

Beyond Network Power? The Dynamics of Formal Economic Integration in Northeast Asia

Vinod K. Aggarwal and Min Gyo Koo

Abstract: At the turn of the new millennium, the traditional institutional equilibrium of East Asian economic integration—the embrace of the WTO at the multilateral level and a focus on market-driven, informal integration at the regional level—is under heavy strain. A growing number of Northeast and Southeast Asian countries are pursuing greater institutionalization at the sub-multilateral level, actively weaving a web of preferential trading arrangements. To examine this development, we focus on the likely new institutional equilibrium in Northeast Asia and its implications for East Asia and beyond. We first examine the various political and economic arguments that have been advanced to explain states' desire to pursue "regionalism." From our perspective, most conventional explanations fail to adequately differentiate various forms of trading arrangements, thereby impairing both theoretical and empirical analysis of trading arrangements. To remedy this lacuna, we develop a more fine-grained typology of different modes of trade management—unilateral, bilateral, minilateral, and multilateral. We then discuss an institutional bargaining game approach focusing on goods, countries' individual situations, and the fit with existing arrangements. This approach is used to analyze how trade arrangements evolved in East Asia in the 1990s, particularly after the Asian financial crisis. We then explore several paths that might lead to formal economic integration in Northeast Asia. Finally, we consider other possible outcomes beyond Northeast Asia.

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I. Introduction

Despite their initial reluctance, East Asian countries have proven to be loyal supporters of the post-war multilateral trading regimes of the General Agreement on Tariffs and Trade (GATT) and World Trade Organization (WTO). Japan joined GATT in 1955 and South Korea followed suit in 1967. The six founding members of the Association of Southeast Asian Nations (ASEAN) all joined the club as well.¹ The inclusion of East Asian countries culminated in the accession of China, which finally became a member of WTO in December 2001 after fifteen years of prolonged negotiations, followed by Taiwan, which secured membership in January 2002.

At the same time, East Asia's economic integration at the regional level has lacked significant formal institutionalization. Even ASEAN, arguably the most successful of regional groupings in East Asia, has eschewed full commitment to the elimination of tariffs and other trade barriers. Another institutional experiment, the Asia-Pacific Economic Cooperation (APEC), remains a consultative forum for trade and investment liberalization rather than a body that has led to significant liberalization (Higgott 1995; Katzenstein 1997; Aggarwal and Morrison 1998; Ravenhill 2002a).

Despite its institutional weakness in a formal sense, East Asia's economic integration, often characterized by its market-driven and informal nature, has been impressive in a practical sense, as indicated by soaring intra-regional trade and investment flows. It is widely held that throughout the 1980s and 1990s the network of Japanese multinationals and overseas Chinese played a critical role in forming virtual East Asian economic integration. For many observers of East Asian regionalism, this informal, network-style integration was seen as a viable substitute for formal

institutionalization of regional economic affairs (Katzenstein 1997; Ernst 1997; Encarnation 1999).

However, the traditional institutional equilibrium of East Asian economic integration—the embrace of the WTO at the multilateral level and a focus on market-driven, informal integration at the regional level is under heavy strain. We have seen many countries' commitment to a broad-based, multilateral trade regime eroding steadily. 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 still cast their shadow over the multilateral global negotiations. At the transregional level, APEC as a formal mechanism to facilitate economic integration has been going nowhere, and the U.S. has increasingly used this forum to discuss security, rather than economic, issues. With respect to informal market integration, the unprecedented economic shocks at the end of 1990s have shown that the seemingly dense networks of Japanese and overseas Chinese business are quite vulnerable (Pempel 1999).

As an alternative, a growing number of East Asian countries have begun the pursuit of greater institutionalization at the sub-multilateral level, actively weaving a web of preferential arrangements with countries both within and outside the region (Dent 2003). The conclusion of Japan's first post-World War II preferential trade agreement, the Japan-Singapore Economic Partnership Agreement (JSEPA), was signed in January 2002. The other economic giant in East Asia, China, also signed a framework free trade agreement (FTA) with its neighbors in Southeast Asia in February 2003. In addition, other East Asian countries have wasted no time in moving toward preferential agreements, departing from their traditional commitment to the WTO.

This article examines the origins of preferential trade arrangements in East Asia and explores some paths that might lead to a new institutional equilibrium in the form of a Northeast Asian Free Trade Agreement (NEAFTA). What factors have motivated a departure from the traditional institutional equilibrium? What drives the variation among countries in choosing to negotiate preferential trading agreements (PTAs)?

Section II begins by briefly examining conventional arguments that explain states' desire to pursue alternative strategies to multilateral trading arrangements. Finding these underspecified, we then present a conceptual approach to analyze different types of trading arrangements by classifying them according to the number of participants and the degree to which individual arrangements are geographically concentrated or dispersed. Building upon a more fine-tuned, synthetic typology, we offer an institutional bargaining game approach to more adequately analyze the process by which various types of trading arrangements have been developed. In Section III, we apply this model to East Asia more generally, and specifically to the Northeast Asian Three, namely China, Japan, and South Korea. Section IV then explores some paths based on our institutional bargaining game factors that might lead to formalized regional economic integration among China, Japan, and South Korea. Finally, we briefly explore how a NEAFTA might lead to other broader forms of trade institutions.

II. Theorizing about the Evolution of Trading Arrangements

This section has three tasks. We first review the conventional explanations that have been advanced to explain the multiple motives behind the pursuit of trade liberalization at the sub-multilateral level. We find that conventional explanations do not adequately

distinguish among the various forms of preferential trading arrangements with different motivations. To remedy this, we develop a more fine-grained typology that systematically classifies trading arrangements on a number of dimensions and categorizes East Asian trading arrangements. Finally, we discuss an institutional bargaining approach to allow us to more adequately analyze both the shift in equilibrium in East Asian trading arrangements and their likely trajectory.

Why Not Multilateralism? The Traditional Theory

We focus on the specific question of when and why PTAs might be preferred to multilateralism. Specifically, we categorize the existing work on PTAs by highlighting the key contributions of three broadly defined approaches: economic, political-strategic, and social constructivist.

(1) Economic Motivations for PTAs

In the absence of an effective multilateral option for trade liberalization, PTAs can offer significant economic incentives. First, preferential liberalization on a sub-multilateral basis broadens the geographic scope of liberalization, while obviating excessive global competition. It increases potential economic gains through economies of scale by widening the market for export industries, while allowing for protection of politically sensitive, import-competing industries. How significant a benefit is gained from PTAs depends on the number of partner economies and their relative size, and has been the subject of extensive economic estimates (Viner 1950; Milner 1997; Chase 2003; Pempel and Urata 2005).

Second, PTAs, which often include investment protection measures, can increase the attractiveness of an economy to potential foreign capital. Transnational corporations that previously supplied separate national markets through exports from outside the region may now find that the enlarged market and strengthened legal protection provided by PTAs makes local production (and hence foreign investment into the member countries) more attractive than before. The best example of this is the dramatic increase that occurred in FDI into Mexico following the conclusion of North American Free Trade Agreement (NAFTA) in 1993 (Rodrik 1989; Lawrence 1996; Buthe and Milner 2004).

Third, the so-called gravity model argues that geographic distance and economic size are positively linked to the choice of a PTA partner. In order to reduce the costs related to geographic distance and to maximize the benefits from economic size, it is suggested that neighboring countries form a PTA with each other, creating a natural trading bloc. From this perspective, while the formation of natural trading blocs will improve welfare gains, the formation of unnatural trade blocs between distant and/or small economies have marginal welfare effects, if any (Krugman 1991; Frankel, Stein, and Wei 1997).

(2) Political-Strategic Motivations for PTAs

Countries may also form PTAs for political-strategic rather than purely economic reasons. Theorists have developed several arguments along these lines. First, hegemonic stability theory argues that the practices of global free trade flourish best when the world economy is governed by a liberal hegemonic power that can enforce the rules of a cooperative game; otherwise, it is likely to lead to a closed or semi-closed structure (Krasner 1976;

Gilpin 1987). This implies that the relative decline of the U.S. is the key reason why regional trading blocs are proliferating in recent years (Bhagwati 1992).

Second, from a negotiations standpoint, preferential negotiations are easier to start, less costly, and usually less complicated politically than multilateral negotiations. PTAs can offer a viable alternative to the problems associated with multilateral negotiations by limiting free rider problems, reducing transaction costs between negotiating parties, and lowering the political salience of negotiations (Schott 1989; Haggard 1997; Aggarwal and Ravenhill 2001).

Third, countries may pursue PTAs in order to strengthen their bargaining power against transnational corporations, bigger countries, or in multilateral negotiations. For example, the foundation of NAFTA and APEC was linked to the U.S. perception that they could help pressure Europeans into trade concessions during GATT's Uruguay Round of trade negotiations. And some others have suggested that the European Economic Community (1957) was motivated in part by European countries' desires to increase their leverage vis-à-vis the U.S. in upcoming GATT talks (Milward 1992).

Fourth, PTAs in one part of the world can trigger PTAs elsewhere through "demonstration," "emulation," or "contagion" effects. Among others, the completion of the single internal market in the European Union (EU) in 1992 and the establishment of NAFTA in 1994 led countries elsewhere to take a keener interest in becoming participants in PTAs for fear of being excluded (Baldwin 1997; Ikenberry 1990).

Fifth, some of the new PTAs came into being because industrialized countries perceived the need to make their trading arrangements with less developed countries compatible with WTO regulations. For example, a WTO Dispute Settlement Panel found

that the EU's new banana regime of 1993 that offered preferential treatment to the African, Caribbean, and Pacific (ACP) countries contravened several of its articles. Faced with the WTO rulings, the EU decided to abandon its previous approach and to negotiate individual preferential arrangements with ACP countries that were compatible with the Article 24 of WTO (Cadot and Webber 2002).

Sixth, countries undergoing the process of economic adjustment may use PTAs for the purpose of "locking in" their reform agenda in a softer way than multilateral or unilateral liberalization, controlling the extent of new competition by choosing suitable partner(s). Mexico's participation in NAFTA is a good example (Haggard 1997; Fernandez and Portes 1998). One of the latest examples includes the Japanese decision to conclude a PTA with Singapore in order to lock in reform policies while protecting vested interests at the same time (Pempel and Urata 2005).

Finally, current PTAs are often designed for the purpose of "training" or "capacity building" for broader and deeper liberalization. Given that most East Asian countries have no or little experiences in PTA formation, this "training" objective has been widely sought in the region (Okamoto 2003). For example, South Korea gave top priority to an FTA with Chile and decided to choose subsequent FTA partners from a list of small and medium-sized countries such as Singapore, Mexico and Thailand, before launching PTA negotiations with major economies such as the U.S., Japan, and China—even though PTAs with the former countries would likely produce marginal economic benefits (Koo 2005).

(3) Social Constructivist Motivations for PTAs

Functionalism and neo-functionalism have been among the most influential approaches to the study of political and economic integration. Early adherents of these approaches posited that governments tend to forge international institutions in order to meet various functional needs. For them, the expansion of economic activity creates incentives for states to further liberalize and standardize economic exchange because doing so enhances the economic welfare of participants (Deutch 1957; Haas 1958).

Non-state actors can play a central role in this process. For example, Haas (1958) focused in part on interest groups and political parties to explain the origins of European Economic Community. By fostering economic growth and managing international economic problems, regional institutions generate the support of groups within states and demands by these groups for further integration. This “spillover” process can lead to ongoing integration and promote the development of regional institutions.

Building upon the functionalist and neo-functional approaches, scholars in the social constructivist school have elaborated further on the role played by non-state, transnational actors in regionalization. For them, the most important features of the new regionalism are its truly worldwide reach, extending to more regions, with greater external linkages; unlike the pattern in the Cold War era, the new regionalism is developing in a multipolar, more spontaneous manner (Hettne 1994: 2).

Furthermore, social constructivism draws particular attention to how regions are socially constructed through the process of interaction and intersubjective understanding (Smith 1997). In similar fashion to neoliberal institutionalists, social constructivists share the idea that norms and beliefs may shape behavior. In contrast with the former’s rationalist/neo-utilitarian view, however, they believe that actors’ interests, motives, ideas,

and identities are not exogenously given but socially constructed by reflective actors, capable of adapting to challenges imposed by the actions of others and changing contexts (Hettne and Soderbaum 2000: 460).

From this analytical view, East Asia may be too heterogeneous to permit the invocation of a “real,” “natural,” or “essential” East Asian identity. That is, Southeast Asia is divided deeply along ethnic, linguistic, and religious lines, while Northeast Asia has yet to overcome the negative effects of Japanese colonialism and imperialism. Such divisions are thought to have inhibited the emergence of a true East Asian identity (Katzenstein 1997). Yet, most recently, there have been scholarly efforts to look beyond power- and interest-based understandings of East Asian regionalism, arguing that ideational forces, such as regional identity and norms, have contributed to the institution building in East Asia in both economics and security (Acharya 2003).

To summarize, the motives for forming PTAs include economic, political-strategic, and social constructivist ones. It is very difficult to assess the strengths and weaknesses of each explanation on anything other than a case-by-case basis, which is beyond the scope of this study.

Our motivation in reviewing the literature is to make two points, one concerning the problems in conceptualizing types of trade governance and the other about a more systematic, analytical framework to capture the dynamics of the formation and evolution of varieties of trade governance. With respect to the first point, from our perspective, the conventional explanations are, to a large extent, underspecified with regard to the different types of trading arrangements and their respective incentives. The term “preferential trading arrangement” or “regional trading arrangement” has been used as

shorthand for widely disparate accords such as APEC, Asia-Europe Meeting (ASEM), ASEAN, NAFTA, Mercosur, bilateral free trade agreements both in and outside the region, and even sectoral agreements such as the Information Technology Agreement (ITA).² This conceptual ambiguity and under-differentiation of the dependent variable makes it more difficult to analyze specific outcomes, and thus may impair our theoretical analysis of trading arrangements.

Turning to the second point, a more fine-tuned, synthetic analysis of the dynamic relationships between economic, political-strategic, and social-constructivist motives has been missing, particularly in the East Asian context where the policy shift towards alternative modes of trade liberalization has been truly dramatic in the past several years. Without adequate specification of what exactly is to be explained, discussions of East Asian regionalism do not adequately theorize about the different causal factors driving the varieties of trading arrangements.

Varieties of Trade Governance

East Asian countries, like others elsewhere, have utilized a host of measures to regulate trade flows. In terms of the number of participants, these include unilateral, bilateral, minilateral, and multilateral strategies; in terms of product coverage, the range has been narrow in scope (a few products) or quite broad (multi-product). Bilateral and minilateral measures can be focused geographically or bind states across long distance. Moreover, these measures can be either market closing or market opening. Also, except for the case of multilateral agreements, we can also focus on whether there are few or many agreements (for unilateral opening, the number of countries liberalizing). Finally, one

could examine characteristics such as the strength and institutionalization of arrangements, their timing, and the like.

Of these many possible dimensions that one might use to classify the varieties of trade governance, Table 1 focuses on multi-product, market-opening measures that vary in terms of *actor scope* and *geography*. For sake of presentation, we do not illustrate product coverage, the strength of institutionalization of arrangements, or the number of accords in this table; we will, however, discuss these elements in our analysis in later sections. Of these three, the dimension of geography is potentially the most controversial. We define a pair of countries are geographically concentrated, if they are contiguous on land or within 400 nautical miles (the sum of two countries' 200-nautical mile exclusive economic zones); otherwise, we view them as being geographically dispersed. According to our definition, for example, China is geographically contiguous to both Southeast and Northeast Asian countries. It is worth noting that this category is complex, since simple distance is hardly the only relevant factor in defining a "geographic region." In fact, despite the interest that regionalism has attracted, the question of how to define a region remains highly contested.³ Despite conceptual difficulties, we maintain that geography matters and that a region is firmly rooted in territorial space. For us, therefore, the inverse relationship between distance and international trade still holds due to transportation costs, which are likely to raise the price of a good in the importing country.

Table 1. Varieties of Trade Governance Measures in East Asia*

NUMBER OF ACTORS						
TRADE LIBERALIZATION MEASURES	Unilateral	Bilateral		Minilateral		Multilateral
		<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 APEC's IAPs	Japan-South Korea FTA (under negotiation) China-South Korea FTA (under study)	Singapore-New Zealand CEP (2000) Japan-Singapore EPA (2002) Korea-Chile FTA (2002) U.S.-Singapore FTA (2003) Taiwan-Panama (2003) Japan-Mexico (2004) South Korea-Singapore (2004)	ASEAN (1967) AFTA (1991) China-ASEAN Framework FTA (2003)	APEC (1989) (transregional) EAEC (1994) (transregional) ASEM (1996) (hybrid interregionalism) ASEAN Plus Three (1998) (hybrid interregionalism)	GATT/WTO (1947/1995) ITA (1997) BTA (1998) FSA (1999)

*Adapted from Aggarwal (2001); Updated as of January 2005.

Unilateral liberalization (cell 1) includes measures taken by Singapore and Hong Kong. The Individual Action Plans (IAPs) of APEC also fall in this category. Other than these few cases, however, unilateral trade liberalization efforts have been relatively rare in East Asia as in other regions. The prospective Japan-South Korea and South Korea-China FTAs fall in the category of *bilateral regionalism* (cell 2). As suggested by the gravity model, creating a natural trading bloc between a pair of neighboring countries can maximize the benefit from geographic proximity and economic size.

The category of *bilateral transregionalism* (cell 3) includes the bilateral FTAs between Singapore-New Zealand (2000), Japan-Singapore (2002), South Korea-Chile (2002), U.S.-Singapore (2003), South Korea-Singapore (2004), as well as prospective FTAs between South Korea-Mexico and Singapore-Chile. These types of bilateral FTAs often reflect political-strategic as well as economic considerations, as we shall discuss below.

Cell 4 focuses on geographically focused *minilateral regionalism* that has traditionally been referred to as “regionalism.” Examples include the ASEAN Free Trade Area (AFTA) and the ASEAN-China Framework FTA. In Northeast Asia, Japan, China, and South Korea are increasingly discussing the potential benefits of institutionalizing economic relations among themselves.⁴ This type of trading arrangement has attracted the most scholarly attention, commensurate with the rise of regional trading arrangements since the 1960s. However, cells 2 and, to some extent, cell 5 have also been considered “regionalism,” although conceptually each may have different implications.

Cell 5 refers to *minilateral* agreements, which can be further differentiated (Aggarwal and Fogarty 2004). Thus, if an accord links two customs unions or free trade agreements together, this is a case of “pure interregionalism,” such as the EU-Mercosur accord. These types of agreements do not yet exist in the Asia-Pacific. Instead, we have cases where countries across more than one region are linked, such as the East Asian Economic Caucus (EAEC) and APEC, which we label “transregionalism.” Finally, we have cases such as the ASEAN-Japan Closer Economic Partnership agreement (proposed in 2002) and the ASEAN Plus Three (APT—ASEAN countries plus Japan, China, and South Korea), which we refer to as “hybrid interregionalism.”

Finally, cell 6 points to *multilateral globalism* such as the GATT and its successor organization, the WTO. Though highly successful throughout the postwar period, multilateral trade forums at the global level have 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 or at multilateral sectoral agreements such as the ITA, Basic Telecom Agreement (BTA) and Financial Services

Agreement (FSA). Many scholars have rejected arguments about the need for an alternative to the GATT on both theoretical and empirical grounds, and there is a lively debate on the impact such accords might have on the global multi-product approach to liberalization.

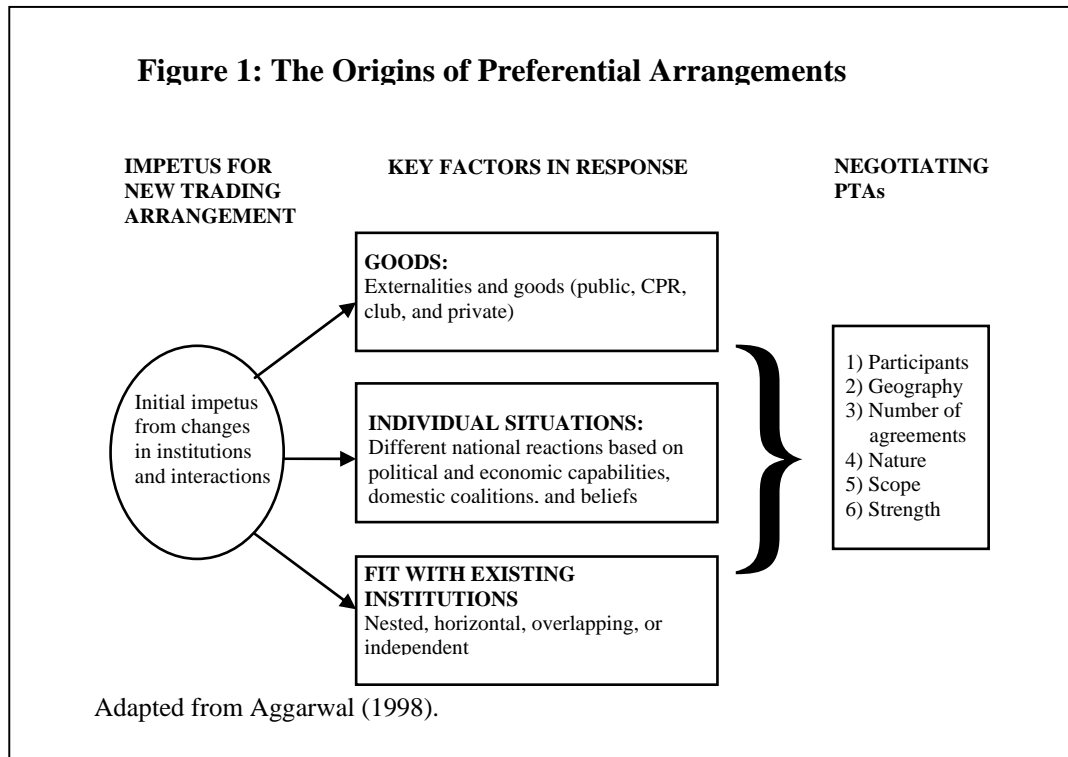
As will be discussed in detail in Section III, the institutional equilibrium in East Asia is currently shifting from a multilateral, broad-based approach (cell 6) to sub-multilateral options including bilateral regionalism (cell 2), bilateral transregionalism (cell 3), unilateral regionalism (cell 4), and unilateral transregionalism (cell 5).

An Institutional Bargaining Game Approach

To more adequately analyze the dynamics among various types of trading arrangements and the likely evolution of new institutional equilibrium, we build on an institutional bargaining game approach (Aggarwal 1998). While we do not claim that this approach always provides a specific causal prediction of each type of accord, it provides a more systematic basis for examining both policy choices and connections among different types of arrangements.

As illustrated in Figure 1, an institutional bargaining game approach begins by identifying an initial impetus for a new trade strategy. The process of a shift from an initial institutional equilibrium to a new one often comes about with an external shock—problems with extant international institutions or a financial crisis, for example—that creates pressure for change. Countries respond to such external shocks in various ways based on the “goods” involved in the negotiations, their individual bargaining situations,

consisting of the international position, domestic political structure and beliefs, and the context of the existing institutional environment.



With respect to goods, an external shock may stimulate or impede the provision of public goods, common pool resources (CPRs), inclusive club goods, or private goods. There is significant debate, reflecting different economic ideas, about how to characterize trade liberalization. Classical trade theory suggests that international trade liberalization should be seen as a harmony game, where everyone’s optimal strategy is to liberalize, independent of what others do. From this perspective, trade liberalization is a public good to the extent that it is non-rival and non-excludable in consumption.

Others, such as neoliberal institutionalists, see trade liberalization 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. PTAs that have fewer participants reduce the possibility of free riders and ensure that gains from trade liberalization are an inclusive club good that accrues only to the participants to the arrangements.

In both theory and practice, the number of participants can be reduced in at least two ways: by limiting the number of countries involved in the negotiations or to limit the size of the agenda for the negotiations, which generally reduces the number of interest groups that actively lobby. The former leads to a surge in PTAs, while the latter produces sectoral liberalization at multilateral or sub-multilateral level such as the European Coal and Steel Community of 1951 and the ITA of 1997 (Aggarwal and Ravenhill 2001).

While there are many factors that might affect national preferences, the most significant elements that influence responses to an external shock 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 and political regime type; and (3) elite beliefs and ideologies.

With respect to international position, a country's relative economic development as well as economic size is a key determinant of trade strategies. For instance, a country with a large market is more likely to entice others to seek it out as a trading partner rather than the other way around. This attractiveness may provide the larger country with greater leverage in negotiations, particularly with few or only one counterpart. Security concerns may also drive an interest in preferential arrangements, as a means of linking one's fate to another country. Countries may prefer trade with their 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. Therefore, one might hypothesize that PTAs are more likely to overlap with alliance relationships (Gowa 1994).

The second dimension of individual bargaining situations concerns a state's domestic coalitions and regime type, which reflect the extent to which states are responsive to demands by various groups either for or against trade liberalization. To some scholars, it is mainly domestic pressure groups that determine countries' trade policies (Grossman and Helpman 1995). In particular, with increasing returns to scale and oligopolistic competition among a few companies, export-oriented corporations prefer a type of arrangement—which creates a larger market, but which is hard for out-of-region corporations to enter—and thus take a leading part in pushing for bilateral or minilateral arrangements. The literature on political regimes contends that countries' policy responses will vary with their regime types. From this perspective, both international and domestic pressures affecting a country's choices are filtered into real outcomes through a powerful state structure (Milner 1992, 1997).

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 unilateral, bilateral, minilateral, or multilateral basis (Haas 1992; Moravcsik 1998). The setback in Seattle has significantly eroded the traditional confidence in multilateralism, leading to the construction of new ideational formulas for supporting preferential alternatives—be they bilaterally- or minilaterally-based. Many

countries have come to share the idea of the desirability of pursuing alternative arrangements, although this idea remains hotly contested and lacks consensus.

With respect to institutional fit, new preferential arrangements or the modification of existing ones are influenced, especially in East Asia, by the context of broader institutional arrangements such as the WTO and APEC. From a theoretical perspective, we can define four types of connections among institutions: (1) nested links, whereby arrangements conform to broader accords; (2) horizontal connections, whereby arrangements reflect a division of labor among institutions without any hierarchy among institutions; (3) overlapping agreements, which may create tension among institutions; and (4) independent institutions, which do not overlap and thus have little or no interaction with existing institutions in functional terms. If institutions already exist and could potentially overlap with each other, actors contemplating institutional innovation must decide how important it is to reconcile institutions through nested or horizontal connections that promote a division of labor.

If one is developing narrow issue-area or sub-multilateral arrangements, and the issue's salience is low relative to broader issue-area or multilateral arrangements, actors will make strong efforts to nest the new institution within the broader one—even if there is no clear substantive connection among issues. We should also expect to see consistent goal ordering, and hence nested institutions, when broader external threats are significant. For example, APEC's founding members were worried about undermining the GATT, and sought to reconcile these two institutions under the rubric of "open regionalism." APEC members saw this approach as a better alternative to using Article 24 of the GATT

to justify this accord that seeks to reduce barriers to goods and services amongst themselves in a GATT-consistent manner.⁵

An alternative mode of reconciling institutions would be to simply create “horizontal” institutions that would create an institutional division of labor, as exemplified by the International Monetary Fund (IMF) and the World Bank, with the former focusing on short-term balance of payment lending and the latter on longer-term structural development (although in practice, this has not always been the case).

Conversely, overlapping arrangements can create conflict because of the potential for task competition. For example, in the case of bilateral FTAs, countries have claimed that these arrangements are nested with GATT/WTO Article 24 and that they are even seen to be WTO enhancing. But as Ravenhill (2005) argues, this claim is dubious, with many sectors being excluded and new names being devised—such as the economic partnership agreement (EPA) between Singapore and Japan. Efforts to create an Asian Monetary Fund (AMF) also reflect the debate over institutional conflict.

Lastly, an example of independent institutions is the case of the North Atlantic Treaty Organization (NATO) and APEC. While the U.S. is a member of both, these institutions have different institutional missions, and thus do not create any conflict. It is worth noting that previously independent institutions (such as the International Labor Organization and WTO) may be linked over time and may be seen to be overlapping and potentially create conflict.

III. Impetus for a New Trade Strategy in East Asia

In this section, we examine the impetus for a new trade strategy in East Asia using our institutional bargaining game approach. We note that East Asia's new institutional equilibrium depends heavily on developments in its northeast sub-region. As such, following a general discussion of East Asia, we further elaborate three Northeast Asian countries' shifting preferences for the mode of trade liberalization.

East Asia

In postwar East Asia, several efforts have been made to create a stronger institutional manifestation of regional economic ties, but these efforts have barely succeeded (Calder and Ye 2004). Analysts have spilled much ink in debating the uniqueness of East Asian regionalism that is often characterized by market-driven, informal integration. Among others, the networks of Japanese transnational corporations and overseas Chinese are seen to have played a key role in forming a virtual economic community in the absence of formal institutionalization of regional economic affairs (Hatch and Yamamura 1996; Bernard and Ravenhill 1995; Katzenstein 1997; MacIntyre 1994). The openness of the U.S. market, natural forces of proximity, and the vertical and horizontal integration of regional economies through Japanese investment along with overseas Chinese business networks seemed to have produced greater economic interdependence without substantial institutionalization at the regional level.

In the 1990s, however, the traditional institutional equilibrium in East Asia became increasingly unstable. Many countries in the region began to actively embrace the latest wave of preferential agreements in an attempt to institutionalize their economic

ties. Although many countries continue to pay lip service to their commitment to multilateral globalism, the erosion of their confidence is visible in various parts of the region.

The pressure for a shift from the traditional institutional equilibrium to a new one came about through two external shocks—one political and one economic in nature. First, broader security shifts such as the end of the Cold War made it politically easier for East Asian countries to consider regional institutionalization (Breslin and Higgott 2000; Ravenhill 2002b). The end of bipolarity has reduced the significance of Cold War perceptions and divisions, breaking down barriers that had precluded regional integration between capitalist and communist blocs. Relatedly, the U.S. no longer adopts an antithetical position towards regional organization.

The second and most critical turning point came in the wake of unprecedented economic shocks in the last years of the decade, to which the seemingly dense networks of Japanese and overseas Chinese investment turned out to be quite vulnerable. To some extent, the impact of the particular pattern of Japanese and overseas Chinese investment contributed to the damaging crisis (Hatch 1998). The rapid expansion of Japanese and overseas Chinese regional production networks in East Asia in the 1980s and early 1990s began to show a tendency to follow investment fads rather than market demand, creating overcapacity in similar manufacturing sectors such as electronics and automobiles.

East Asian economies could delay the ultimate bursting of their bubble as long as they were able to find export markets where they could sell the investment-fueled output that vastly exceeded the absorption capacity of domestic consumers. However, the structural problems finally exacted a heavy toll in the closing years of the 1990s. For

East Asian countries (with the exception of China), the seemingly endless export boom of 1980s and early 1990s began to face problems in the mid-1990s.⁶ At the end of 1995 the “trade triangle” that had linked Japanese (and overseas Chinese) capital, developing East Asian manufacturing capacities, and Western markets appeared to be in trouble (Altbach 1998; Pempel 1999).

One major option for the crisis-ridden countries and their affected neighbors was to secure preferential access and create a more diversified export market. In other words, the new trend in East Asia reflects a convergence of interests in securing inclusive “club goods” in the face of anemic, if not shrinking, export prospects. Many East Asian countries came to recognize that tighter institutionalization—rather than loosely-structured production networks—might be a better commitment mechanism for providing economic security. With traditional mechanisms within WTO and APEC offering no salient solutions, these countries quickly turned towards PTAs to assure a market for their products.

Turning to the first element of individual situations, namely, an actor’s international position, many East Asian countries’ approach to China as an FTA partner illustrates the importance of a large market in enticing the negotiation of trading arrangements. This attractiveness, of course, provides China with greater leverage in negotiations. In addition to standard economic considerations, there is a strong indication that security concerns drive an interest in the creation of PTAs, as seen in the ASEAN-China Framework FTA (Kwei 2005).

In East 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 and South Korea—to highly authoritarian—e.g., China 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 has altered the economic payoffs facing individual countries, as they march toward more democratic regimes, rendering intergovernmental cooperation more likely and the requirements of institution-building less daunting (Yoon 1999).

In addition, countries' changing perceptions regarding the importance of supporting multilateral institutions has affected the choice of preferential mechanisms. Many East Asian trade experts now are part of an “epistemic community” which shares the view that PTAs can be trade-enhancing and serve a similar purpose of multilateral trade liberalization. On the other hand, cases of negative diffusion are also increasing in number as countries make a bolder move toward preferential arrangements that are clearly at odds with at least the spirit of the multilateral rules of GATT/WTO. In this case, the Japanese have followed the EU precedent in their negotiations of the JSEPA: the few products in the ultra-sensitive agricultural sector that Singapore exported to Japan were excluded from the liberalization provisions. Other East Asian countries have quickly signaled that they intend to follow Japan's precedent (Ravenhill 2005).

Finally, the existing institutional context at the multilateral level drives the political initiatives and intrinsic interest to create PTAs in East Asia, reflecting the growing need for an “insurance policy” to realize free trade sub-multilaterally when

multilateral trade liberalization is stalled or proceeding slowly. Furthermore, it is worth noting that the incentive for an “insurance policy” often goes beyond trade in goods. Many of the recent preferential arrangements in East Asia attempt to cover broader areas and elements like trade in services, factor mobility, investment rules, intellectual property rights, and government procurement. At the same time, many East Asian countries, stricken by the financial crisis, have shown a strong interest in accessing the financial resources that might accompany a preferential accord, especially with the region’s financial giant, Japan.⁷

Turning to the outcomes that result from individual countries’ responses to external shocks, the latest enthusiasm for preferential agreements in East Asia seems to revolve around a bilateral FTA as a popular mode of participation, while there are also strong indications of multilateral participation such as the APT and the China-ASEAN Framework FTA. To this point, East Asia’s new appetite for PTAs is geographically open. On the one hand, these PTAs go beyond the traditional concept of a region defined by geographical proximity (See Table 1). On the other hand, while some PTAs go beyond the concept of geographical region, other transregional and/or (hybrid-) interregional initiatives have emerged that attempt to formalize the emergent concept of an East Asian Community (EAC) with multiple cross-cutting linkages of trade and investment, promoted by the APT initiative (Webber 2001).

The strength of these preferential arrangements will reflect not only the power of different actors, but also the willingness of governments to give up some autonomy. Moreover, the nature and scope of coverage of such arrangements will also be driven by economic concerns about trade competition, investment diversion, and the danger of

capital outflows. Many of the recent PTAs in East 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 arrangements are potentially incompatible with the WTO provisions since some sensitive sectors are deliberately excluded, thereby setting up the possibility of institutional conflict.

Northeast Asia

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 East Asia (Yoon 1999; Moon 2003; Calder and Ye 2004). These countries have not yet acted vigorously to institutionalize economic relations. In the wake of the aforementioned external shocks in the 1990s, however, the new dynamics of rivalry between Japan and China are now playing a critical part in shaping the newfound rush to preferential arrangements. Besides standard welfare calculations, for both Japan and China, emerging interest in PTAs provides a convenient venue to vie for regional economic leadership. In the regional context of growing Sino-Japanese rivalry, South Korea pursues PTAs in order to strengthen its bargaining position.⁸

In Northeast Asia, the national responses to common external shocks are, of course, not uniform in motivation and strategy. Each country's preference for the mode of trade liberalization is somewhat in flux, but we can consider the views of these states with respect to the number of participants and geographic coverage of their current and/or prospective PTAs.

In Japan, free trade advocates now see PTAs as devices that would achieve economic restructuring in ways that would be more palatable than either sweeping

domestic reform programs or commitment to more comprehensive global free trade measures (Pempel and Urata 2005). When it comes to participants and geography, Japan prefers “general bilaterals,” namely a web of geographically open bilateral agreements. For Japan, a trilateral arrangement with China and South Korea seems least attractive despite its lip service to the proposal. This may reflect Japan’s ambivalence towards China: Japan hopes to integrate China into the region but, at the same time, is worried about China’s rising hegemony. Japan’s first PTA guidelines announced in October 2002 make it clear that its long-term objective is to create a transregional East Asian FTA, rather than an exclusive focus on Northeast Asian bilaterals, presumably because the former would provide a larger buffer between Japan and China than the latter.

China had spent the lion’s share of its diplomatic capital on securing WTO membership. For Chinese leaders, no serious distraction from multilateral schemes is desirable, since it would likely taint one of their biggest diplomatic achievements in recent years. It is not surprising that China appears to be moving somewhat more slowly than its neighbors with regard to PTAs. In addition, China’s dazzling economic performance makes the need for inclusive club goods less compelling to it than to its trade-dependent neighbors. As Kwei (2005) argues, China is more likely to engage in “one-to-many” negotiations or “hybrid bilateral” arrangements, rather than pure bilateral PTAs, except where security or political imperatives dominate.

In South Korea, a reformist political leadership and a fluid social coalition that emerged in the wake the 1997-98 financial crisis paved the way for promoting PTA negotiations (Koo 2005). South Korea has deliberately focused on transregional “lightweight” PTA partners such as Chile, Singapore, Mexico, and Thailand. Ultimately,

however, South Korea eyes Japan as an ideal PTA partner. As Cheong (2003) notes, South Korea hopes that this web of PTAs would attract China to form a Sino-South Korea PTA. In order to maximize its bargaining position and diplomatic weight alike between its two giant neighbors, South Korea also actively supports regional and transregional schemes such as a NEAFTA and APT.

In sum, although the Northeast Asian countries' pursuit of PTAs does not mean that they downplay the significance of the broad-based multilateral trade systems, the policy departure is obvious and significant. In principle, their new preferences seem to be open in terms of the participants and geography. It is noteworthy that the latest enthusiasm revolves around "general bilaterals" as a popular mode of participation

IV. Getting to a NEAFTA and Beyond

How is the current institutional mix in Northeast Asia likely to evolve over the next decade? Many recent analyses tend to have a strong normative tendency, with enthusiasm expressed for a particular type of arrangements over the other (Lee 2003; Cheong 2003; Abe 2003). We seek to avoid such a teleological bias by leaving all possibilities open in terms of the future institutional settings in Northeast Asia.

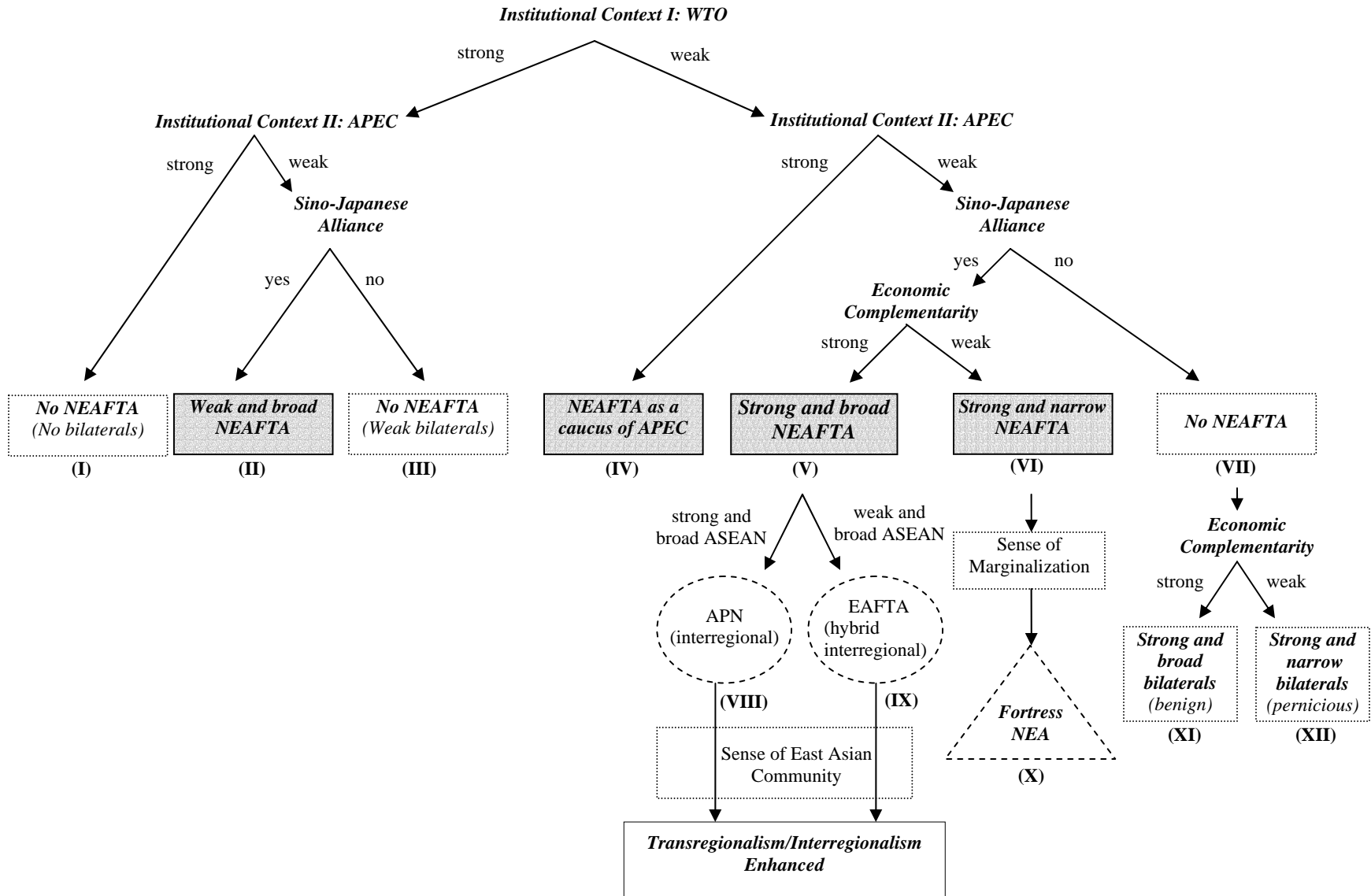
Ideally, to create likely scenarios that allow all the possible outcomes illustrated in Table 1, we would have to simultaneously consider the variation in all the variables in our institutional bargaining game, namely goods, individual bargaining situations, and the context of existing institutions. However, analyzing each of the many possible outcomes would be a nearly impossible task, particularly given the many uncertainties involved. Instead, we simply explore various paths that might lead to some type of NEAFTA—that is, the nature of a prospective trilateral PTA that is market-opening with a geographic

coverage focused on Northeast Asia. Then, we briefly consider the most likely paths that NEAFTA or non-NEAFTA outcomes might take within or beyond Northeast Asia.

To systematically construct our simplified scenarios, we assume a certain hierarchical order among the variables in our institutional bargaining game. To begin with, drawing on the factors illustrated in Figure 1, we give pride of place to the status of extant broad-based, international institutions as a primary source of *initial impetus* for change. We assume that the status of the WTO and APEC may stimulate or impede the provision of trade liberalization as a public good.⁹ Specifically, we believe that the weakness of each of these institutions will encourage the pursuit of a club good, whereas their strength will discourage incentives for pursuing club goods.

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. We focus on three variables in order of their presumed significance—the institutional strength of the WTO and APEC, alliances, and economic complementarity between countries. We draw the following causal relationships from our theoretical and empirical observations: the number of participants, strength, and scope of a prospective NEAFTA are a negative function of the strength of the WTO and APEC, and a positive function of alliances—particularly a Sino-Japanese alliance¹⁰—and economic complementarity (See Figure 2).

Figure 2: Paths to NEAFTA and Beyond



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 a positive, albeit tentative, alliance between China and Japan came into existence (and thus a trilateral alliance 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 allied Northeast Asian countries to form a NEAFTA—immediately or by merging separate bilaterals—in order to maximize the benefit from the geographic proximity and size of their economies. By contrast, if there is no Sino-Japanese alliance, 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 bilateral alliances 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).¹¹

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 reach a political alliance (thereby leading to a trilateral alliance in the region), 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, it 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 we have considered to this point, we further explore the likely paths from the three particular outcomes that are based on the combination of a weak WTO and a weak APEC.

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 EAC where ASEAN is united, but South Korea, Japan, and China are not. In this case, members would participate in the capacity of individual Southeast Asian states and South Korea, Japan and China as members of NEAFTA (outcome IX).

Next, we explore 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 stable, the growing interconnectedness and the networked nature of interstate economic activities may produce an increasing awareness and sense of community among East Asian countries (Terada 2003). 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.

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 among 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).

In outcome VII, although we rule out a 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 be heightened 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 among other countries (Bergsten 1996; Schott 2004). 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, if any (Irwin 1993; Aggarwal and Ravenhill 2001; Bhagwati 2002).

V. Conclusion and Prospects

At the turn of the new millennium, the traditional institutional equilibrium in East Asia—the embrace of the WTO at the multilateral level and a focus on market-driven, informal integration at the submultilateral level—is under heavy strain. A growing number of Northeast and Southeast Asian countries are pursuing greater institutionalization at the sub-multilateral level, actively weaving a web of preferential arrangements. This article examined the likely path of trading arrangements in Northeast Asia, and also attempted to explore its likely implications for East Asia and the global trading system more generally.

We have found conventional accounts of trading arrangements wanting. By and large, while identifying economic, politico-strategic, and sociological constructivist arguments that have an impact on trade accords, the primary focus of most studies has been on a rather diffuse notion of “regionalism” that does not adequately capture the varieties of trade governance measures. To remedy this lacuna, we developed a more fine-grained, synthetic typology—unilateral, bilateral, minilateral and multilateral—and showed how this approach can help us to classify East Asian trading arrangements more systematically.

Explaining the large variety of trading accords poses a challenge. In an effort to understand the diversity of accords, we proposed an institutional bargaining game approach, which focuses on goods, countries' individual situations, and the fit with existing arrangements. With respect to goods, we assumed that any disturbances in the provision of trade liberalization as a public good motivate countries to seek for club goods as a viable alternative. In looking at countries' individual situations, we focused on their international strategic and economic interests, their regime types, and their beliefs about the value of pursuing trading arrangements in the proliferation of PTAs in the other parts of the world.

The institutional bargaining approach allowed us to explore how trading arrangements evolved more generally in East Asia and specifically in Northeast Asia in the 1990s. Specifically, we showed how the changing nature of broader institutions interacted with country characteristics to alter institutional payoffs in the region. In particular, the pursuit of club goods replaced a more generalized commitment to public goods in the aftermath of the Asian financial crisis, which also undermined the myth that loose-structured production networks in East Asia could be a viable alternative to tighter, formal institutionalization.

Going beyond analysis of past events, we then explored possible paths to formal economic integration in Northeast Asia. We argued that the strength or weakness of the WTO and APEC opens up or close institutional space by affecting the provision of public goods and thus the incentives for club goods. If the WTO and APEC weakened, a NEAFTA could well be a possibility. Yet much depends on the possibility of a Sino-Japanese alliance and economic complementarity between individual countries. We then

examined possible development of a NEAFTA into broader transregional- and/or inter-regionalism. As our scenario analysis indicates, a NEAFTA has both benign and pernicious elements, depending on the ideas and beliefs held by regional actors.

In sum, we are literally at a fork in the road of choosing trading arrangements. In view of the tremendous political and economic uncertainty in the global economy, the path to freer trade in Northeast Asia, East Asia, and the world system is likely to be a bumpy one.

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¹ Indonesia (1950), Malaysia (1957), Singapore (1973), the Philippines (1979), Thailand (1982), and Brunei (1993).

² 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. Some exceptions include Aggarwal and Ravenhill (2001), Dent (2003), Ravenhill (2003), Hatsuse (1999), and Hettne (1994).

³ Many scholars regard a region as a geographically specified area. Based on this definition, economic regionalism refers to the disproportionate concentration of economic flows or the coordination of foreign economic policies among a group of countries in close geographic proximity to one another (Mansfield and Milner 1999; Frankel, Stein, and Wei 1997; Krugman 1991; Bhagwati 1992; Gilpin 1987). Conversely, others—particularly within constructivist camp—define regionalism in non-geographic terms. For them, countries that share common cultures, languages, religions, or ethnic backgrounds could be considered regional partners regardless of their geographic proximity (Hettne and Soderbaum 2000; Katzenstein 1997).

⁴ Some of the most popular examples from outside the East Asian region include the European Community (1958; after 1992, European Union), Mercosur (1991), NAFTA (1993), and the like.

⁵ GATT/WTO Article 24 requires that customs unions and free trade areas should cover “substantially all trade” among the participants. Member countries have exploited the lack of specificity of Article 24 to reduce the domestic political costs of entering PTAs.

⁶ 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.

⁷ For the failed attempt to create an AMF during the early stages of the 1997-98 financial crisis, see Amyx (2003).

⁸ This point was driven home most dramatically with regard to ASEAN. At the APT meeting in Brunei in 2001, China proposed an ASEAN-China FTA, and signed a surprise agreement in

February 2003 with the 10 ASEAN countries pledging free trade by 2010. Challenged to do the same, Japan proposed a Japan-ASEAN FTA at the ASEAN summit of 2002. It also hosted the ASEAN-Japan Commemorative Summit in December 2003, confirming its enthusiasm for promoting collaboration with ASEAN members. South Korea has recently jumped on board as well (Pempel and Urata 2005; Koo 2005).

⁹ 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.

¹⁰ It is quite plausible to assume that the current quasi-alliance relationship between Japan and South Korea will persist and is likely to evolve into a full-fledged alliance in the foreseeable future—given their strong bilateral ties with the U.S. and common security threat from North Korea. As such, the question of alliance in Northeast Asia really comes down to whether China and Japan could form an alliance (albeit an uneasy one) through a Franco-German type of *rapprochement*. South Korea would unlikely choose to remain excluded if a Sino-Japanese alliance came into being. This alliance hypothesis is predicated on the assumption that countries prefer to form PTAs with their allies rather than with their enemies because of the security externalities of trade. As noted in our theory section, the relative gains realized from preferential trade can cause changes in the relative distribution of power, thereby leading countries to avoid entering into PTAs with their enemies.

¹¹ 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.