of understanding trade liberalization, the potential need and role of institutions, and their creation, and then examines different forms of trade governance based on several criteria. In Section III, I present an institutional bargaining game approach to address the question of the evolution of trade accords. I show how such an approach can help us to understand the building and modification of different types of international institutions in trade. Section IV applies this institutional bargaining approach to examine the development of trade arrangements in Northeast Asia (NEA) by constructing scenarios to explore the interaction of different variables in leading to different modes of trade governance. Section V concludes with an assessment of possible avenues to pursue in the broader research program of understanding the dynamics of trade liberalization.

II. THE ROLE OF INSTITUTIONS IN TRADE LIBERALIZATION

In thinking about trade liberalization, one can focus on several key questions. First, why is cooperation necessary in trade? Second, if cooperation is indeed necessary, how might institutions foster such cooperation? Third, from a bargaining perspective, how can institutions be created? Fourth, what are the options with respect to the development of different types of trade governance mechanisms? Fifth, what underlying factors drive different forms of trade governance and how might they evolve?

The Need for Trade Cooperation

The conventional wisdom in international economics is that economic openness and integrated world markets ensure an optimal allocation of factors of production and maximize both

⁶ Beth and Robert Yarbrough 1992, in particular, have been leaders in an effort to theorize about alternative modes of trade liberalization.

aggregate world welfare and individual national welfare.⁷ Yet, in practice, the benefits of globalization cannot always be realized by states pursuing independent policies; cooperative action is required. In particular, the changing distribution of costs and benefits from trade liberalization can result in strong political opposition both for and against further liberalization. For commodity producers, price volatility and ultra-specialization can bring severe adjustment costs. Developing countries that emphasize manufactured exports face significant adjustment challenges as they compete with each other for market share, particularly in the face of the rise of the Chinese export juggernaut. And for their part, rich countries often face strong domestic lobbies in agriculture, textiles, steel, and other sectors, creating pressure for trade restrictions.

Given these political constraints, countries may either be unwilling or unable by themselves to sustain processes of economic liberalization. While others continue to fully implement their market opening commitments, they could slow or halt theirs. But their counterparts may find this unacceptable, and react by reneging on their own commitments. International cooperative action may therefore be required to avoid the unfortunate effects of this “temptation to free ride.” More formally, analysts have discussed the question of the “type of goods” involved in trade liberalization. Is free trade a public good from which all can benefit? Classical trade theory suggests that international trade liberalization should be seen as a public good that is easily provided because everyone’s optimal strategy is to liberalize, independent of what others do. From this perspective, trade liberalization can be modeled nicely using a harmony game. By contrast, John Conybeare argues that free trade should be modeled as a prisoners’ dilemma game, and not a public good.⁸ Yet his analysis conflates the goods involved in a particular issue-area with the *game used to model it*. It may simply be that membership in

⁷ The first three subsections draw on Aggarwal and Dupont (2007).

⁸ 1984. Gowa (1989) provides a convincing response by showing that retaliatory efforts have public goods characteristics.

the GATT, for example, is best modeled as an inclusive club good, and thus a different game may be more appropriate.⁹

If there are strong elements of a PD in the case of trade liberalization, how might the PD be resolved? One avenue that has been much discussed is the possibility of cooperation with iterated play.¹⁰ Yet even under with iteration, cooperation is not a foregone conclusion as if actors overly discount the importance of future iterations owing to a dire economic or political situation at home for governments, they will be tempted to free ride.

Institutions and Cooperation in Trade

To address the problem of achieving trade liberalization, neoliberal institutionalists have examined the role that international institutions may play in facilitating cooperation in trade. First, institutions may help secure positive outcomes in bargaining processes. They can play the role of a third party and enforce a mutual agreement, making the parties more willing to settle on a bargaining outcome in the first place. Second, institutions may reduce distributive problems. They may eliminate some sharply asymmetric outcomes and may provide focal point solutions for both benefit and cost sharing. Third, institutions may be useful even if there is some powerful political entrepreneur, or hegemon, that provides public goods. Hegemons wish to coerce weaker actors to move away from free riding on the unilateral provision of goods and carry some of the burden. Institutions can facilitate the linkage of issues and decrease the temptation to free ride. Fourth, institutions can create a mechanism for exclusion, transforming public goods into club or private goods. For example, trade arrangements with fewer

⁹ See Aggarwal and Dupont (1999) for a formal analysis of goods, games, and institutions.

¹⁰ See Axelrod and Keohane 1986, Cornes and Sandler 1996, Taylor 1987.

participants reduce the possibility of free riding (by definition) and ensure that gains from trade liberalization accrue only to the participants in the agreement.¹¹

Institutional Creation

Although institutions can help cooperation in several ways, how might institutions be formed in the first place? From the perspective of a power-based tradition, regimes affect the distribution of costs and benefits of state interaction. For analysts in this school,¹² institutions have distributional consequences and can be used as devices to seek and maintain asymmetric gains. They can also help control other actors' behavior, both at home and abroad. The central theme in this literature has been the role of hegemonic powers in fostering the development of institutions through both positive and negative incentives.¹³ Benevolent hegemons, for example, may provide public goods because their large size makes it worthwhile for them to take action on their own to overcome collective action problems. But while suggesting that regimes may form when powerful states desire them, this approach does not tell us much about the nature of regimes, or actors' desire to pursue multilateral versus bilateral solutions.

Building on these criticisms of the neo-realist approach, neo-liberal institutionalists have examined the specific incentives for states to create institutions—as opposed to simply engaging in *ad hoc* bargaining. As we have already discussed, institutions provide many useful functions in helping actors to coordinate their actions or achieve collaboration. This theoretical approach assumes that collaborative action is primarily demand driven—that is, actors will create institutions because they are useful but does not really specify a mechanism for how they would go about actually creating them. An important theme of this work has been how existing institutions may constrain future institutional developments. One key constraint is the presence

¹¹ Gowa 1989.

¹² Krasner 1991, Aggarwal 1985, and Knight 1992.

¹³ Kindleberger 1973, Gilpin 1975, Krasner 1976, and Keohane 1984.

of existing institutions with a broad mandate that influence the negotiation of more specific institutions, leading to the ‘nesting’ of regimes within one another.¹⁴ A third approach to examining institutional innovation and change places emphasis on the role of expert consensus and the interplay of experts and politicians.¹⁵ New knowledge and cognitive understandings may lead decision makers to calculate their interests differently, thereby directly affecting payoffs and play. From this perspective, institutions may fundamentally alter actors’ preferences.

Classifying Modes of Trade Governance

What types of institutions are states likely to create to deal with the problem of trade cooperation? In examining regional, sectoral, and bilateral agreements, analysts often conflate different type of arrangements and used them synonymously. For example, the term “regional agreement” has been used to refer to widely disparate accords such as Asia Pacific Economic Cooperation (APEC), the North American Free Trade Agreement (NAFTA), bilateral free trade agreements both in and outside a region, and even sectoral agreements such as the Information Technology Agreement (ITA).¹⁶ This conceptual ambiguity makes it difficult to develop causal arguments to account for the variety of trade arrangements.

To address this problem, I focus on several dimensions in classifying modes of trade governance: the number of participants; product coverage; geographical scope; market opening or closing, and institutionalization. I define the number of participants in terms of bilateral, minilateral, and multilateral participation in an agreement.¹⁷ I use the term bilateral to refer to

¹⁴ Keohane and Nye 1977. See Aggarwal 1985 on nesting.

¹⁵ Haas 1980.

¹⁶ See for example, Mansfield and Milner 1999, 592, who recognize the problematic nature of the term “regionalism” but then proceed to use this term in their analysis.

¹⁷ For theoretical completeness, I also consider “unilateral” approaches to liberalize trade.

two countries and minilateral to more than two.¹⁸ In terms of product coverage, the range is from narrow (a few products) to broad (multiproduct) in scope. Geographical scope differentiates between arrangements that are concentrated geographically and those that bind states across great distances. A fourth dimension addresses whether these measures have been either market opening (liberalizing) or market closing (protectionist). Fifth and finally, one can also look at the degree of institutionalization or strength of agreements.¹⁹ Based on these dimensions, Table 1 presents a typology of trade agreements.

Table 1 here

The table itself omits discussion of protectionist measures and degree of institutionalization for presentation purposes, although I do consider these elements in the scenarios of Northeast Asian trade arrangements in Section IV.

Explaining Trade Governance Measures

Analysts have developed a wide variety of causal explanations for different trade liberalization measures. Given space constraints, I briefly consider some general arguments about specific forms, as well as efforts to account for variation and evolution across types of accords.

The first row focuses on sectoral agreements (cells 1-6). These involved liberalization in a relatively few number of products, as in the classic example of British opening of its grain market with the removal of the Corn Laws in 1846.²⁰ Most analysis of British motivation for this unilateral action focuses on domestic politics although others have emphasized the U.K.'s

¹⁸ This usage differs from that of Yarbrough and Yarbrough 1992, which conflates third party enforcement with these terms so that “bilateral” for them can also mean three countries, a highly counterintuitive use. Keohane 1990 refers to an agreement among three or more states as multilateralism. Richardson 1987 is consistent with my usage.

¹⁹ Of these, the dimension of geographical scope is the most controversial. It is worth noting that this category is quite subjective, since simple distance is hardly the only relevant factor in defining a “geographic region.” Despite the interest that regionalism has attracted, the question of how to define a region remains highly contested. See the discussion by Mansfield and Milner 1999, Katzenstein 1997, and Aggarwal and Fogarty 2004, among others.

²⁰ See Schonhardt-Bailey 1996.

international position as a hegemonic power.²¹ Sectoral arrangements have also been pursued bilaterally, both on a geographically dispersed and transregional basis. These accords appear to be driven by politically strong but narrow interests that are pursuing greater economies of scale. The resulting arrangements tend to promote intra-industry trade as with the U.S.-Canada auto accord.²² Transnationally, voluntary import expansions (VIEs) have been used to pressure countries to open up their markets, directly tied to domestic pressure and often in the context of Super 301.

In looking at sectoral accords, we might ask: Why don't we have more industry driven specific agreements to capture private goods? Here, the role of institutional constraints proves critical. The best example of this is Article 24 of the GATT, which calls for the coverage of "substantially all trade" when free trade areas or customs unions are developed. Indeed, when the Coal and Steel Community (ECSC) was created in 1951 (driven by both domestic interests and concern about international security), its members faced criticism for creating this accord. Although challenged as being inconsistent with the GATT by Czechoslovakia, the ECSC members managed to obtain a GATT waiver of obligation, with the strong support of the U.S., which was of course interested in encouraging West European states to work together to resist the Soviet Union.²³ Another example of an effort to promote sectoral accords also took place in the context of pre-existing institutions. In 1997, APEC Ministers agreed to Early Voluntary Sectoral Liberalization (EVSL) in nine sectors as a package for fast track liberalization. Article 24 was also important here, as this approach could run counter to the GATT. To address this, one idea was to liberalize in areas where non-APEC countries would not compete and to promote voluntary liberalization without asking for extra-APEC reciprocity. In the end, however, this

²¹ See McKeown 1983 and James and Lake 1989, among others.

²² See Milner and Yoffie 1989.

²³ Curzon 1966, 266-268.

approach ran into difficulties as several countries particularly objected to the liberalization of certain agriculture, forestry, and fishery products in the context of the East Asian financial crisis.

Finally, a new development has been the effort to promote sector specific multilateral liberalization (with the ITA, the Basic Telecom Agreement, and the Financial Service Agreement (cell 6). The emergence of these types of agreements is a particularly important. Laura Tyson, for example, has argued that among multilateral trade options, this sectoral approach is a sound alternative to the multi-sector WTO approach.²⁴ Yet open sectoralism can be politically and economically hazardous, particularly from the perspective of the impact of one type of trade accord on another.²⁵ From a political perspective, sectoral market opening, driven by narrow domestic lobbies, is likely to *reduce* political support for multilateral, multi-sector negotiations. Because sectoral agenda setting involves a limited and easily polarized set of domestic interests, the margin for coalition building and political give-and-take is much slimmer. Moreover, from an economic perspective, such agreements may *reduce* economic efficiency. By liberalizing only specific, highly competitive sectors, open sectoral trade agreements can lead to incentives to invest in or discourage exit from the least efficient areas of the economy.

We turn next to broader multiproduct liberalization (cells 7-12). Unilateral liberalization was feasible for Britain thanks to its industrial strength, its limited investment in transaction-specific assets for trade, and its quasi-monopsony power in raw material and export markets—which contrasted with other countries' limited alternatives to importing British manufactured

²⁴ Tyson 2000.

²⁵ For details of this argument see Aggarwal 2001 and Aggarwal and Ravenhill 2001.

goods.²⁶ Contemporary examples include unilateral liberalization measures taken by Australia, New Zealand, Hong Kong, and Singapore, driven often by globally minded state elites.

Bilateral arrangements of both a regional and transregional actor scope have rapidly proliferated over the last few years. More often than not, such agreements draw upon not only geographic, historic, and cultural affinities but also complementarities in economic structure. In order to reduce the costs related to geographic distance and to maximize the benefits from economic size, analysts argue that neighboring countries will often form preferential trade agreements (PTAs) with one another, creating a natural trading bloc. Yet we have also seen examples of geographically dispersed bilateral agreements covering multiple products.²⁷ Some of these bilateral FTAs—for example, the U.S-Israel FTA and the U.S.-Jordan FTA—have been clearly motivated primarily by political-strategic rather than economic reasons.²⁸ Others such as the FTAs between Japan and Singapore and South Korea and Chile—are largely designed for the purpose of “training” or “capacity-building” for countries with little prior experience in FTA formation.²⁹ And as with the recent U.S.-South Korea accord, these accords may reflect efforts to lock in key markets in the context of problematic global negotiations.

Regional accords have attracted the most scholarly attention, commensurate with the rise of such arrangements since the 1960s. Conventional explanations for the move toward minilateral regionalism have focused on both economic and political-strategic motivations. Some economic arguments include: enlarging economies of scale without excessive global competition; increasing the attractiveness of an economy to foreign capital; and creating natural

²⁶ Yarbrough and Yarbrough 1992. McKeown 1983 makes a strong case that Britain did not exhibit hegemonic power in the move to liberalization in the nineteenth century but rather chose to liberalize on its own.

²⁷ For an insightful discussion comparing intra versus cross-regional bilateral accords, see Katada and Solis (2007).

²⁸ Aggarwal and Urata 2006.

²⁹ Koo 2006.

trading blocs according to geographic proximity.³⁰ Political-strategic economic reasons include signaling or strengthening one's bargaining position in relation to more powerful partners; responding to the erosion of U.S. support for multilateralism; locking in a domestic reform agenda; a domino effect; limiting free rider problems; reducing transaction costs between negotiating parties; and lowering the political salience of negotiations.³¹

It is worth noting that these explanations of "regionalism" actually fall into several cells of my typology, namely 2, 4, and 8—and, to some extent, cell 11 as well, indicating the conceptual ambiguity and under-differentiation inherent in the existing literature on regionalism. Thus, it is useful to separately consider arrangements that span countries across continents (cell 11). The term "interregionalism" can itself be broken down into more specific types. I refer to an agreement as "pure interregional" if it formally links free trade areas or customs unions, as in the case of EU-Mercosur.³² If a customs union negotiates with countries in different regions, but not with a customs union or free trade agreement, we refer to this as "hybrid interregionalism" (e.g., the Lomé Agreement). Finally, if an accord links countries across two regions where *neither* of the two negotiates as a grouping, then we refer to this as "transregionalism" (e.g., APEC). Aside from conventional political and economic motivations that drive regionalism, the EU's inter-regionalism also seem to be driven by its efforts to project its success in regional integration on an international basis.³³

Finally, we have the case of global, multiproduct trading arrangements such as the GATT and its successor organization, the WTO. Both liberal economists and neoliberal institutionalists prefer this approach as being one that maximizes global efficiency and reduces transaction and

³⁰ On economies of scale, see Milner 1997; on foreign capital, see Lawrence 1996; and on natural trading blocs, Frankel 1997.

³¹ See respectively Milward 1992; Gilpin 1987 and Krasner 1976; Haggard 1997; Oye 1992 and Baldwin 1997; and Yarbrough and Yarbrough 1992 among others.

³² Aggarwal and Fogarty 2004.

³³ Ibid.

information costs. Yet as we have seen, the WTO has increasingly encountered difficulties in hammering out new terms of trade liberalization. This, in turn, has fueled interest in preferential arrangements at the sub-multilateral level.

III. EXPLAINING THE RISE AND EVOLUTION OF TRADE ARRANGEMENTS

The literature on different forms trade arrangements has grown in recent years in step with the rise of such agreements. Yet most analysis does not adequately examine the choice of trade governance mechanism in comparative perspective, although there are important exceptions. The most innovative effort to look at explanations for the choice of trade accords builds on transaction costs and power based arguments. Beth and Robert Yarbrough have argued that the *form* of trade accords is driven by the combination of transaction-specific investments and the possibility of hegemonically driven cooperation.³⁴ In brief summary, they argue that British dominance combined with the lack of asset specific investments in the 19th century to make unilateral multisectoral liberalization a viable option for Britain. After World War II, although asset specificity increased, U.S. power enabled it to promote multilateral trade liberalization through the GATT. More recently, with relative U.S. decline, they argue that minilateralism (and bilateralism) are likely to rise as countries attempt to ensure that their asset specific investments in trade are not impaired in view of the declining commitment to the WTO. Other analysts have considered whether regional accords serve as building blocks or stumbling blocks for multilateral liberalization.³⁵ And more recently, considerable debate has been generated about the implications of bilateral trade accords for the global trading system.³⁶

³⁴ 1987, p. 4. See also Yarbrough and Yarbrough 1992.

³⁵ See for example, Bhagwati 1991.

³⁶ See Aggarwal and Urata (2006) for a discussion.

Although these analytical approaches are insightful, they often fail to account for the variety of trade accords. Almost all fail to distinguish between the implications of sectoral vs. broader liberalization and most have little to say about the difference between regionalism and inter-regionalism, be it on a bilateral or multilateral basis. In an effort to more adequately analyze and capture the implications of the rich variety of trade governance measures, I use an institutional bargaining game approach to examine such arrangements.³⁷ Although this approach does not provide a precise causal prediction of each type of accord, it provides a more systematic basis for examining both policy choices and connections among types of arrangements and can be used to explore alternative scenarios.

As illustrated in Figure 1, an institutional bargaining game approach begins by identifying an initial impetus for new trade accords, and then considers the goods involved, actors' individual situations, and the impact of existing institutions to construct a "bargaining game." The result of the strategic interaction leads to some type of preferential agreement with various characteristics. We examine each element in turn.

Figure 1 here

The process of a shift from an initial institutional equilibrium can come about with some external shock— for example, the end of the Cold War or simply a decline in U.S. hegemony. But contrary to realist accounts, the driving force for institutional change can also come from problems with existing institutions (as with the Doha Round of the WTO) or the Asian financial crisis of 1997-8. Countries respond to such external shocks in various ways based on the "goods" involved in the negotiations. As we have already, there is considerable debate over the types of goods involved in trade negotiations (public goods, common pool resources, inclusive

³⁷ See Aggarwal 1998. Owing to space constraints, my discussion of this approach is sharply abbreviated.

club goods, or private goods), but this step allows us to identify the basic underlying structure of the bargaining problem.

Next, we can consider factors that help us predict actors' payoffs. These include: (1) an actor's international position, as defined by its overall power and its specific economic competitiveness in trade and security matters; (2) the makeup of its domestic coalitions, reflecting pressure groups that respond to underlying economic competitiveness based on such factors as trade complementarity and asset specificity; and (3) elite beliefs and ideologies. These factors will vary by country and thus determine each country's preference ordering with respect to trade arrangements. Finally, pre-existing institutions will affect the play of a trade bargaining game (if they exist). Thus, in creating new arrangements or modifying existing ones, connections among existing and proposed institutions will influence the outcomes.³⁸ An example of this is the concern about conforming to GATT Article 24's strictures on free trade areas and customs unions.

Finally, with respect to outcomes, if countries decide to create a new agreement or modify an existing one, they must decide on its characteristics. As discussed in Table 1, these include the participants, products, geography, market opening or closing, and degree of institutionalization. One can also then consider additional rounds of play, that lead to further modification or creation of new institutions.³⁹

IV. TRADE ARRANGEMENTS IN NORTHEAST ASIA AND BEYOND

³⁸ From a theoretical perspective, we can define four types of connections among institutions: (1) nested links, whereby narrow arrangements conform to broader accords; (2) horizontal connections, whereby arrangements reflect a division of labor without any hierarchy among institutions;³⁸ (3) overlapping agreements, which may create tension among participants' obligations under each agreement; and (4) independent institutions, which govern distinct fields and thus have little or no interaction in functional terms.

³⁹ See Aggarwal 1998 for a discussion of this idea.

We now turn to an institutional trade bargaining game approach to explore organizational outcomes and implications in Northeast Asia, drawing on my work with Min Gyo Koo.⁴⁰ Ideally, we would simultaneously consider the variation in all the variables in our institutional bargaining game, namely the factors of goods, individual situations, and context of existing institutions. Given the many uncertainties involved, I consider a narrower range of factors from these broad categories to look at outcomes in NEA. To construct our simplified scenarios, I assume a certain hierarchical order among the variables in our institutional bargaining game. I give pride of place to the status of extant broad-based, international institutions as a primary source of *initial impetus* for change. In particular, I assume that the status of the WTO and APEC may stimulate or impede the provision of trade liberalization as a public good.⁴¹ Specifically, the weakness of each of these institutions should encourage the pursuit of a club good, whereas their strength will discourage such attempts.

Given the nature (market opening) and geographic coverage (Northeast Asia) of a prospective PTA, individual bargaining situations and institutional context will determine the other elements of bargaining outcomes, namely the number of participants (1, 2, or 3), strength of institutions (for example, the degree to which the agreements are binding and the presence of dispute settlement procedures), and scope of products included. I focus on three variables in order of their presumed significance—the institutional strength of the WTO and APEC, alliances-type relationships (rapprochement, for example, in the China-Japan case), and economic complementary between countries. I draw the following causal relationships from our theoretical and empirical observations: the number of participants, strength, and scope of a

⁴⁰ This section draws on Aggarwal and Koo 2005.

⁴¹ Strictly speaking, the WTO and APEC are club goods to the extent that it requires membership to benefit from trade liberalization that they materialize. With the former's global membership and the latter's spirit of "open regionalism," their provision of the broadest club good virtually serve as global public goods.

prospective NEAFTA are a negative function of the strength of the WTO and APEC, and a positive function of alliances and economic complementarity (See Figure 2).

FIGURE 2 ABOUT HERE

Paths to a NEAFTA

How might we get to a NEAFTA from the current institutional mix in Northeast Asia that consists of the participation of China, Japan, and South Korea in bilateral regionalism and transregionalism (general bilaterals), minilateral transregionalism (APEC and APT), and multilateral globalism (GATT/WTO)?

If both the WTO and APEC are *strong*, there is little *raison d'être* for a NEAFTA. Essentially, all the incentives for securing club goods (even through bilateral agreements) would be gone with the broad-based institutions operating and dominating the institutional space (outcome I).

A combination of a *strong* WTO and a *weak* APEC creates some incentives for pursuing club goods, thereby permitting institutional room for either trilateral or bilateral regionalism in Northeast Asia. If there is significant security rapprochement between China and Japan (and thus possibly a trilateral arrangement including South Korea), a weak but broad NEAFTA might be a possibility (outcome II). The logic here is that the strength of the WTO would dissuade a major focus on club goods. But the weakness of APEC would motivate politically secure Northeast Asian countries to form a NEAFTA—immediately or by merging separate bilaterals—to maximize the benefit from the geographic proximity and size of their economies. By contrast, if there is no Sino-Japanese rapprochement, a NEAFTA would be highly unlikely due to strong relative gains concerns between the two regional rivals. Yet this does not eliminate the possibility of some type of bilateral alliances or security agreements between Japan and South

Korea and, potentially, between China and South Korea. Given the weakness of APEC, bilateral PTAs between these two dyads would remain a viable option, but their strength is likely to be weak in the presence of a *strong* WTO (outcome III).

The combination of a *weak* WTO and a *strong* APEC is likely to result in a very weak NEAFTA. The WTO's weakness would motivate the three countries to pursue trilateral club goods, even without formal alliance arrangements amongst themselves, since a strong APEC would decrease relative gains concerns. In this case, however, a NEAFTA would be reduced to a caucus of the three countries *within* APEC—rather than a separate, strong negotiating body—since APEC operates as a principal locus of trade liberalization (outcome IV).⁴²

Finally, if both the WTO and APEC are weak, considerable institutional space and a multiplicity of options are likely to emerge. If China and Japan achieve some type of security rapprochement, the formation of a *strong* NEAFTA is highly likely. In this case, the scope of a resulting NEAFTA is predicated on economic complementarity. If such complementarities exist among the three countries, they will broaden the scope of product coverage (outcome V). If there are weak economic complementarities, we can expect a strong but narrow (or sectoral) NEAFTA (outcome VI). By contrast, if there is no alliance between China and Japan, a NEAFTA is not a possibility (outcome VII).

Beyond-NEAFTA Outcomes

Among the seven possible scenarios I have considered to this point, I further explore the likely paths from the three particular outcomes that are based on the combination of a weak WTO and a weak APEC.

⁴² According to this scenario, a NEAFTA as a caucus is likely to consolidate APEC as a *transregional* arrangement that combines its members as individual states rather than formal groupings.

To begin with, how would a *strong* and *broad* NEAFTA (outcome V) evolve if we broaden our focus beyond Northeast Asia? Within East Asia, if this type of NEAFTA is combined with a *strong* and *broad* ASEAN, the most likely outcome is an *interregional* arrangement—that is, a bilateral arrangement between two separate PTAs—possibly in the form of an ASEAN Plus NEAFTA (APN) (outcome VIII). Alternatively, if a strong and broad NEAFTA links up with a broad but weak ASEAN, we can expect the advent of a *hybrid interregional* arrangement that creates an East Asian FTA (EAFTA)—currently manifesting itself in the reverse form of APT or East Asian Community (EAC) where ASEAN is united, but South Korea, Japan, and China are not. In this case, members would participate in their individual capacity as Southeast Asian states and South Korea, Japan and China as members of NEAFTA (outcome IX).

Next, we can examine how an East Asian grouping—be it APN, APT, EAFTA, or EAC—might contribute to broader transregional and/or interregional arrangements such as APEC and ASEM. If an East Asian grouping is created that proves stability, the growing interconnectedness and the networked nature of interstate economic activities may produce an increasing awareness and sense of community among East Asian countries.⁴³ As either APN or EAFTA countries become more confident in their ability to create their own transregional grouping, they might be more willing to extend their institutionalization efforts to the transregional level of APEC, thereby giving it new life. This could also lead to more an *interregional* rather than a transregional outcome, with the Australia New Zealand Closer Economic Relations (CER) Agreement, APN, and NAFTA operating within APEC as three distinct hubs. Similarly, the increasing sense of community within East Asia could facilitate the ASEM forum, leading to pure Asia-Europe interregionalism.

⁴³ Terada 2003.

What about paths from outcome VI? In this case, we could end up with the formation of an exclusive, if not pernicious, “Fortress Asia” commensurate with the oft-voiced fears of a “Fortress Europe” and “Fortress America.” The strategic relationship between Northeast Asia and the rest of the world will be of key significance here. Most importantly, if the U.S. continues its focus on the Free Trade Area of Americas (FTAA) and the EU continues on an eastward and possibly southward expansion path, others may feel excluded. Under these circumstances, the decade-long perception between Northeast and Southeast Asians that Western regional arrangements are forming against them may well rekindle the Mahathir-promoted notion of an exclusive East Asian bloc (outcome X).

Finally, in outcome VII, although I rule out some type of trilateral alliance, two separate dyads—Japan-South Korea on the one hand, and China-South Korea on the other—are likely to have strong incentives to secure club goods through bilateral arrangements between themselves. In this case, the strength of bilateral arrangements would increase due to the weakness of both the WTO and APEC and these bilaterals would operate as the dominant mode of trade liberalization in Northeast Asia. If an individual dyad has strong economic complementarity, it might result in a *strong* and *broad* bilateral arrangement (outcome XI). This path can lead to *benign* bilateralism if it catalyzes a competitive dynamic to liberalize in other countries.⁴⁴ Conversely, if an individual dyad has weak economic complementarity, it might lead to a *strong* but *narrow* bilateral accord (outcome XII). In this case, it is plausible that the Northeast Asian countries may be polarized between two camps—China versus Japan—on a sectoral basis, thereby undermining regional integration efforts. Ultimately, a pernicious web of competitive, sectoral bilaterals would likely damage other broad-based, multilateral trading accords.⁴⁵

⁴⁴ Bergsten 2001.

⁴⁵ Aggarwal and Ravenhill 2001 and Irwin 1993.

To conclude, the various scenarios derived from the institutional bargaining game model suggest the need to analyze the variety of institutional forms discussed in Table 1 of this chapter. As I have argued, the more careful specification of arrangements helps us to move the discussion from a vague specification of contention between “regionalism” vs. “multilateralism” to a more nuanced analytical exploration based on the causal variables of goods, individual situations, and institutional context.

V. CONCLUSION

The puzzles of cooperation is necessary in trade, the creation and role of institutions in fostering cooperation, the variety of institutional forms, and their impact over time have stimulated a dynamic research program focusing on transaction costs, security externalities, reciprocity, and institutional design. As a consequence, our understanding of types of trade arrangements, their evolution, and likely impact on broader trading regimes has advanced considerably in last two decades.

In this chapter, I have set out to build on these insights by more carefully specifying and examining the variety of liberalizing trade arrangements. A key step in this analytical effort to understand trade arrangements is to properly “differentiate” the dependent variable. To this end, I have sought to categorize the many forms of trade arrangements by the dimensions of number of actors, product scope of agreements, geography, degree of institutionalization, and orientation in terms of market opening or closing. This scheme allows us to more clearly specify and categorize not only trading accords but also to get a handle on the vast literature produced by political scientists and economists on trading arrangements.

I believe that this approach can help us assess how far we have come in our understanding of the diversity of trading accords and point to lacunae in our understanding of the dynamics of both trade liberalization and protection. In terms of research effort, many of the terms that I have used remain contested. For example, we have seen that the question of how to define “geography” has been debated. Similar issues can be raised about product scope: how many products define a sector? In the economics literature, much has been written about cross-elasticities of demand in defining “markets.” To this point, the question of defining a sector adequately still remains. Similar questions arise with respect to defining levels of institutionalization and the extent to which an accord promotes or dissuades market opening.

With respect to causal arguments about types of agreements, much research has been done on specific accords. The most intriguing line of research, however, concerns the dynamics of trade arrangements. In this vein, Beth and Robert Yarbrough have attempted to specify a model to predict the origin of forms of trade liberalization.⁴⁶ Although this has been a fertile effort, the importance of looking at sectoral accords and differences among “regional agreements” suggests that much work remains to be done on the origin and evolution of trade arrangements. I have proposed an institutional bargaining game as a way to cut into this question, which focuses on types of goods, the source of national preferences, and institutional context, building on the insight of Robert Keohane and others. In particular, I have argued that the difference between club goods and private goods in trade is particularly salient. And in looking at countries’ individual situations, I examined how international strategic and economic interests, government type, and beliefs about the value of pursuing trading arrangements beyond multilateralism are likely to impact the formulation and evolution of trading accords.

⁴⁶ Yarbrough and Yarbrough 1992.

Although general theoretical arguments provide insights into the dynamics of the evolution of trading arrangements, careful empirical exploration of particular arrangements and how they are likely to change over time can advance our insights. In this chapter, I have sought to demonstrate the utility of an institutional bargaining game approach by exploring how trade arrangements are likely to evolve in Northeast Asia. Specifically, I have examined how the strength or weakness of the WTO and APEC opens up or closes institutional space and showed how combinations of goods and individual's situations would result in a NEAFTA of varying strength. I have drawn on my classification of institutional variety to consider the alternatives of bilateral agreements as well as the possible development of a NEAFTA into East Asian regionalism, transregionalism, and interregionalism. In view of the dramatic rise of preferential trading arrangements in Asia and elsewhere, particularly after the end of the Cold War, I believe this line of inquiry is likely to be and will continue to be a progressive research program that will of value to both scholars and policymakers. Similar questions about the evolution in the Americas, Europe, the Middle East, and elsewhere would greatly enrich our understanding of the dynamics of the evolution of trade arrangements.

Table 1: Classifying Trade Arrangements¹

		<i>ACTOR SCOPE</i>					
		Unilateral	Bilateral		Minilateral		Multilateral
			<i>Geographically Concentrated</i>	<i>Geographically Dispersed</i>	<i>Geographically Concentrated</i>	<i>Geographically Dispersed</i>	
PRODUCT SCOPE	Few Products	(1) UK Corn Law removal (1846)	(2) U.S.-Canada Auto Agreement (1965)	(3) U.S.-Japan VIEs (1980s-1990s)	(4) ECSC (1951)	(5) EVSL (1997)	(6) ITA (1997), BTA (1998), FSA (1999)
	Many Products	(7) APEC Individual Action Plans (IAPs)	(8) Canada-U.S. FTA (1989) Australia-New Zealand CER (1983)	(9) U.S.-Israel FTA (1985) U.S.-Jordan FTA (2001) Canada-Chile FTA (1997)	(10) EC/EU (1958/1992) NAFTA (1993) Mercosur (1991)	(11) APEC (1989) (transregionalism) LOME (hybrid interregionalism) EU-Mercosur (pure interregionalism)	(12) GATT /WTO (1947/1995)

¹ Adapted from Aggarwal (2001).

Figure 1: The Origins of Preferential Trade Agreements

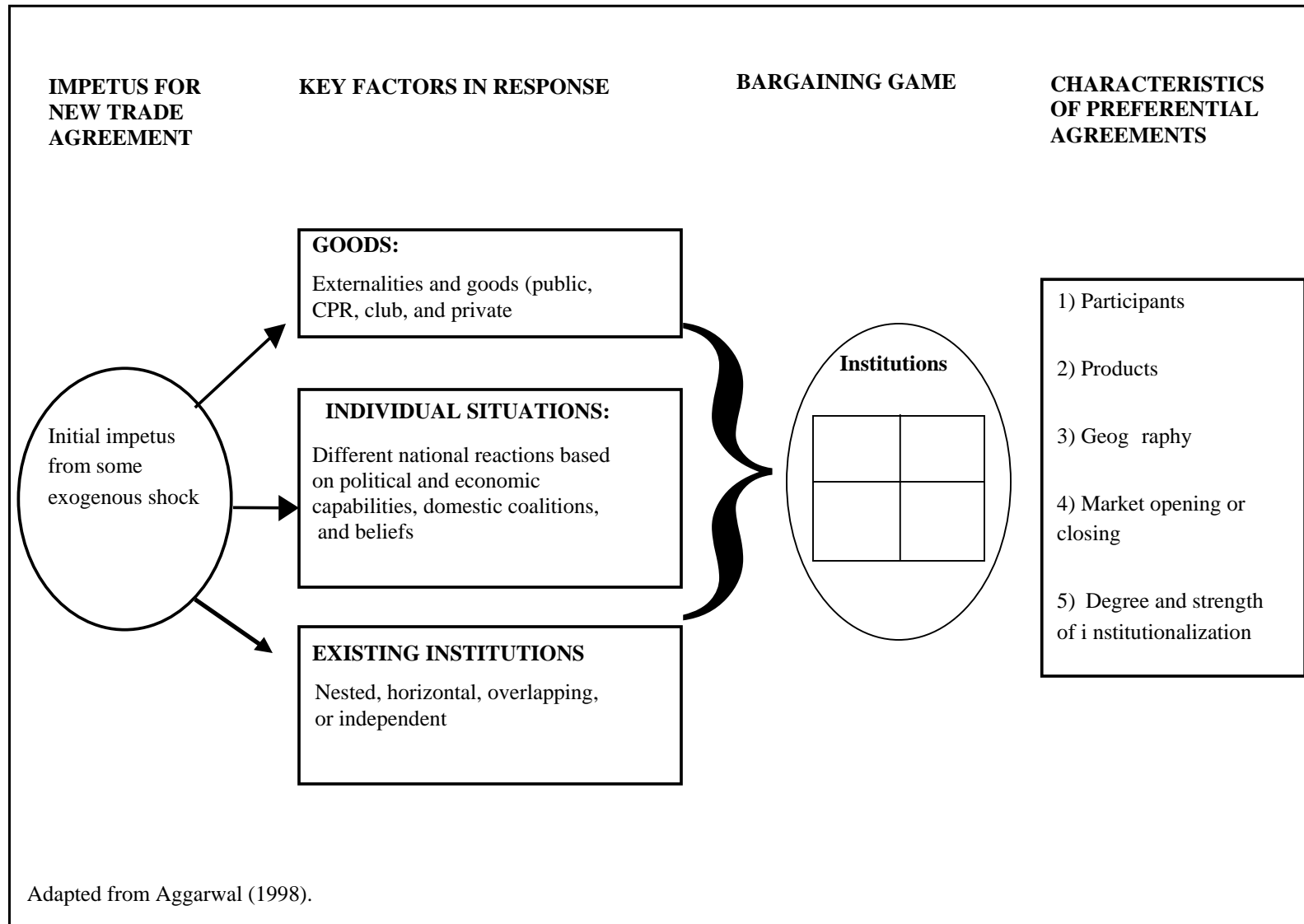
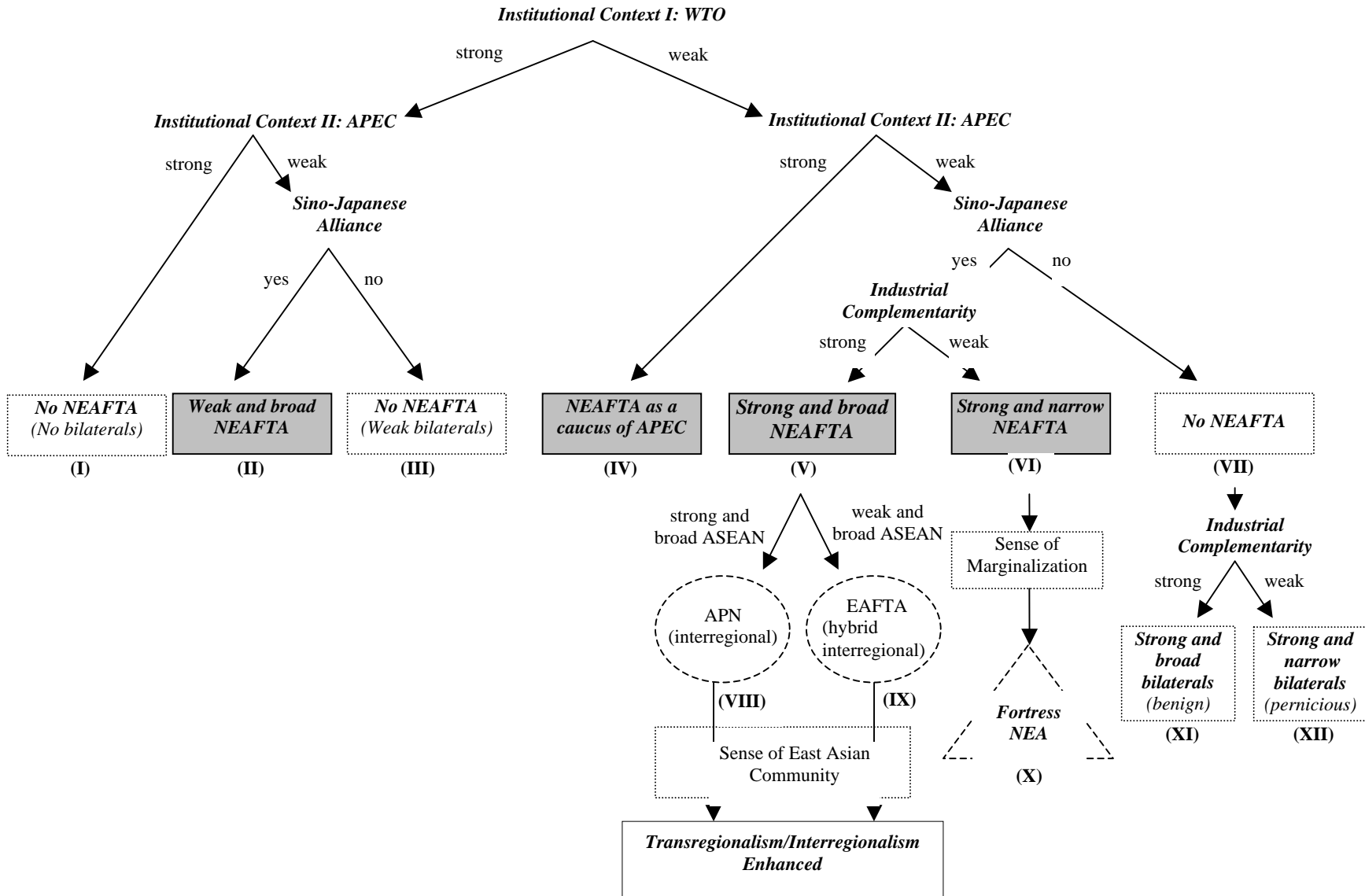


Figure 2: Paths to NEAFTA and Beyond



Based on Aggarwal and Koo, 2005.

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