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THE DYNAMICS OF TRADE LIBERALIZATION

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I. INTRODUCTION

In 1999, World Trade Organization (WTO) participants in Seattle unsuccessfully attempted to launch a new trade round. Many commentators saw this as the swan song of the global approach to negotiations and began to call for alternative modes of trade liberalization. Suggestions for coping with the perceived complexity of the WTO included negotiating among a more restricted set of actors and limiting the set of issues discussed.[1] Although such avenues increasingly became the norm, the success of the November 2001 Doha meeting of the WTO in setting a timetable for negotiations seemed to once again restore faith in the global approach. Yet the seesaw continued. First came the dramatic collapse of the Cancún negotiations in September 2003, followed shortly thereafter with the success of the July 2004 WTO meeting in Geneva. WTO members have already missed the January 2005 deadline for concluding the Doha Round. In this environment, many countries continue to look for other trade options in view of the likelihood of prolonged talks before an agreement is reached.

In the post-World War II era until the early 1990s, the General Agreement on Tariffs and Trade (GATT) remained the primary approach to trade liberalization, with the most significant exception being the formation and evolution of a customs union in Europe. By contrast, trade protection has taken a variety of forms, with unilateral, bilateral, minilateral, and multilateral restrictions both on a sector specific and multiproduct basis. Robert Keohane's work has been particularly illuminating in developing an explanation for the persistence of trade liberalization in the face of these protectionist measures. Drawing on the seminal work of Ronald Coase and Oliver

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

Williamson, Keohane applied a transaction cost approach to understand the persistence of the GATT regime in promoting openness in the face of declining U.S. hegemony.[2] Keohane's work highlighted several themes, including the role and evolution of institutions in fostering cooperation, constraints on the provision of public goods, the role of reciprocity, and the importance of institutional design. This work has inspired research by many scholars in this area including Robert and Beth Yarbrough, Edward Mansfield and Helen Milner, Kenneth Oye, Timothy McKeown and a host of others who have analyzed the dynamics of trade liberalization and protection.[3]

My objective in this chapter is to build in the tradition of this research program on trade negotiations. In earlier work with Robert Keohane and David Yoffie,[4] we focused on the evolution of trade protectionism. In this chapter, building on Keohane's work, the work of his other students, and other scholars who have focused on trade issues, I examine some selected aspects of the dynamics of trade liberalization.[5] To this end, Section II of this paper begins by more systematically categorizing the different types of arrangements that have increasingly populated the trade landscape.[6] The objective of this exercise is both conceptual and empirical. From a conceptual standpoint, I argue that a more detailed specification of different types of trade accords helps us to clarify what we are seeking to explain. From an empirical standpoint, the categorization allows us to understand the origins and evolution of different types of arrangements to serve as grist for our theoretical mill. Section III of the paper then presents an institutional bargaining game approach to examine the evolution of trade arrangements. In Section IV, I explore how this approach might

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[2] Coase 1960, Williamson 1975, and Keohane 1984.
[3] Yarbrough and Yarbrough 1992, Mansfield and Milner 1997, 1999, Oye 1992, McKeown 1983 and 1991
[4] Aggarwal, Keohane, and Yoffie 1987.
[5] Beth and Robert Yarbrough 1992, in particular, have been leaders in an effort to theorize about alternative modes of trade liberalization.
[6] In doing so, I have also been particularly inspired by Alexander George, who as a colleague of Robert Keohane at Stanford University in the 1970s, helped me and a number of other participants in this volume to think carefully about differentiating our "dependent variable" more adequately.

help us to understand emerging developments in the trading system, with a specific focus on Northeast Asia. I conclude in Section V with an assessment of possible avenues to pursue in the broader research program of understanding the dynamics of trade liberalization.

II. VARIETIES OF TRADE GOVERNANCE

In the post World War II period, states have utilized a host of measures to regulate trade flows. Yet many analysts have conflated different type of arrangements and used them synonymously. For example, the term “regional agreement” has been used to refer to widely disparate accords such as Asia Pacific Economic Cooperation (APEC), Asia Europe Meeting (ASEM), North American Free Trade Agreement (NAFTA), bilateral free trade agreements both in and outside a region, and even sectoral agreements such as the Information Technology Agreement (ITA).[7]

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. In an effort to more clearly specify types of trade arrangements, I distinguish them along several dimensions: the number of participants, product coverage, geographical scope; market opening or closing, and institutionalization. I define the number of participants in terms of unilateral, bilateral, minilateral, and multilateral participation in an agreement; I use the term bilateral to refer to two countries and minilateral to more than two.[8] In terms of product coverage, the range is from narrow (a few products) to broad (multiproduct) in scope. Geographical scope differentiates between arrangements that are concentrated geographically and those that bind states

[7] See for example, Mansfield and Milner (1999), p. 592, who recognize the problematic nature of the term “regionalism” but then proceed to use this term in their analysis. See also Bergsten (2001).
[8] This usage differs from that of Yarbrough and Yarbrough 1992 that conflates third party enforcement with these terms so that “bilateral” for them can also mean three countries, a highly counterintuitive use. Keohane 1990 refers to an agreement among three or more states as multilateralism. Richardson (1987) is consistent with my usage.

across great distances. A fourth dimension addresses whether these measures have been either market opening (liberalizing) or market closing (protectionist). Fifth and finally, one can also look at the degree of institutionalization or strength of agreements.[9]

Table 1 develops a typology of trade agreements based on these dimensions but omits categorization of their liberal or protectionist nature and degree of institutionalization for presentation purposes. In addition, my discussion of scholarly work in these various cells omits discussion of protectionist accords and institutionalization, although I do consider these elements in the scenarios of Northeast Asian trade arrangements in Section IV.

I begin by considering product coverage. The narrowest coverage is that of one or very few products, or what is referred to as sectoralism. Although we have seen a number of trade opening measures in this area, it is worth keeping in mind that sectoral approaches in the post-World War II era have been discouraged by GATT Article 24, which requires that free trade agreements or customs unions must cover "substantially all trade." The exact meaning of this clause has been hotly disputed, and sectoral measures have rarely been challenged in the GATT/WTO. [10]

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[9] Of these five, the dimension of geographical scope is the most controversial. It is worth noting that this category is quite subjective, since simple distance is hardly the only relevant factor in defining a "geographic region." In fact, despite the interest that regionalism has attracted, the question of how to define a region remains highly contested. See the discussion by Mansfield and Milner (1997), Katzenstein (1997), Ravenhill (2004), and Aggarwal and Fogarty (2004), among others.

[10] On this issues, see Frankel (1997) and Ravenhill (in press).

Table 1: Classifying Varieties of Trade Governance[11]

		NUMBER OF PARTICIPANTS					
		Unilateral	**Bilateral**		**Minilateral**		**Multilateral**
			Geographically Concentrated	*Geographically Dispersed*	*Geographically Concentrated*	*Geographically Dispersed*	
PRODUCT SCOPE	**Few Products**	(1) UK Corn Law removal (1846) Super 301 (1990s)	(2) U.S.-Canada Auto Agreement (1965)	(3) U.S.-Japan VIEs (1980s-1990s)	(4) ECSC (1951)	(5) EVSL (1997)	(6) ITA (1997) BTA (1998) FSA (1999)
	Many Products	(7) UK (1860s) APEC Individual Action Plans (IAPs)	(8) Canada-U.S. FTA (1989) Australia-New Zealand CER (1983)	(9) U.S.-Israel FTA (1985) U.S.-Jordan FTA (2001) U.S.-Singapore FTA (2004) Japan-Mexico FTA (2004)	(10) EC/EU (1958/1992) ASEAN (1967) NAFTA (1993) Mercosur (1991)	(11) APEC (1989) LOME AFTA (under negotiation) EU-Mercosur (under negotiation)	(12) GATT /WTO (1947/1995)

Sectoral Unilateralism

Cell 1 focuses on unilateral sector specific measures, the classic example of unilateral sectoral market opening being the British opening of its grain market with the removal of the Corn Laws in 1846.[12] Although some sectoral opening took place in the twentieth century, a variant of sectoral opening that is tied to bilateral bargaining took place in the late 1980s and 1990s. The United States used Super 301, a Congressionally mandated trade policy instrument, to threaten to close its market to force other countries to "unilaterally" open up their market in specific products. This particular form of sectoralism sparked a heated scholarly debate. Bhagwati and Patrick, for example, dub this

[11] Adapted from Aggarwal (2001).

[12] For a good discussion, see for example, Schonhardt-Bailey (1996).

unusual U.S. practice as "aggressive unilateralism."[13] Some analysts argue that U.S. efforts at aggressive unilateralism generated positive outcomes by forcing the liberalization of otherwise closed Japanese, European, and other Asian markets.[14] Yet Bhagwati and Patrick hold a highly skeptical view of this claim, arguing that pursuit of aggressive unilateralism may spread cynicism toward multilateral commitments and provoke retaliation by other countries.

Sectoral Bilateral Regionalism

In cell 2, we have sectoral agreements between a pair of countries that are geographically concentrated. From a market opening perspective, this approach often reflects pressures from politically strong but narrow interests that are pursuing greater economies of scale. The resulting arrangements tend to result in intra-industry trade among developed countries.[15] The best example of this kind is the U.S.-Canada Automotive Products Trade Agreement of 1965.[16] Prior to the 1988 Canada-US Free Trade Agreement (CUSFTA), the Auto Pact was the only major success in the long-standing effort to liberalize bilateral trade between the U.S. and Canada. For almost forty years after its conclusion, few have questioned the exclusive benefits that such an arrangement confined to a discrete sector had brought to both the U.S. and Canada in terms of increased production, investment, employment, and exports. Eventually, the Auto Pact was incorporated into CUSFTA and NAFTA.[17]

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[13] Bhagwati and Patrick (1990). For them, it is "aggressive" since the U.S. employed a threat of closure of its market against those countries that employ allegedly unfair trade practices; it is "unilateral" in that the U.S. alone determines whether a trade practice is contrary to its national interests without giving out any reciprocal concessions. This is a somewhat different usage than my own focus on unilateral in the sense of removal of restraints by one county without an agreement. As with "Voluntary Export Restraints" (VERs), the unilateral vs. bilateral aspect is often muddied by coercive actions.

[14] Bayard and Elliot (1994).

[15] See Milner and Yoffie (1989), among others.

[16] Keeley (1983).

[17] Fuss and Waverman (1986).

Sectoral Bilateral Transregionalism

Cell 3 refers to sectoral agreements between a pair of countries that are geographically dispersed. Protectionist examples of this sort of agreement include voluntary export restraints (VERs) and voluntary import expansions (VIEs), both of which have generally but not always been across regions.[18] The word "voluntary" is obviously misleading, as such agreements are often the result of coercive pressures. These sorts of agreements set off a lively debate about "(mis-)managed trade" and the notion of a "fair and level playing field".[19] The origins of these VIEs have been extensively analyzed and their implications have been modeled. More recently, a less coercive example of bilateral sectoral liberalization can be seen in the negotiations between the U.S. and EU over the streamlining of testing and approval procedures through the creation of Mutual Recognition Agreements in several sectors.[20]

Sectoral Minilateral Regionalism

In cell 4, we have sectoral agreements among three or more countries that are geographically close to each other. The best example is the European Coal and Steel Community (ECSC), created in 1951. Its main task was to integrate the post-war European coal and steel industry, but it also to serve as foundation and stepping stone for the political and economic union of Europe. From the start, ECSC faced criticism for its inconsistency with Article 24 of the GATT, which calls for liberalization on a multiproduct basis, rather than only for a few products. Although challenged as being inconsistent with the GATT by Czechoslovakia, the ECSC members managed to obtain a

[18] See for example Bhagwati (1987) and Nagoka (1997) on VIEs.
[19] See Tyson (1992) and Irwin (1994).
[20] For a discussion of the context of these agreements, see Fogarty (2004).

GATT waiver of obligation.[21] After the ECSC evolved into the European Economic Community, the issue of sector-specific accords became moot.

Sectoral Minilateral Transregionalism

Cell 5 provides an example of geographically dispersed sectoral transregionalism. One example is the case of the Early Voluntary Sectoral Liberalization (EVSL) under the auspices of APEC. In Vancouver in 1997, Ministers agreed to consider nine sectors for fast track liberalization: chemicals, energy-related equipment and services, environmental goods and services, forest products, medical equipment, telecommunications equipment, fish and fish products, toys, and gems and jewelry, and to discuss liberalization in six other sectors. The United States promoted this nine-sector liberalization a package to discourage countries from picking and choosing sectors based on domestic concerns. This strategy initially appeared viable, but quickly ran into difficulties as Japan and several other countries objected to the liberalization of some sectors—particularly agriculture, forestry, and fishery products—in the context of the East Asian financial crisis and in the face of U.S. pressure for sectoral concessions and reciprocity. Furthermore, the tension and uncertainties arising from a lack of consensus in the APEC forum polarized the public positions of APEC members with respect to environmental and labor linkages to trade issues. In the end, the package was sent to the WTO rather than being considered for liberalization at the APEC level.[22]

Sectoral Multilateralism

Cell 6 provides an example of multilateral sectoral accords. This category includes measures such

[21] Curzon (1966): 266-8.
[22] Aggarwal 2001a. See also Krauss (2004). A good example of a protectionist oriented sector specific minilateral approach is the Lancashire Pact in cotton textiles and apparel, negotiated among the U.K., Hong Kong, India, and Pakistan.

as the ITA, the Basic Telecom Agreement (BTA), and the Financial Service Agreement (FSA). The emergence of this type of agreement is a particularly important development that is worth examining at greater length. Laura Tyson, for example, has argued that among multilateral trade options, this sectoral approach is a sound alternative to the multi-sector WTO approach. In her words,

> ... the global-round approach to trade talks, involving all WTO participants in a comprehensive agenda requiring bargains across several sectors, may have outlived its usefulness. Focused negotiations on trade issues in specific sectors among a smaller group of WTO members are a promising alternative. Such negotiations have produced significant agreements in information technology, telecommunications, and financial services.[23]

Yet open sectoralism can be politically and economically hazardous.[24] From a political perspective, sectoral market opening is likely to *reduce* political support for multilateral, multisector negotiations. Because sectoral agenda setting involves a limited and easily polarized set of domestic interests, the margin for coalition building and political give-and-take is much slimmer. Thus, ironically, industries that have succeeded in securing sectoral liberalization may pose a threat to a global liberalization agenda. These groups will see little reason to risk their existing benefits by supporting their relocation in the WTO-centered multilateral, multiproduct regime. By giving highly motivated liberal-minded interests what they wanted in their specific sector, countries have undermined the classic cross-sectoral "horse trading" that has long been the hallmark of the GATT process. Moreover, from an economic perspective, such agreements may *reduce* economic efficiency. By liberalizing only specific, highly competitive sectors, open sectoral trade agreements can thus lead to incentives to invest in or discourage exit from the least efficient areas of the economy.

[23] Tyson (2000).

Multiproduct Unilateralism

We turn next to broader multiproduct liberalization. Cell 7 focuses on unilateralism, the most significant example being nineteenth century Britain. Unilateral liberalization was feasible for Britain thanks to its industrial strength, its limited investment in transaction-specific assets for trade, and its quasi-monopsony power in raw material and export markets—which contrasted with other countries' limited alternatives to importing British manufactured goods.[25] Contemporary examples include unilateral liberalization measures taken by Australia, New Zealand, Chile, Hong Kong, and Singapore. Although they represented wishful thinking, the Individual Action Plans of APEC, which describe unilateral measures in fifteen specific areas by 2010 for developed economies and 2020 for developing economies, also fall in this category. Yet multiproduct unilateralism appears to be the exception rather than the norm in terms of its frequency.

Multiproduct Bilateral Regionalism

Bilateral arrangements of both a regional and transregional actor scope have rapidly proliferated over the last few years. Cell 8 refers to bilateral trade agreements covering multiple products between a pair of adjacent countries, such as the Canada-U.S. Free Trade Agreement (1988) and Japan-South Korea FTA (under negotiation). More often than not, such agreements draw upon not only geographic, historic, and cultural affinity but also complementarity in industrial structure.[26]

The so-called gravity model has been proposed to explain the positive links between the volume of bilateral trade and geographic distance and economic size (as well as other affinity

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[24] For this argument, see Aggarwal (2001b) and Aggarwal and Ravenhill (2001).

[25] Yarbrough and Yarbrough (1987): 19-21. McKeown (1983) makes a strong case that Britain did not exhibit hegemonic power in the move to liberalization in the 19th century but rather chose to liberalize on its own.

[26] On bilateralism more generally see Oye (1992). For the Asia-Pacific, see Dent (2003) and Aggarwal and Urata (in press).

variables). In order to reduce the costs related to geographic distance and to maximize the benefits from economic size, analysts argue that neighboring countries will often form preferential trade agreements (PTAs) with one another, creating a natural trading bloc. 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.[27]

Multiproduct Bilateral Transregionalism

In cell 9, we have cases of geographically dispersed bilateral agreements covering multiple products. Examples include FTAs between the United States and Israel (1985), Mexico and Israel (2000), the United States and Jordan (2001), Japan and Singapore (2001), South Korea and Chile (2002), the United States and Singapore (2004), and Japan and Mexico (2004). Some of these bilateral FTAs—for example, the U.S-Israel FTA and the U.S.-Jordan FTA—have been clearly motivated primarily by political-strategic rather than economic reasons.[28] Some such as the FTAs between Japan and Singapore and South Korea and Chile—are largely designed for the purpose of "training" or "capacity-building" for broader and deeper trade liberalization. More recently, this training and capacity-building objective has been widely sought in East Asia as many in the region have begun to seek FTAs with little prior experience in FTA formation.[29]

Multiproduct Minilateral Regionalism

Cell 10 focuses on geographically concentrated minilateral agreements, which have traditionally been referred to as "regionalism." For the past decades, these types of accords have attracted the most attention, commensurate with the rise of regional trading arrangements since the 1960s.

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[27] Krugman (1991); Deardorff (1997); Frankel, Stein, and Wei (1996).
[28] Ravenhill (in press).

Conventional explanations for the move toward minilateral regionalism have focused on both economic and political-strategic motivations. Some economic arguments include: enlarging economies of scale without excessive global competition; increasing the attractiveness of an economy to foreign capital; and creating natural trading blocs according to geographic proximity.[30] Political-strategic economic reasons include signaling or strengthening one's bargaining position in relation to more powerful partners; responding to the erosion of U.S. support for multilateralism; locking in a domestic reform agenda; a domino effect; limiting free rider problems; reducing transaction costs between negotiating parties; and lowering the political salience of negotiations.[31]

There has also been a significant amount of work examining regional variations in terms of the nature, strength, depth, and scope of minilateral arrangements. These works usually compare European or North American "success" with Asian or Latin American "failure," focusing on historical, cultural, politico-institutional differences within and between different geographical groupings.[32] It is worth noting that what properly might be called "regionalism" fall into several cells, namely 2, 4, and 8—and, to some extent, cell 11 as well.

Multiproduct Minilateral Interregionalism. Another important recent development in trade arrangements concerns links that span countries across continents, as noted in Cell 11. Many analysts lump their examination of accords such as NAFTA with the EU's efforts to link up with Mercosur or with APEC—which seems potentially inaccurate for the purposes of developing causal accounts of these arrangements. Indeed, authors have addressed multiproduct interregionalism with

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[29] Koo (in press).

[30] On economies of scale, see Viner (1950), Milner (1997), and Chase (2003); on foreign capital, see Rodrik (1989) and Lawrence (1996); and on natural trading blocs, see Krugman (1991) and Frankel, Stein, and Wei (1996).

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

reference to APEC and ASEM, as well as in an embryonic literature focuses on EU-Mercosur and other such EU-centered developments, and the causal factors raised are often quite different than those driving regionalism.[33]

The term "interregionalism" can itself be broken down into more specific types, based on the prevalence of FTAs and/or customs unions as constitutive units within interregional agreements. In work with Edward Fogarty,[34] we refer to an agreement as "pure interregional" if it formally links free trade areas or customs unions, as in the case of EU-Mercosur. If a customs union negotiates with countries in different regions, but not with a customs union or free trade agreement, we refer to this as "hybrid interregionalism" (e.g., the Lomé Agreement). Finally, if an accord links countries across two regions where *neither* of the two negotiates as a grouping, then we refer to this as "transregionalism" (e.g., APEC). From the vantage point of explaining why the EU, for example, might choose to pursue interregional agreements, we can focus on the *commercial treatment of the counterpart* region—if one side is a customs union (e.g., the EU), does it choose to treat all countries in a counterpart region uniformly, or does it prefer different rules for different countries if they are not part of a customs union or free trade area? Space limitations preclude further discussion of our findings that assess the value of neoliberal institutional approaches versus a variety of other arguments for the different approaches that the EU has followed around the world. But we find examples of the EU specifically encouraging the institutionalization of other regional groupings to serve as a single negotiating counterpart. Thus, the possible formation of an Asia-specific regional grouping (explored later in this paper) appears to have been driven in part by EU strategy towards the region. This finding suggests the importance of taking into account the diverse

[32] Haggard (1997), Grieco (1997), Katzenstein (1997).
[33] On APEC, see the chapters in Aggarwal and Morrison (1998), Ravenhill (2001), Crone (1993), and Kahler (2000) among others. On ASEM, see Gilson (2004), and on EU-Mercosur, see Faust (2004).
[34] Aggarwal and Fogarty (2004).

driving forces and effects of interregionalism—as opposed to more “garden-variety” regional arrangements.

Multiproduct Multilateralism

Finally, cell 12 refers to the case of global, multiproduct trading arrangements such as the GATT and its successor organization, the WTO. Neoclassical trade theory argues that unilateral trade liberalization is the best means to promote overall economic welfare. Though theoretically solid, this option is often not feasible politically. As a second-best option, therefore, economists have preferred multilateral trade strategies to sub-multilateral, preferential approaches.

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. 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 that the many arrangements that we have examined thus fare will have on the global multiproduct approach to liberalization.

III. AN INSTITUTIONAL BARGAINING APPROACH TO TRADE ARRANGEMENTS

As we have seen, the literature on trade arrangements has grown in recent years in step with the proliferation of such agreements around the world. Although the theoretical approaches add considerably to our understanding of why countries choose to pursue different types of arrangements, the question of how these various causal arguments might be integrated—as opposed to the fashionable one or two variable explanation approach—remains an open one. On the one hand, focusing on a very limited number of variables allow us to investigate their causal effect. Yet at the same time, these approaches are often too narrow and fail to adequately differentiate among different types of arrangements. On the other hand, multivariable approaches are generally richer, but often become a catchall and do not allow for systematic causal assessment. In an effort to steer a middle path, I build on an institutional bargaining game approach to look at the dynamics of trade liberalization.[35] While this approach does not provide a precise causal prediction of each type of accord, it provides a more systematic basis for examining both policy choices and connections among types of arrangements and can be used to explore alternative scenarios.

As noted in Figure 1, an institutional bargaining game approach begins by identifying an initial impetus for new trade accords. The process of a shift from an initial institutional equilibrium to a new one generally comes about with some external shock—problems with extant international institutions or a financial crisis, for example—creates pressure for change. Countries respond to such external shocks in various ways based on the "goods" involved in the negotiations, their individual political-economic situation—consisting of their international position, domestic political structure, and beliefs—and the context of the existing institutional environment.

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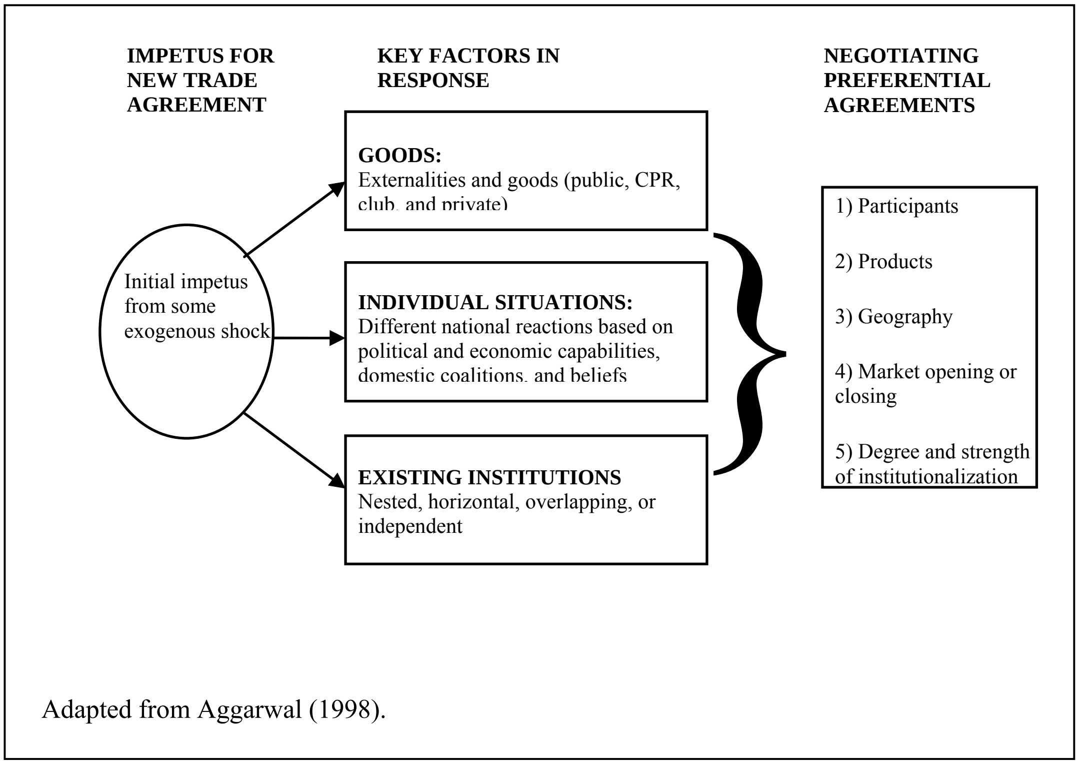
[35] Aggarwal (1998).

Figure 1: The Origins of Preferential Arrangements



Goods

With respect to goods, an external shock may stimulate or impede the provision of public goods, common pool resources, 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 the game of 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.[36] Trade arrangements that have fewer participants reduce the possibility of free riding (by definition) and ensure that gains from trade liberalization are an inclusive club good that accrues only to the participants to the agreement.[37] For example, to prevent free riding with public and CPR goods, institutional strategies might alter the nature of the good.[38] An example of this is the decision by major powers to prevent developing countries from free riding via the most-favored-nation (MFN) norm of the GATT. Thus, in the Tokyo Round, only those countries that signed on to specific codes (subsidies, government procurement, etc.) were given the benefits of liberalization entailed by these codes.

Individual Situations

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. This three-level analysis can be used to evaluate state preferences in the narrower context of preferences about types of trade arrangements as a means to identify shifting positions over time.

Institutional Context

In examining how states respond to shocks by creating new arrangements or modifying existing ones, we can look at the questions of institutional fit with broader institutional arrangements such as the WTO. From a theoretical perspective, we can define four types of connections among

[36] Keohane (1984).
[37] On this point, see Gowa (1989).

institutions: (1) nested links, whereby narrow arrangements conform to broader accords; (2) horizontal connections, whereby arrangements reflect a division of labor without any hierarchy among institutions; (3) overlapping agreements, which may create tension among participants' obligations under each; and (4) independent institutions, which govern distinct fields and thus have little or no interaction 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 regional-based accords, and the issue's salience is low relative to broader issue-area or regional 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." Participants saw this approach as a better alternative to using Article 24 of the GATT to justify APEC's trade provisions, which seeks to reduce barriers to goods and services amongst themselves in a GATT-consistent manner.

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 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). Overlapping arrangements can create conflict because of the potential for task competition.[39] For example, in the case of bilateral trade arrangements, countries have claimed that these arrangements

[38] See Snidal (1979) and Aggarwal and Dupont (1999).
[39] The failure of efforts to create an Asian Monetary Fund nicely illustrates such institutional conflict.

are nested with the WTO—pursuant to Article 24—and are even seen to be WTO enhancing. But this claim is dubious at best, with many sectors being excluded and new names being devised—such as the New Economic Partnership between Singapore and Japan.

Institutional Characteristics

Finally, with respect to outcomes, if countries decide to create a new or modify an existing one, they must decide on its characteristics. As discussed in Table 1, these include the participants, products, geography, market opening or closing, and degree of institutionalization. Moreover, the institutional design of these arrangements will also affect their institutional fit with existing arrangements.

IV. TRADE ARRANGEMENTS IN NORTHEAST ASIA AND BEYOND

To see how an institutional trade bargaining game approach might allow us to explore a variety of organizational outcomes as developed in Table 1, I draw on work with Min Gyo Koo to explore the question of how the current institutional mix in Northeast Asia—and East Asia more generally—might evolve over the next decade into a Northeast Asian Free Trade Agreement (NEAFTA) and how this outcome would affect existing trade arrangements.[40]

Ideally, to create likely scenarios that allow all the possible outcomes discussed in Table 1, we would simultaneously consider the variation in all the variables in our institutional bargaining game, namely the factors of goods, elements of individual situations, and 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, I consider a narrower range of

[40] This section draws heavily on Aggarwal and Koo (2005).

factors from these broad categories, and then focus on various paths that might lead to some type of NEAFTA as well as alternative paths that lead to non- or beyond NEAFTA outcomes.

To systematically construct our simplified scenarios, I assume a certain hierarchical order among the variables in our institutional bargaining game. To begin with, drawing on the factors illustrated in Figure 1, I give pride of place to the status of extant broad-based, international institutions as a primary source of *initial impetus* for change. I also assume that the status of the WTO and APEC may stimulate or impede the provision of trade liberalization as a public good.[41] Specifically, the weakness of each of these institutions should encourage the pursuit of a club good, whereas their strength will discourage incentives for pursuing club goods.

Given the nature and geographic coverage of a prospective PTA, individual bargaining situations and institutional context will determine the other elements of bargaining outcomes, namely the number (*NUM*) of participants ($1 \leq NUM \leq 3$), strength (*STR*) of institutions (for example, the degree to which the agreements are binding, and the presence of dispute settlement procedures), and scope (*SCP*) of products included. I focus on three variables in order of their presumed significance—the institutional strength of the WTO and APEC (*WA*), alliances (*ALL*), and economic complementary between countries (*IC*). I draw the following causal relationships from theoretical and empirical observations: *NUM*, *STR*, and *SCP* of a prospective NEAFTA are a negative function of *WA* and a positive function of *ALL*—particularly a Sino-Japanese alliance[42]—and *IC* (See Figure 2).

[41] Strictly speaking, the WTO and APEC are club goods to the extent that it requires membership to benefit from trade liberalization that they materialize. With the former's global membership and the latter's spirit of "open regionalism," their provision of the broadest club good virtually serve as global public goods.
[42] 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

FIGURE 2 ABOUT HERE

Paths to a NEAFTA

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

If both the WTO and APEC are *strong*, there is little raison d'etre 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).

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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

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).[43]

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, I further explore the likely paths from the three particular outcomes that are based on the combination of a weak WTO and a weak APEC.

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

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security externalities of trade.

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 can examine how an East Asian grouping—be it APN, APT, EAFTA, or EAC—might contribute to broader transregional and/or interregional arrangements such as APEC and ASEM. If an East Asian grouping is created that proves 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

[43] 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.

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 I 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).

To conclude, the various scenarios derived from the institutional bargaining game model suggest the need to analyze the variety of institutional forms discussed in Table 1 of this chapter.

As I have argued, the more careful specification of arrangements helps us to move the discussion from a vague specification of contention between “regionalism” vs. “multilateralism” to a more nuanced analytical exploration based on the causal variables of goods, individual situations, and institutional context.

V. CONCLUSION

The puzzle of how trade arrangements develop and evolve has stimulated a dynamic research program. Robert Keohane’s work on how international arrangements might change after hegemony, his work on cooperation, multilateralism, reciprocity, and the dynamics of protectionism has been particularly critical in stimulating new lines of inquiry. As a consequence, our understanding of types of trade arrangements, their evolution, and likely impact on broader trading regimes has advanced considerably in last two decades.

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

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

With respect to causal arguments about types of agreements, much research has been done on specific accords. The most intriguing line of research, however, concerns the dynamics of trade arrangements. In this vein, Beth and Robert Yarbrough have attempted to specify a model to predict the likelihood of types of trade liberalization.[44] Although this has been a fertile effort, much work remains to be done on examining how arrangements have changed over time.[45] I have proposed an institutional bargaining game as a way to cut into this question, which focuses on types of goods, the source of national preferences, and institutional context—all elements that Keohane and many of his students have explored. In particular, I have argued that the difference between club goods and private goods in trade is particularly salient. And in looking at countries’ individual situations, I examined how international strategic and economic interests, government type, and beliefs about the value of pursuing trading arrangements beyond multilateralism are likely to impact the formulation and evolution of trading accords.

Although general theoretical arguments provide insight into the dynamics of the evolution of trading arrangements, much theoretical benefit can arise from the careful empirical exploration of particular arrangements and their change over time. In this chapter, I have sought to demonstrate the utility of an institutional bargaining game approach by exploring how trade arrangements are

[44] Yarbrough and Yarbrough (1992).

likely to evolve in Northeast Asia. Specifically, I have examined how the strength or weakness of the WTO and APEC opens up or closely institutional space and showed how combinations of goods and individuals situations would result in a NEAFTA of varying strength. I have drawn on my classification of institutional variety to consider the alternatives of bilateral agreements as well as possible development of a NEAFTA into East Asian regionalism, transregionalism, and interregionalism. In view of the dramatic rise of preferential trading arrangements in Asia and elsewhere, particularly after the end of the Cold War, I believe this line of inquiry is likely to be is and will continue to be a progressive research program that will be of value to both scholars and policymakers. Similar questions about the evolution in the Americas, Europe, the Middle East, and elsewhere would greatly enrich our understanding of the dynamics of the evolution of trade arrangements.

Although one can teach aspiring students how to conduct research, there is little substitute for inspiration. Such inspiration may come from many sources, including one's physical environment, the luxury of a contemplative life, and the cooperative and competitive dynamic of a scholarly community. Yet in the end, there is no substitute for the guidance of a mentor who encourages his students to strive for the highest intellectual standards but not lose sight of their ethical and moral obligations. On this score, I must count myself fortunate to have had the privilege to work with Robert Keohane, who has served as both mentor and friend to me over the last thirty years. I am grateful to be able to contribute this chapter and be part of a group of scholars who have been and continue to be inspired by his path breaking work on the global political economy.

[45] See Aggarwal and Dupont (2002) on European contributions to changing institutional design in trade and monetary arrangements over time.

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Figure 2: Paths to NEAFTA and Beyond