

THE POLITICAL ECONOMY OF THE ASIA PACIFIC

Vinod K. Aggarwal
Min Gyo Koo
Editors

Asia's New Institutional Architecture

*Evolving Structures
for Managing Trade,
Financial, and
Security Relations*

 Springer

The Political Economy of the Asia Pacific

Editor

Vinod K. Aggarwal, University of California, Berkeley, CA, USA

Vinod K. Aggarwal · Min Gyo Koo
Editors

Asia's New Institutional Architecture

Evolving Structures for Managing Trade,
Financial, and Security Relations

 Springer

Professor Vinod K. Aggarwal
University of California
Berkeley APEC Study Center
802 Barrows Hall
Berkeley, CA 94720-1970
USA
vinod@berkeley.edu

Professor Min Gyo Koo
Yonsei University
Department of Public Administration
134 Shinchon-dong Seodaemun-gu
Seoul 120-749
Korea
mgkoo@yonsei.ac.kr

ISBN 978-3-540-72388-2

e-ISBN 978-3-540-72389-9

DOI 10.1007/978-3-540-72389-9

Library of Congress Control Number: 2007936183

© 2008 Springer-Verlag Berlin Heidelberg

This work is subject to copyright. All rights are reserved, whether the whole or part of the material is concerned, specifically the rights of translation, reprinting, reuse of illustrations, recitation, broadcasting, reproduction on microfilm or in any other way, and storage in data banks. Duplication of this publication or parts thereof is permitted only under the provisions of the German Copyright Law of September 9, 1965, in its current version, and permission for use must always be obtained from Springer. Violations are liable to prosecution under the German Copyright Law.

The use of general descriptive names, registered names, trademarks, etc. in this publication does not imply, even in the absence of a specific statement, that such names are exempt from the relevant protective laws and regulations and therefore free for general use.

Production: LE-TeX Jelonek, Schmidt & Vöckler GbR, Leipzig

Coverdesign: eStudio Calamar S.L., Girona, Spain

Printed on acid-free paper

9 8 7 6 5 4 3 2 1

springer.com

10. The Past, Present, and Future of Asia's Institutional Architecture

Vinod K. Aggarwal¹
University of California at Berkeley

Min Gyo Koo
Yonsei University

10.1 Introduction

Asia's institutional order is in flux. The erosion of Asian countries' traditional confidence in bilateral alliances and multilateral globalism is increasingly visible, manifesting itself in the burgeoning interest in intra- and extra-regional free trade agreements (FTAs), regional financial institutions, and cooperative security dialogues. The sudden shift in Asia's institutional equilibrium has led to an extensive and thriving literature on the theory and practice of Asian regionalism.

Only a decade ago, it was widely believed that Asian countries were inherently incapable of managing their own economic and security affairs in an institutionalized manner. Asia seemed to be poor soil for implanting a sense of community and regional institutions in the post-World War II era, even when other parts of the world were busy surfing the wave of regionalism—albeit with varying degrees of success—following the birth of the European Community in 1958. Southeast Asia has been divided along ethnic, religious, and ideological lines for the past decades. Northeast Asia remains equally separated as a result of Japanese colonialism and Cold War confrontation. And more generally, conventional analysis separated South Asia from their East Asian counterpart.

In Asia, by many accounts, economic and security coordination at the minilateral level remained under-institutionalized for over five decades

¹ We would like to thank Jonathan Chow for his useful comments on this concluding chapter.

following the end of the Second World War. A series of proposals for a more exclusive regional economic club largely failed. And unlike Europe in the security arena, Asia has lacked an equivalent to the North Atlantic Treaty Organization (NATO) and the Organization for Security and Cooperation in Europe (OSCE) in the Euro-Atlantic region. Many scholars have attributed the lack of formal regionalism in Asia to the hub-and-spoke alliance network of the San Francisco system, under which economic and security issue areas were managed by a transregional mix of bilateral and multilateral institutions, as opposed to intraregional unilateralism. This peculiar mixture became a defining feature of institutional cooperation in Asia and especially East Asia.

Among others, Peter J. Katzenstein has argued that East Asian regionalism is best understood as “market-driven network-style integration in contrast to the exclusive character of Europe’s emphasis on formal institutions.”² For him, Asian regionalism operated not only under the auspices of a private-public link between private *keiretsu* networks and the Japanese government but also through the efforts of overseas Chinese across Asia. As such, he argued that East Asian regionalism was shaped primarily by bottom-up economic integration that obviated or at least substituted for formal rule-based regional institutions.

Indeed, the San Francisco system offered America’s Asian allies access to the U.S. market in return for bilateral security agreements. At the same time, U.S. allies were strongly encouraged to participate in broad-based, multilateral forums in institutions such as the United Nations (UN) in security and the General Agreement on Tariffs and Trade (GATT) and the International Monetary Fund (IMF) in trade and finance. Aside from informal networks based on corporate and ethnic ties, the San Francisco system created few incentives for Asian countries to develop exclusive regional arrangements.

In recent years, however, we have seen dramatic changes in perceptions about and responses to Asia’s long-standing trade, financial, and security order. In the post-“triple shocks” period, which we characterize as being marked by the end of the Cold War, the financial crisis of 1997-98, and the attacks of September 11, 2001, the new dynamics of rivalry and cooperation among states at both the intraregional and transregional levels are redefining institutional pathways in Asia. Whereas the traditional postwar trade, financial, and security order focused on bilateral alliance structures, global economic and security institutions, and informal corporate and ethnic solutions, the new institutional environment in Asia now revolves

² Katzenstein (1997:3)

around the proliferation of FTAs, regional financial cooperation, and bilateral and minilateral security dialogues.

How effective will these burgeoning regional and interregional institutions be in managing Asia's increasingly complex economic and security ties? What are the intrinsic linkages between trade and security arrangements? What do these new trends mean for the future of Asia? The future institutional trajectory of Asia is still open, but this volume has explored both recent efforts and possible future scenarios for the region to understand the types of institutional solutions that may be feasible in Asia. Based on an institutional bargaining game approach, contributors to this book provide a rich theoretical and empirical analysis of trends and prospects both within and among Northeast, Southeast, and South Asia.

The remainder of this chapter proceeds as follows. Section 10.2 presents a discussion and evaluation of our theoretical argument. We then consider the broad shifts in Asia's economic and security environment that we have seen based on John Ravenhill's and Keiichi Tsunekawa's chapters, respectively, in Section 10.3. Section 10.4 highlights the key findings of subregional chapters on Northeast Asia, Southeast Asia, and South Asia. Section 10.5 examines the key links between security and trade issues in the formation and evolution of new institutions. Finally, in a more speculative vein, Section 10.6 evaluates the prospects for Asian regional integration in trade and security in a rapidly changing context and its implications for both Asia and other regions of the world.

10.2 Evaluating an Institutional Bargaining Game Approach to Explaining Asian Institutional Change

How well does the institutional bargaining model presented in Chapter One and used by the contributors to this volume help to illuminate the process of institutional transformation in Asia? To address this question, we begin by briefly reviewing our approach. Our analysis focuses on how the traditional institutional equilibrium in Asia has come under heavy strain in light of the "triple shocks". The institutional transformation that we are interested in explaining can be characterized along several dimensions, including the number of actors involved in an accord (unilateral, bilateral, minilateral, and multilateral) and whether the accord is geographically concentrated or dispersed (see Table 1.1 in Chapter One). Other important elements that help to define new institutional arrangements include the strength, nature, and scope of accords.

The model we present in Chapter One used shocks as driving factors in altering actors' incentives. We argue that actors' responses will be driven by three key elements: 1) the types of "goods" that are involved; 2) actors'

individual bargaining situations based on their international and domestic context and beliefs; and 3) pre-existing institutions. We characterize goods in terms of whether they are public, common pool resources, club goods, or private goods. With respect to goods, we argue that in trade and finance, Asian states have over time become disillusioned with the public good provision aspects of the GATT/WTO club and the IMF, leading them to more directly seek club goods on a bilateral and minilateral basis. Similarly, the public goods aspects of the San Francisco system in security also appear to be increasingly fragile, leading states to seek security through club goods.

Turning to countries' individual bargaining situations, the rise of China has become a key factor in actors' international calculations. Now, security, finance, and trade are increasingly linked (a fact we discuss later in this chapter), increasing the politicized nature of trade and finance in particular and leading states to use both economic and security institutions to help them address the changing balance of power in the region. At the domestic level, we find that the increasing democratization of states in the region has had a mixed effect: on the one hand, this trend has increased prospects for cooperation; on the other hand, democratization has led to the rise of nationalistic and protectionist interests, making negotiations in trade and security more volatile. Finally, at the level of beliefs, we find a shift toward a view that regional (and bilateral accords in trade) may provide a means of coping with the changes that have taken place in the San Francisco system with the changing role of the U.S. and the rise of China.

Lastly, with respect to pre-existing institutions, the problems of the WTO and APEC in fostering trade liberalization, and the IMF in dealing with the Asian financial crisis, have made concerns with nesting new trade or financial accords within these institutions less compelling. In particular, as the U.S. and the EU, among others, pursue their own bilateral and minilateral arrangements in trade, Asians have begun to increasingly pursue their own institutional arrangements. And in security, the concern with maintaining the San Francisco system has given way to the search for a new security architecture in the region that would be significantly less centered on the U.S.

How does this approach compare to that of other analysts of institutional transformation in Asia? At the most basic level, few analysts have attempted to actually contrast and compare change in trade, financial and security institutions in the three subregions of Northeast Asia, Southeast Asia, and South Asia. For the most part, scholars have focused their attention on one or another of these subregions, and thus the lack of a unified framework has made it difficult to theoretically understand the institutional transformation of Asia from a broader regional perspective.

An exception to this generalization is the work of Peter J. Katzenstein, particularly his ambitious book *A World of Regions*. In that volume, Katzenstein builds on his previous collaborative work to argue that the Asian region (as well as Europe) has been deeply affected by Asian countries' relationships to the U.S. In his view, the dynamics of the relationship of key states in each of these regions, namely Japan and Germany, have been a core element in determining the nature of regional arrangements in Asia and Europe, respectively. In addition, Katzenstein focuses on the lack of common cultural identity among Asians in contrast to Europe, and also the ties that bind the U.S. to Europe based on longstanding connections driven by European immigration. Finally, he emphasizes the wariness of Asian states toward formal institutions that might impinge on their post-colonial independence or cause any interference in their domestic affairs.

Although we find Katzenstein's approach to be closer to our analysis in terms of a multi-causal approach that is sensitive to power, norms, and economic changes, we are less convinced by his commitment to "analytical eclecticism." Because this approach fails to tightly categorize types of institutional arrangements and adequately differentiate among types of accords, we find the dependent variable inadequately specified, preventing an analysis of important nuances and shifts in types of trade, financial, and security arrangements. Furthermore, although many of the causal factors that we and Katzenstein identify are similar, the lack of a clear conceptual framework that addresses the impact of different variables makes it difficult to link these factors to clearly specified institutional outcomes in Asia. Although this problem is less evident in Katzenstein's own single-authored work, his edited volume *Beyond Japan* illustrates the problems in having authors examine trends in Asia in a systematic and comparable analytical fashion.³ Of course, in comparing approaches, the most important question is the extent to which one or another perspective is helpful in illuminating and possibly anticipating future changes in Asia.⁴ It is to our empirical findings that we now turn.

³ As discussed below, in Chapter Two, Tsunekawa attempts to bridge Katzenstein's analytical eclecticism and our institutional bargaining game approach.

⁴ For details of our evaluation of Katzenstein's work, see Aggarwal and Koo (forthcoming).

10.3 The Evolution of Economic and Security Institutions in Asia

The second part of this book provides a broad overview of trade, financial, and security institutions in Asia. In Chapter Two, John Ravenhill discusses how the “triple shocks” have affected the development of regional and transregional economic institutions. First, the end of the Cold War provided the prerequisite for launching region-wide inter-governmental collaboration—such as APEC—by removing residual ideological constraints from the calculus of economic cooperation between countries that had once been in opposing blocs. In the decade since the Asian financial crisis, economic institutions have proliferated at multiple levels, including the regional and trans-regional levels. In particular, Ravenhill highlights a growing desire both for collaboration on an “Asian” basis, and for the pursuit of trade agreements on a much more “practical” scale, that is, either bilaterally or minilaterally. Finally, he argues that the external logic created by the 9/11 attacks was of less significance in its impact on economic collaboration than were developments within Asia—most notably, the rapid growth of the Chinese and Indian economies.

While acknowledging a variety of economic and diplomatic purposes that Asia’s new economic institutions may serve, Ravenhill concludes with some cautious notes on their future, particularly with respect to FTAs. These accords, be they bilateral or minilateral, are inherently exclusive rather than inclusive. He argues that we cannot assume that the negotiation of such agreements will necessarily have a positive impact on economic and diplomatic relations, warning that trade negotiations can actually do lasting damage unless concluded within a reasonable period of time. As he notes, this has not always been the case in Asia as seen in the negotiations between Japan and South Korea and between the Association of Southeast Asian Nations (ASEAN) and India. Furthermore, the “club” or “positional” goods characteristic of FTAs may aggravate conflict, particularly when participation in the new FTAs across the region is not even. For instance, Taiwan has effectively been excluded from negotiating arrangements with other Asian countries by Beijing’s insistence that the “one China” principle must extend to trade agreements. Similarly, most of the lower-income countries in the region have also been excluded as they simply are not attractive partners except as part of a larger coalition (in this instance, ASEAN). Ravenhill also predicts that FTAs could have a destabilizing influence on the region if China and South Korea sign an agreement but neither side enters into similar arrangements with Japan. In this regard, Ravenhill’s view clearly contrasts with Katzenstein, whose Japan-centric

view of Asian regionalism argues that “FTAs tend to be stepping stones, not stumbling blocks, for porous regions.”⁵

In Chapter Three, Keiichi Tsunekawa examines how the “triple shocks” have shaped the development of regional security institutions throughout Asia. While sympathetic with Katzenstein’s view that regional phenomena in Asia are so complex that a variety of theoretical approaches is necessary to capture their multiple facets, Tsunekawa explicitly adopts a constructivist approach that emphasizes how cognitive and perceptual shifts interact with material structures such as military power and existing institutions. As he suggests, the role of actors’ shifting perceptions looms particularly large in the face of America’s weakening bilateral alliances, the strengthening of the U.S.-Japan alliance, the growth of minilateral organizations to manage regional security (particularly ASEAN and its derivative organizations in Southeast Asia), and China’s deepening engagement in regional security mechanisms. The latter development is clearly illustrated by China’s proactive role in the ASEAN Regional Forum (ARF), the Shanghai Cooperation Organization (SCO), and the Six Party Talks (SPT).

Tsunekawa holds that a key question for regional security institutions is whether their scope should be expanded to include more extra-regional actors or whether their membership is best confined to states located within Asia. In his view, the resolution of this question depends largely on America’s China policy. As China continues its economic growth and adopts an increasingly assertive stance on the regional stage, it will undoubtedly heighten perceptions of threat among policymakers in Washington. If the U.S. perceives China as a competitor, it may eschew minilateral forums in favor of broader cross-regional ones where China’s influence can be diluted. If, on the other hand, bilateral relations between China and the U.S. grow warmer, Washington may play a larger role in creating and strengthening regional security organizations to share the burden with Beijing.

The second critical bilateral relationship in the region in Tsunekawa’s view is between Japan and China. Historical rivalries have helped to foster threat perceptions on both sides, inhibiting the formation of any robust security institution in Northeast Asia. For him, defusing popular nationalism, altering threat perceptions, and solving major existing conflicts would certainly be necessary (if not sufficient) conditions for establishing a strong regional security institution. Similarly, the relationship between India and Pakistan is key to the subregional order in South Asia, and more broadly its relations with the rest of Asia. As long as India and Pakistan continue to fear the outbreak of war between them, the South Asian Association for

⁵ Katzenstein (2005:25)

Regional Cooperation (SAARC) will continue to languish in irrelevance as the norm of consensus will essentially enable them to veto each other.

Finally, Tsunekawa notes that ASEAN has been the most successful model of regional security cooperation in Asia by fostering norms of cooperative security and promoting conflict resolution through non-violent means. Although ASEAN and its derivative institutions are limited by their consensus-based decision-making process, they are nevertheless important in allowing for the development of greater trust among decision-making elites and socialization into norms of peaceful dispute resolution. Yet, as he cautions, confidence-building does not necessarily translate into mutually satisfactory solutions to stubborn geopolitical disputes, although it may help to prevent such disputes from spiraling out of control. Ultimately, for security to progress beyond the confidence-building stage, individual states must first settle their unfinished business and remove the sources of threat perceptions.

10.4 Subregional Developments

In the third part of this book, the authors of subregional chapters capture the new dynamics of Asian regionalism which involve a complex interplay among the key players in the region. To quickly summarize the main findings, at the heart of the shifting balance of Northeast Asian regionalism are the rise of China and the resultant triangular relationship among the U.S., Japan, and China. The complex balance of power in this part of the region does not allow for a single pacesetter, thus motivating these major powers to consider sharing (and competing for) regional leadership and influence with each other through multilateral economic and security forums including the ASEAN Plus Three (APT), the East Asia Summit (EAS), the Northeast Asian Cooperation Dialogue (NEACD), and the SPT. Southeast Asia is a unique subregion in that it features the widest variety of regional institutional arrangements in Asia. Despite its structural limitations, ASEAN has shown a certain degree of institutional resilience and adaptability in the emergence of Asian regional institutions such as the ARF and the APT. As Helen Nesadurai and Ralf Emmers note below, while ASEAN may not be the leader, it has served as the gravitational center of Asian regionalism, thus bringing together otherwise mutually suspicious neighbors such as China, India, and Japan. To that extent, many have recognized that ASEAN's principal contribution to Asian regionalism has been normative and social, rather than material and structural.⁶ Finally, South Asia re-

⁶ Acharya (2003)

mains essentially inhospitable to dialogues intended to resolve regional security and trade issues. In particular, subregional conditions set by the enduring rivalry between India and Pakistan fail to meet the minimal levels of trust and incentives for official and unofficial dialogues to institutionalize their trade, financial, and security relations. Nevertheless, the rise of India as an economic powerhouse and its integration into East Asian economic networks have galvanized interest in forming cooperative regional institutions in trade, financial, and security issue areas.

10.4.1 Northeast Asia

In Chapter Four, Mie Oba discusses the development of trade and finance institutions in Northeast Asia, highlighting the cooperation and rivalry between Japan and China. As she demonstrates, the triple external shocks have dramatically transformed elite beliefs and perceptions in the two regional powers regarding bilateral and minilateral economic arrangements. On the one hand, Japanese policymakers no longer consider FTAs as an inferior option to the multilateral trading system of the GATT/WTO, while Chinese leaders recognize that engagement in regional institutions outweighs the potential political cost of being constrained by them. On the other hand, the political cleavages between China and Japan over territorial issues and historical animosities pose critical obstacles to deeper regional institutionalization. Moreover, China and Japan offer different visions of a regionally integrated economic community, with Japan advocating the inclusion of external actors such as Australia, New Zealand, and India, while China prefers a more exclusively East Asian membership.

Can these differences be reconciled? Oba argues that images of being a “great power,” a “global power”, a “regional power”, or even an “Asian country” can influence policy directions and filter perceptions of exogenous events. She argues that self-perceptions and ideal images of each country held by a handful of political and business elites can disproportionately affect the identity of the country, thus distinguishing the contemporary institutional changes in Northeast Asia from their earlier counterparts during the Cold War period. Although it is still unclear as to what constitutes “Asia” or “Asian identity” beyond a collection of national identities, she argues that political and business leaders in China and Japan (as well as South Korea) have dramatically improved their relationships with one another as a result of sharply expanding economic ties over the past few decades. While such interactions will not settle all of the disputes and confrontations in Northeast Asia in the short run, Oba presents an optimistic picture that they will nevertheless provide Northeast Asian countries with the basic conditions for improving their relationship in the long run

and lay the groundwork for a potentially robust regional institutional architecture.

In Chapter Five, Min Ye examines security institutions in Northeast Asia, showing how global, regional, and domestic level forces are shaping a new security multilateralism. She begins with an observation that after each of the three external shocks, traditional security mechanism centered on bilateral alliance ties appeared insufficient to cope with structural changes and volatile security threats in the region, while new dynamics of domestic and transnational politics has nurtured a new sense of security interdependence.

On the one hand, the U.S. is clearly more concerned with counterterrorism and homeland security, while its key regional ally, Japan, tries to expand its international role and become a “normal state.” In the meantime, anti-U.S., anti-Japan, and anti-China sentiments are on the rise in South Korea, while China is conspicuously more nationalist in its regional diplomacy, especially toward Japan. As Ye aptly points out, all these trends have the potential to upset regional stability.

On the other hand, transnational economic actors and local governments in China, Japan, and South Korea have a considerable stake in regional stability and peace. Ye argues that multilateral cooperation—such as the ARF, the Korean Peninsula Energy Development Organization (KEDO), the APT, the Northeast Asian Cooperation Dialogue, and the Six Party Talks—has provided a more pragmatic means than bilateralism to address regional issues. For instance, China’s nationalist domestic audience is more likely to disapprove of any bilateral compromises that China would make with Japan than a diplomatic bargain in a multilateral setting. Similarly, the South Korean government is less likely to be constrained in multilateral diplomacy in the region than bilateral interactions with either Japan or China. Similarly, Japan’s drive to become an international power is more likely to succeed without setting off regional alarm bells if such growth is managed within multilateral frameworks. Although their strength and effectiveness remain unclear, Ye concludes that the variety of channels for security interactions in Northeast Asia certainly indicates promising signs for regional cooperation.

10.4.2 Southeast Asia

In Chapter Six, Helen Nesadurai investigates the establishment of new economic institutions in Southeast Asia, focusing on elite perceptions of trade and investment diversion in the wake of the “triple shocks”. Most notably, the Asian financial crisis prompted strong interest within ASEAN to build regional capabilities for preventing and responding to future crises. As she notes, however, this required the help of ASEAN’s richer Northeast

Asian neighbors and explains why financial cooperation proceeded under the auspices of the APT rather than ASEAN. Although the APT aspires to a comprehensive regional cooperation agenda covering both trade and non-traditional security, it is presently best known for its projects in regional *financial* cooperation, namely the Chiang Mai Initiative (CMI) and the Asian Bond Market Initiative (ABMI).

Nesadurai demonstrates that the 9/11 terrorist attacks had little effect on Southeast Asia's drive toward trade and financial cooperation but did provide a boost for APEC, renewing Washington's interest in the organization as the site for a variety of trade security initiatives, including counterterrorism. Furthermore, the need to secure access to markets and investment also accounts for the turn by a number of Southeast Asian countries to bilateral FTAs as insurance policies in a post-9/11 world. Singapore has been the most active proponent of bilateralism, while Thailand and Malaysia are not far behind.

The most compelling explanation for these changes, according to Nesadurai, is the central role played by elites' interpretations of external events. These interpretations provided the political space for those elites to initiate new institutions and review the designs of existing ones. Nesadurai argues that external shocks and events are always interpreted through the prism of what they mean for "economic growth" because growth remains a central basis of political legitimacy in Southeast Asia and acts as a guarantor of domestic regime security. In this regard, her view sharply contrasts with the conventional cultural explanation that the wariness of Asian states for formal institutions impinges on their deep-seated aversion to any intervention in their domestic affairs.

In Chapter Seven, Ralf Emmers examines a variety of Southeast Asia's collective security measures, focusing on the three most important arrangements: ASEAN (including the ASEAN Security Community or ASC), the ARF, and the APT. As held widely, ASEAN and its various region-wide initiatives have been at the core of the overlapping multilateral security structure in the region. Yet, in the post-"triple shocks" period, the erosion of the U.S. defense commitment, on the one hand, and the growing presence of China, on the other, has complicated the picture in Southeast Asia.

Against this background, Emmers claims that the institutional changes in Southeast Asia have occurred primarily in terms of widening geographical and issue scopes rather than institutional strength. As noted by other chapter writers as well, ASEAN's geographic expansion resulted in its institutional merger with Northeast Asian countries in various security and semi-security forums such as the ARF, the APT, and Track Two dialogues. Yet he argues that, despite the existence of a growing number of complementing and overlapping structures, minilateral security arrangements in

Southeast Asia still lack institutional capacity to effectively manage common security problems, both conventional and unconventional. Unlike the willingness to delegate part of their economic sovereignty to international institutions, Southeast Asian countries are still protective of their sovereignty and unwilling to give up national autonomy to supra-national structures.

Not surprisingly, it is questionable whether the ARF, despite its institutional utility, will succeed in moving from confidence building to preventive diplomacy. This view can be supported by the fact that great powers have lost their interest in the ARF, as indicated by the failure of the foreign ministers of the U.S., Japan, China, and India to attend its 2005 ministerial meeting. In addition, the APT does not have the institutional strength to effectively address changes in security, mainly because no consensus exists between its two key participants, China and Japan, on the security approach the institution should adopt. As a result, Emmers reaches a skeptical conclusion, arguing that ARF and APT are likely to remain as moderate confidence-building exercises rather than evolving into full-fledged security institutions.

10.4.3 South Asia

In Chapter Eight, Vinod K. Aggarwal and Rahul Mukherji focus on the evolution of India's new economic policies within the context of the larger transformation of Asia's economic and security architecture. Aside from the triple shocks, the authors find that India's balance of payments crisis in 1991 and the decision of both India and Pakistan to test nuclear weapons in 1998 were also critical factors.

As the authors show, India's import substitution industrialization (ISI) policy reflected the convergence of India's security and economic needs. During the Cold War period, strategic relations with Moscow fostered India's trade with the Soviet Union, whereas its need for regional export markets in the U.S. bloc was not significant. Since 1991, however, India's economy has undergone a remarkable transformation, departing from its ISI policy to a more liberal domestic economic model and an increasing focus on improving its export competitiveness.

Most notably, Aggarwal and Mukherji hold, the fall of exports to crisis-ridden East Asia, on the one hand, and India's nuclear tests (and consequent U.S. trade sanctions), on the other, prompted Delhi to seek bilateral trade agreements within South Asia, culminating in the signing of the Indo-Lanka FTA (ILFTA) in December 1998. For the authors, the ILFTA was a model of asymmetrical concessions that India was willing to make in search of markets at a time when the markets for Indian exports seemed restricted elsewhere.

In the post-9/11 period, India's institutional engagement with Asian economies is truly remarkable, enhancing its efforts to build on its Look East Policy (LEP). While SAARC has failed to facilitate free trade due to the fragile security situation between India and Pakistan and the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) remains nascent, India has strengthened its economic ties to Southeast and Northeast Asia as illustrated by its participation in a number of bilateral FTAs. After successfully concluding the FTA with Thailand in 2003, India signed the Comprehensive Economic Cooperation Agreement (CECA) with Singapore in 2005. India is actively negotiating FTAs with ASEAN and South Korea and has participated in the East Asia Summit. It is also working toward preferential agreements with Japan and New Zealand, while its trade relations with China have become increasingly cordial. Moreover, it continues to lobby strongly for an ASEAN Plus Six (APS) arrangement that would include Australia, New Zealand, and India, in addition to the APT. Aggarwal and Mukherji conclude that all these changes point to the possibility of further broad regional integration in the future.

In Chapter Nine, Eswaran Sridharan analyzes the evolution of regional security institutions in South Asia following the end of the Cold War, the Indian and Pakistani nuclear tests of 1998, and the 9/11 attacks. He argues that regional security institutionalization is extremely constrained by severe territorial and border conflicts within the region, particularly between India and Pakistan. To some extent, the threat of nuclear war resulting from the 1998 nuclear tests generated an impetus for confidence-building measures to improve transparency. Nevertheless, Sridharan presents a rather pessimistic view that existing forums such as SAARC will not be able to institutionalize security arrangements as long as the India-Pakistan territorial conflict over Kashmir remains unresolved. In addition, he notes that factors militating against the institutionalization of security cooperation in South Asia include the deteriorating state of Indo-Bangladesh relations, the Sri Lankan ethnic conflict, and Sino-Pakistan security cooperation that threaten India.

Sridharan contends that growing economic cooperation within the region will only slightly mitigate but not transcend this state of affairs, particularly given the much more limited scope for, and ratio of, intra-regional trade in South Asia due to India's overwhelming dominance. Relatedly, rapidly growing Sino-Indian trade will mitigate but not transcend the implications of China's basic alignment with Pakistan, at least so long as the Sino-Indian border problem, which has been shelved rather than fully resolved.

Nevertheless, it should be noted that cross-regional security relations between South Asian countries and the U.S. as well as East Asia countries

have improved. The 9/11 attacks have created an impromptu triangular relationship among India, China, and the U.S., stabilizing the otherwise hostile Sino-India relationship. The improvement of South Asia's relationship with Southeast Asia has also been dramatic since India launched its LEP in the early 1990s. Pakistan followed suit by signing the Treaty of Amity and Cooperation (TAC) with ASEAN and joining the ARF in 2004. Most recently, India has become the one of the most popular destinations for Northeast Asian countries' trade and investment. All in all, Sridharan concludes that South Asia itself will most likely lack comprehensive regional security arrangements, but that India's economic integration with the East Asian region indicates that the merger of two subregions in security terms remains a distinct, albeit uncertain, possibility.

10.5 The Nexus between Trade and Security

With the key findings of subregional chapters on Northeast Asia, Southeast Asia, and South Asia in mind, we now turn to examine the prominent links between security and trade issues in the formation and evolution of new institutions. Although financial issues have been linked to security, our interest in the scholarly literature on trade and security leads us to focus on the latter. How trade and security might be connected has attracted extensive scholarly attention in the field of international relations and international political economy. As John Ravenhill notes in Chapter Two of this volume, countries may pursue FTAs for a variety of strategic and diplomatic purposes, from confidence-building among countries with little contact with one another, to winning diplomatic points over regional rivals, to establishing an international legal personality, to locking extra-regional powers into the region. In a similar vein, Mireya Solis and Saori Katada persuasively show that, aside from prospective economic benefits, East Asian countries' cross-regional FTA initiatives have been strongly driven by security and diplomatic leverage considerations.⁷

Indeed, many Asia scholars agree that economic regionalism has implanted norms and institutional forms, and became precedents for Asian countries when reformulating their regional security architecture.⁸ In particular, many contemporary Asian FTAs aim to build "security-embedded" trade ties, thus providing the context for regional security institution-building. Security institutions, in turn, are regarded as instrumental in im-

⁷ Solis and Katada (2007)

⁸ Job (2003:254-255)

proving the conditions of economic prosperity. In what follows, we briefly consider four examples of security-embedded FTAs in Asia.

First, Singapore considered security as the single most important motive for entering an FTA with the U.S. in 2003, while it considered economic benefits of the agreement insignificant due to its traditional openness and the small size of its economy. At the same time, Singapore has approached China both economically and diplomatically so that the U.S.-Singapore FTA would not irritate Beijing. As a result, Singapore and China have made conscious effort to improve their political and economic relations for the past years. Singapore's dual approach to the U.S. and China clearly show the nexus between trade and security institutions in Asia.⁹

Second, the ASEAN-China FTA (ACFTA) is also security-embedded in that for both China and ASEAN, security concerns—rather than pure economic considerations—drove an interest in the creation of the ACFTA.¹⁰ China's rapid rise has raised fears about its intentions in the region and its likely foreign objectives. In response, China has chosen to use not only purely security forums like the ARF and the SCO, but also economic and other soft institutional mechanisms—such as the 2002 Code of Conduct in the South China Sea and the 2003 TAC with ASEAN—to diminish concern about its rise. Indeed, Beijing's proactive participation in a variety of regional institutions reflects a broader trend towards a “cooperative security” in the region.¹¹

Third, the South Korea-U.S. FTA (KORUS FTA), which was concluded on April 1, 2007, shows how countries can simultaneously, albeit implicitly, pursue economic benefits and strategic interests in trade negotiations. In addition to the goal of maximizing the gains from trade and investment, South Korea wanted to hedge against the growing strategic uncertainties in Northeast Asia by cementing its economic ties with the U.S., while the U.S. realized that an FTA with South Korea would give Washington a strong foothold to maintain its strategic and economic presence in the region. Furthermore, the KORUS FTA has the potential to alter the dynamics of the diplomatic and security relations in Northeast Asia where the balance of power is shifting due to the rise of China, the normalization of the Japanese state, and the nuclear adventurism of North Korea.¹²

Fourth and finally, in the case of India's relations with the rest of Asia, the interplay of security and trade concerns has been paramount, a point

⁹ Pang (2006)

¹⁰ Kwei (2006)

¹¹ Shambaugh (2004); Yahuda (2005)

¹² Lee and Koo (2006); United States Trade Representative (2007)

that Aggarwal and Mukherji have emphasized in this volume. India's ISI strategy was intimately tied to the Cold War and its links to the Soviet Union in export markets. And the end of the Cold War helped to drive India's economic liberalization strategy and subsequent turn to a more export-oriented focus in the face of shrinking markets in the Soviet Union. It also helped India to reorient its policy toward other parts of Asia. The Look East Policy helped India to secure membership in the ARF, policies that India could not pursue in light of its tilt toward the Soviet Union. The nexus between trade and security continued after India and Pakistan tested nuclear weapons tests in 1998. Together with the Asian financial crisis, India's LEP encountered problems with declining growth in East Asia and significant criticism by East Asian states of the nuclearization of South Asia. In this context, India concluded an FTA with Sri Lanka in its drive to continue its trade openness strategy. As relations improved with the U.S. and East Asia in the post-9/11 period, India continued this bilateral strategy, in part to maintain its credibility, and in part to balance against China, by signing FTAs with Thailand (2003) and Singapore (2005) and actively negotiating with ASEAN, Japan, South Korea, New Zealand, and the EU.

10.6 The Future of Asia's New Institutional Architecture

In an effort to understand the shifting institutional dynamics in Asia, this book utilizes a common framework that focuses on the role of external shocks, goods, countries' individual bargaining situations, and the fit of new accords with existing arrangements. Specifically, we focus on the "triple shocks": the end of the Cold War, the Asian financial crisis of 1997-98, and the 9/11 attacks. With respect to goods, we argue that disturbances in the traditional mechanism to provide trade liberalization, financial stability, and regional security have motivated countries to seek club goods as a viable alternative to the diminishing supply of public goods. This observation undermines the myth that the combination of bilateral and multilateral arrangements under the San Francisco system and loosely structured production networks will be a viable alternative to tighter formal institutionalization at the regional level.

Despite the many positive developments for the past few decades, there continues to be a view that the Asian region remains largely inhospitable soil in which to cultivate multilateral institutions, as most countries still stick to the notion of Westphalian sovereignty and non-interference. At the same time, there has been a spate of scholarly attempts at creating future scenarios for how regional and transregional Asian institutions in trade and

security might evolve.¹³ Yet, in light of the “triple shocks” and the resultant changes in Asian countries’ preferences for collective goods, we argue that insufficient efforts have been made to systematically link the dynamic interaction of key powers with broader institutions in both the trade and security issue areas. For instance, it is not enough to claim that “FTAs tend to be stepping stones, not stumbling blocks, for porous regions”¹⁴ or that “the emerging regional security architecture will be firmly grounded in national self-reliance, with strong and important bilateral connections, and a gradually thickening but still very thin veneer of multilateralism.”¹⁵ Instead, we must explore the conditions under which these agreements are likely to evolve into broader accords as well as the conditions under which they might undermine global institutions by failing to be firmly nested in those institutions.

As noted in the previous section, the findings of this volume indicate that economic regionalism will provide the context for regional security institution-building, rather than the other way around. At the same time, the security context is critical for the future of regional economic institutions. Using our institutional bargaining game approach designed to systematically examine the dynamic interaction of key powers and broader institutions, we construct simplified scenarios of possible institutional paths that Asia is likely to take, focusing primarily on the links between trade and security. For us, the future of Asia’s new institutional architecture primarily depends on the following causal variables: 1) the strength of broad-based, global institutions such as the UN and the WTO; 2) the China-Japan, China-India and India-Pakistan regional rivalries; 3) economic complementarity among countries; and 4) the “balance of interests” between the U.S. and the EU concerning Asia as their trading and security partner.

For instance, if the global trading regime of the WTO weakens, considerable institutional space and a multiplicity of options are likely to emerge at the regional level. In this case, if China and Japan reach a political alliance, the formation of a strong Northeast Asian Free Trade Area (NEAFTA) is highly likely. If economic complementarities exist among the member countries, they will broaden the scope of product coverage; otherwise, we can expect a strong but narrow (or sectoral) NEAFTA. By contrast, if there is no alliance between China and Japan, a NEAFTA is not

¹³ For instance, see Acharya (2003), Aggarwal and Koo (2005a, 2005b), Alagappa (2003), Ball (2000), Buzan (2003), and Katzenstein (2005, 2006).

¹⁴ Katzenstein (2005:25)

¹⁵ Ball (2000: 143)

a possibility.¹⁶ A similar logic of spillover effects can be applied to economic cooperation in other parts of Asia—particularly with respect to India and Pakistan.

Will Asia remain a porous region? The decade-long perception among Asians that Western regional arrangements are forming against them may well rekindle the notion, promoted by former Malaysian Prime Minister Mahathir bin Mohamad, of an exclusive East Asian bloc—be it the East Asia Summit or APT (or ASEAN Plus Six)—or a new regional hierarchy centered on China. In contrast, if either the U.S. or the EU (or both) maintains a strong focus on the region, Asia will remain an open region.¹⁷

Currently, the U.S. maintains its economic and diplomatic focus on the Free Trade Area of Americas (FTAA) and the EU continues on an eastward and southward expansion path. Nevertheless, it is unlikely that either the U.S. or the EU will disengage from Asia. Among others, the China and India factor will entice them to stay actively involved in the shaping of Asian regionalism. The U.S., for its part, has recently called for the creation of a Free Trade Area of the Asia Pacific (FTAAP). And with India, the U.S. has been actively pursuing stronger ties, including agreement on nuclear materials. Europeans have continued to work with East Asia through the Asia-Europe Meeting (ASEM) process and have begun negotiations with India, South Korea, and ASEAN countries for a free trade agreement. But if these efforts do not prove fruitful—and currently, the prospects for an FTAAP are politically dim¹⁸—the likelihood of a more exclusive region in Asia, be it APT or APS, will grow.

To this point, China has pursued regional arrangements in a politically astute manner, using such accords to allay suspicions about its rising power and to prevent the region from being overly influenced by external powers. Aside from exclusive or hybrid security institutions in the region such as the ARF, the SCO, and APEC, China began to use FTAs with its neighbors to build “security-embedded” trade ties. A key element in the dynamic of regionalism in Asia will revolve around China, India, Japan, and South Korea’s ability to come to an accommodation on who “belongs” in an Asian agreement. Currently, various formulae such as an inner circle based on APT and an outer circle of APS have been vetted, but the institutional contours of Asian regionalism remain in flux.

The KORUS FTA illustrates the new great power dynamics of security-embedded FTAs. Many in China (as well as in Japan) have expressed con-

¹⁶ Aggarwal and Koo (2005a)

¹⁷ Aggarwal and Koo (2005b)

¹⁸ Aggarwal (2006)

cern that the accord would put their country at a competitive disadvantage in the U.S. and South Korea market and pose a potential security threat. Such recognition has motivated Beijing (and Tokyo as well) to seek an FTA with Seoul.¹⁹ Ironically, then, just as the Europeans helped to promote East Asian unity through the ASEM process, by pressing them to negotiate as a group, American actions may help to foster integration among Asian countries through its negotiation of bilateral trade accords, leading to an outcome that it is seeking to avoid.

Asia currently stands at a crossroads. How Asia designs its regional institutions will undoubtedly have major implications for the shape of trade, finance, security, and political cooperation. If Asian states decide to restrict the development of regional institutions in favor of a new hub-and-spoke system centered on China or some other form of bilateralism, it will inhibit economic growth, create artificial barriers to cooperation, and limit the region's ability to compete in the global market. Given the proliferation of bilateral FTAs and the weakness of regional arrangements, this is a very real possibility. There is a brighter alternative, though. If Asian actors take regional cooperation seriously and set aside parochial national interests, they may yet be able to tap their vast collective political and economic resources and maximize their potential for peaceful and prosperous growth.

Bibliography

- Acharya A (2003) Regional institutions and Asian security order: norms, power, and prospects for peaceful change. In Alagappa M (ed) *Asian security order: instrumental and normative features*. Stanford University Press, Stanford
- Aggarwal VK (2006) The political economy of a Free Trade Area of the Asia Pacific: A U.S. perspective. *Business Asia* 14(2): 10-16
- Aggarwal VK, Koo MG (2005a) Beyond network power? The dynamics of formal economic integration in Northeast Asia. *The Pacific Review* 18(2): 189-216
- _____ (2005b) The evolution of APEC and ASEM: implications of the new East Asian bilateralism," *The European Journal of East Asian Studies* 4(2): 233-261
- _____ (forthcoming) The evolution of regionalism in East Asia. In Roundtable: Peter J. Katzenstein's contributions to the study of East Asian regionalism, *Journal of East Asian Studies*.
- Alagappa M (2003) Constructing security order in Asia. In Alagappa M (ed) *Asian security order: instrumental and normative features*. Stanford University Press, Stanford

¹⁹ Lee and Koo (2006); *Chosun Ilbo* (2007)

- Ball D (2000) Multilateral security cooperation in the Asia-Pacific region: challenges in the post-cold war era. In Tien H, Cheng T (eds) *The security environment in the Asia-Pacific*. M.E. Sharpe, Armonk
- Buzan B (2003) Security architecture in Asia: the interplay of regional and global levels. *The Pacific Review* 16(2): 143-173
- Chosun Ilbo (2007) Chinese Premier hopes for FTA with Korea soon. April 6. Available online at: <http://english.chosun.com/w21data/html/news/200704/200704060013.html>
- Job BL (2003) Track 2 diplomacy: ideational contribution to the evolving Asian security order. In Alagappa M (ed) *Asian security order: instrumental and normative features*. Stanford University Press, Stanford
- Katzenstein PJ (1997) Introduction: Asian regionalism in comparative perspective. In Katzenstein PJ, Shiraishi T (eds) *Network power: Japan and Asia*. Cornell University Press, Ithaca
- _____ (2005) *A world of regions: Asia and Europe in the American imperium*. Cornell University Press, Ithaca
- _____ (2006) East Asia—beyond Japan. In Katzenstein PJ, Shiraishi T (eds) *Beyond Japan: the dynamics of East Asian regionalism*. Cornell University Press, Ithaca
- Kwei E (2006) Chinese bilateralism: politics still in command. In Aggarwal VK, Urata S (eds) *Bilateral trade arrangements in the Asia-Pacific: origins, evolution, and implications*. Routledge, New York
- Lee S, Koo MG (2006) South Korea's multi-track FTA strategy: moving from reactive to proactive. A paper presented at the 2006 Annual Meeting of the American Political Science Association, Philadelphia
- Pang E (2006), Embedding security into free trade: the implications of the United States-Singapore free trade agreement (USSFTA) for Southeast Asia. A paper presented at a conference on East Asian Cross Regionalism, organized by the Center for International Studies, the University of Southern California, Los Angeles, October 14
- Shambaugh D (2004) China engages Asia: reshaping the regional order. *International Security* 29(3): 64-99
- Solis M, Katada S (2007) Understanding East Asian cross-regionalism: an analytical framework. *Pacific Affairs* 80(2).
- United States Trade Representative (2007) United States and Korea conclude historic trade agreement, April 2. Available online at: http://www.ustr.gov/Document_Library/Press_Releases/2007/April/United_States_Korea_Conclude_Historic_Trade_Agreement.html
- Yahuda M (2005) Chinese dilemmas in thinking about regional security architecture. *The Pacific Review* 16(2): 189-206