

# **The Evolutionary Dynamics of Institutional Balancing in East Asia**

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### I. Introduction

East Asia as a region is underinstitutionalized compared to Europe and North America, and since the 1990s, various observers with different theoretical underpinnings have asked why this is so. First, highlighting the lingering impact of the security system created in the early Cold War period in East Asia, neorealist explanations argue that although economic interdependence rapidly increased in the post-Cold War era, the hub-and-spoke bilateral security system centered around the United States has still retarded the formal institutionalization of East Asian regionalism (Acharya 1991; Hemmer and Katzenstein 2002; Aggarwal and Koo 2007).<sup>1</sup> In this view, the interests of the United States as an offshore player have broadly defined East Asian regionalism's contours (Crone 1993; Grieco 1997). In deference to U.S. preference, East Asian countries have largely chosen a regional forum with wide geographic scope and weak institutionalization, creating an "organizational gap" in the region (Calder and Ye 2004).

Second, noting the widespread presence of production networks in the region, another group of scholars contends that East Asian countries have largely preferred informal networking in the region rather than transforming highly advanced economic regionalization among them into a formalized regionalism (Doner 1997; Katzenstein 1997). With this backdrop, Japan has been content with "leadership from behind" in the face of neighboring countries' suspicions regarding the Japanese initiative in building up regional institutions.

Third, constructivist explanations argue that the weak institutionalization of East Asian regionalism has to do with East Asia's peculiar legal culture and underdeveloped concept of



community (Kahler 2000). In the case of ASEAN, for instance, the norm of noninterference is a persistent obstacle to deeper institutionalization of that organization (Jones and Smith 2007; Haacke 2003). It is said that whether East Asian countries will be able to institutionalize regional cooperation hinges upon their ability to “internalize and localize” concepts and norms of community imported from Western countries (Acharya 2004).

Whereas prior explanations have aptly pointed to the primary nature of East Asian regionalism, it is also undeniable that East Asia has demonstrated a greater appetite for the formal institutionalization of regionalism since the first part of the new millennium. After its accession to the World Trade Organization (WTO), China has turned to East Asia to promote regionalism for economic and strategic reasons. Responding to this Chinese initiative, Japan has been anxious to fortify its regional institutional leadership, although it has been ambivalent about whether and how to involve the United States. ASEAN, with long experience in building up institutions and self-confidence measures, has also attempted to reestablish itself as a central locomotive for institutionalizing East Asia.

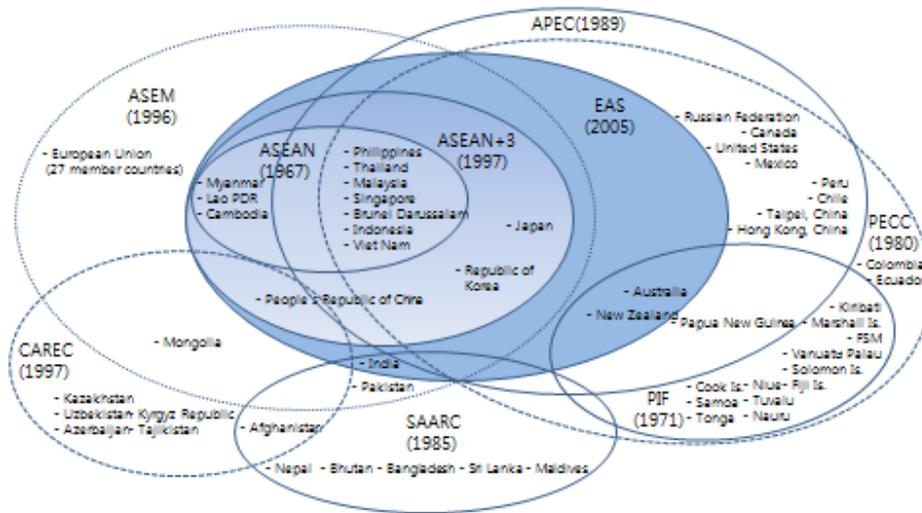
It is particularly noteworthy that East Asian countries’ interest in the institutionalization of regionalism has grown under the changing regional landscape, such as the relative decline yet continued presence of the United States and the rise of China. Under these structural shifts, East Asian countries are actively forging regional institutions, showing no signs of hard balancing. A number of regional institutions have developed with different geographical scope and functional needs, particularly since the 1990s, while other institutions, such as Association of Southeast Asian Nations (ASEAN), Pacific Islands Forum (PIF), and Pacific Economic Cooperation Council (PECC), find their origins in earlier periods (see <Figure 1>). The Asian financial crisis was a major catalyst. ASEAN+3 (APT) was created in 1997 in the wake of the Asian financial crisis as East Asian countries were frustrated with the IMF’s (mis-)handling of the crisis with the backing of the U.S (Stubbs 2002). At the same time, the Asian financial crisis pushed East Asian countries to search for other institutional alternatives because they were not content with the inability of existing regional institutions such as ASEAN and APEC to deal with the crisis. The APT became a major institutional platform through which East Asian countries could sustain and enhance cooperation in a variety of areas, such as finance. In 2005, with the inclusion of new members such as India, Australia, and New Zealand, the East Asia Summit (EAS) came into being as an overarching institution to nurture common views on regional issues.<sup>2</sup> While the EAS could be conceived as an institutional evolution from the APT, its creation was a reflection of Japan’s and other countries’ worries over the increasing influence of China in regional affairs.

The East Asian countries’ push for deeper institutionalization has taken place in specif-



ic issue areas as well. In trade, East Asian countries have actively undertaken negotiations for free trade agreements (FTAs) in the first decade of the new millennium. As of 2010, East Asian nations were involved in a total of 79 deals. Out of these 79, 33 FTAs are currently in effect and 5 FTAs have been signed. The five largest economies in East Asia have extensively engaged in multiple FTA deals over the last decade. Singapore, which is the most enthusiastic about FTAs in East Asia, has concluded 12 FTAs, of which 10 are in effect and 2 are signed. In addition, 5 more are under negotiation and 2 have been proposed.

<Figure 1> Institutional Architecture in East Asia



Source: Adapted from Dent (2007) and Asian Development Bank (2008).

In finance as well, in the aftermath of the Asian financial crisis, East Asian countries were successful in eliciting institutionalized cooperation for liquidity provision in the event of any future crisis by creating the Chiang Mai Initiative (CMI) in May 2000, or networks of bilateral currency swap agreements (Grimes 2006; Pempel 2006; Amyx 2008; Henning 2009). Although the CMI initially started with limited amounts of money and lending provisions congruent with IMF regulations, East Asian countries steadily expanded the CMI's swap line to \$90 billion by 2009. Subsequently, in May 2009, East Asian countries facing the global financial crisis once again succeeded in elevating the CMI to the Chiang Mai Initiative Multilateralization (CMIM). It is said that the CMIM, with a



collective centralized reserve fund and a single contractual agreement, has the potential to become an Asian Monetary Fund (Kawai 2010).

What is the driving force behind these new dynamics of institutionalizing East Asia? I argue that the logic of institutional balancing explains East Asian countries' heightened interest in regional institutionalization. The steady progress of institutionalization has been made possible because major countries in East Asia have become both interested in institutionalizing the region and tolerant of other countries' preferences for regional institutions.

## II. The Logic of Institutional Balancing: Inter-Institutional Balancing vs. Intra-Institutional Balancing

East Asia's interest in regional institutions is not new. However, rather than sticking with one particular institutional arrangement, East Asian countries have searched for a number of regional institutions that could deal effectively with regional issues. As a result, we observe the mushrooming of disjointed institutions with no systematic linkages with each other (Pempel 2010). Contrasting analytical explanations have emerged to capture this unforeseen nature of East Asian regional institutionalization (Terada 2004). Some researchers point out that East Asian institutions have evolved in decentralized, contradictory, and ad hoc ways rather than in deepening and solidifying regionalism. These observers highlight this feature of East Asian regionalism by dubbing it "thin gruel (Friedberg 1993)," "soft regionalism (Zhao 1991)," or "informal regionalism (Katzenstein 1997)."

On the contrary, other scholars provide a rosy picture of East Asian regionalism, anticipating that the evolutionary dynamics of institutionalizing East Asia will unfold in the coming decades. They argue that East Asian countries' turn to bilateral FTAs testifies to their increased interests in state-to-state engagement (Bowles 2002). Christopher Dent argues that lattice regionalism in East Asia, formed by a number of bilateral FTAs, ultimately takes a "bilateral to plurilateral and regional" path to institutionalization. In his view, bilateral FTAs will ultimately turn into region-wide FTAs even without a regional "nerve center," because interlocking and overlapping FTAs will inevitably generate high transaction costs (Dent 2003).

Despite the growing number of studies explaining the mushrooming of institutions in East Asia, the studies that explore the state's motivation for its institutional strategies are scant. To fill this gap, I employ the logic of institutional balancing to explain how and why



East Asian countries are motivated to engage in an institutional balancing strategy. In contrast to existing studies that primarily focus on institutional dynamics at the regional level, I explain state behaviors and strategies underpinning institutional evolution in East Asia. This research strategy is valid because in East Asia individual states' strategies tend to take precedence over the collective identities and values of the East Asian community.

I concur with existing literature that highlights East Asian countries' soft balancing as one of the emerging features of East Asian regionalism.<sup>3</sup> East Asian countries have displayed soft balancing behaviors such as limited arms buildup, ad hoc cooperative exercises, and collaboration in regional or international institutions. Instead of examining East Asian countries' soft balancing behaviors in a holistic way, I focus on one particular type of soft balancing, or institutional balancing. A focus on institutional balancing makes sense because most East Asian countries—whether big or small—are involved in institutional balancing, while only a few great powers in East Asia, such as China and Japan, pursue a soft balancing strategy in a broad sense, as demonstrated by China's charm offensive and Japan's idea of the East Asian community (Shambaugh 2005; Sohn 2010).

Kai He provides a useful guide to explain how East Asian countries have been involved in institutional balancing. After making a distinction between inclusive and exclusive institutional balancing, he argues that whether a country chooses either inclusive or exclusive institutional balancing depends on the distribution of power and the degree of economic interdependence (He 2008).<sup>4</sup> While he aptly explains East Asian countries' institutional balancing behaviors that have developed since the Asian financial crisis, he rules out the possibility that a state's institutional balancing behavior can change without invoking changes in power distribution and degree of economic interdependence. His explanation does not provide the causal logic that systematically links independent variables to dependent variables.

In order to remedy this analytical pitfall, I offer alternative concepts of institutional balancing pursued by East Asian countries since 2000: inter-institutional balancing and intra-institutional balancing. "Inter-institutional balancing" refers to a state's behavior to seek to create overlapping or separate institutions to balance against a target state. The main thrust of this behavior is to balance against the target state. States involved in this behavior compete to attract more countries to their sides while avoiding joining the institutions created or dominated by the target state. The membership of these institutions may vary as institutions are either mutually exclusive or overlapping. A state implements inter-institutional balancing behavior to (re)design the regional institutional architecture at the expense of its target state. The widespread presence of multiple overlapping but not identical institutions in East Asia vindicates the idea that East Asian countries are actively



engaged in inter-institutional balancing strategy. The pattern of inter-institutional balancing is prevalent in trade as demonstrated by the fact that China, Japan, and South Korea all concluded an FTA with ASEAN, respectively. Strategic considerations are obviously at work in inter-institutional balancing, given that both China and Japan preferred an FTA with ASEAN, although expected economic gains are greater in a China-Japan FTA. As a consequence, the ASEAN+1 type of FTA emerged as a dominant institutional feature in East Asia, creating institutional overlap. And the Trans-Pacific Partnership (TPP) is the most recent example of inter-institutional balancing in the trade area. On November 12, 2011, on the eve of the APEC summit, Japanese Prime Minister Yoshihiko Noda announced that Japan would join the TPP negotiations, which aim for “high quality” trade liberalization.<sup>5</sup> The Chinese government recognized this move as Japan’s attempt to encircle China through close cooperation with the United States and other East Asian countries.<sup>6</sup>

By contrast, “intra-institutional balancing” refers to the strategy that competing states cooperate to create an institution when the demand for public goods is high. However, intra-institutional balancing does not necessarily imply cooperation within the institution. Although states cooperate to create an institution to provide the public good, once created, they seek various cooperative as well as balancing behaviors within institutions such as bargaining, struggle, and confrontation. This type of institutional balancing is dominant in finance, where in the wake of the Asian crisis, East Asian countries successfully collaborated to create the CMI. China and Japan, archrivals in East Asian regionalism, agreed to create the CMI because regional states found it necessary to strengthen regional financial safety nets to effectively cope with future crises. In the face of mounting pressure emanating from the global financial crisis, China and Japan continued to collaborate to transform the CMI into the CMIM. However, both countries competed against each other for greater (economic and strategic) influence from the creation to the evolution of the CMI. Under intra-institutional balancing, cooperation and conflicts coexist within an institution.

## 1. FTAs: The Case of Inter-Institutional Balancing

The proliferation of FTAs in East Asia shows that East Asian countries are seeking inter-institutional balancing as they incorporate security and political factors in promoting FTAs under the swiftly shifting regional economic and security environments. Conventional wisdom explains crucial features of East Asian countries’ FTAs, such as economic, political, and security determinants of FTA policy. It is generally argued that an economic “domino effect” spurred countries to rush to FTAs to evade negative economic impacts.<sup>7</sup> However, given East Asian countries’ tendency to sign with minor economic partners, the



limited coverage of FTAs, and weak evidence of an active business lobby, the proliferation of FTAs in East Asia is driven not by pure economic interests but by political and strategic domino effects (Ravenhill 2010). Government policymakers in negotiating FTAs indeed take strategic considerations into account (Feinberg 2003; Ravenhill 2008). An overemphasis on solely economic factors would fail to shed light on institutional balancing behaviors.

The fact that political and strategic domino effects are one of the driving forces of FTAs in East Asia calls for a close investigation of how each East Asian country attempts to implement inter-institutional balancing strategy. It is particularly worth exploring how and why East Asian countries execute an inter-institutional balancing behavior when negotiating FTAs. For example, rather than selecting FTA partners purely on the basis of economic benefits, great powers are more likely to form FTAs with allies as a means to reward military allies and strengthen their security status. The U.S. government has been explicit in closely linking foreign economic and security policy. The U.S. government has traditionally utilized FTAs as a means of foreign policy, as demonstrated in the cases of the U.S.-Israel FTA and the U.S.-Jordan FTA. The “securitization” of FTA policy has further accelerated in the post-9/11 era (Higgott 2004), as the United States has concluded FTAs with those countries that were supportive of its war against terrorism such as Australia, South Korea, and Singapore.

By contrast, small countries are also inclined to sign FTAs for various strategic reasons. For example, small states in fear of regional institutionalization dominated by one great power are likely to pursue FTAs with other great powers to strengthen their security (Grieco 1997). Small countries enter into FTA negotiations with bigger countries, although they sometimes are forced to concede more in FTA negotiations. That is, the fear of exclusion and security vulnerability forces the smaller countries to engage in FTA negotiations even if they prefer the *status quo* from a purely economic point of view (Gruber 2000).

Seen this way, FTAs have profoundly changed regional dynamics in complex, overlapping, and exclusive ways as East Asian countries have sought FTAs in various forms in terms of the number of partners and geographic distance. FTAs such as the Japan-Singapore FTA are explicitly regional, but others, such as the Korea-U.S. FTA, are cross-regional. The China-ASEAN FTA is minilateral, while the Korea-Singapore FTA is simply bilateral.<sup>8</sup> This situation suggests that East Asian countries are involved in various kinds of inter-institutional balancing. East Asian countries pursue inter-institutional balancing FTAs to link FTAs to broader security considerations. I examine three countries—China, Japan, and Singapore—to show how and why they have adopted an inter-institutional balancing strategy when they negotiate FTAs.

At the core of the strategic consideration is intensifying competition between China



and Japan. The rise of China and the relative decline of Japan has pushed the two countries to redefine not just their bilateral relations but also their regional strategies, substantially altering the institutional dynamics of the regional. Both China and Japan, under shifting power distributions, incorporate aspects of both competition and cooperation into their inter-institutional balancing FTA strategies. On the one hand, neither country impedes the other's vital interests. Japan avoids signing an FTA with Taiwan despite urgent calls from the Taiwanese side, believing that doing so would offend Beijing.<sup>9</sup> On the other hand, the Sino-Japanese rivalry has greatly influenced the selection of FTA partners. First of all, the rivalry militates against the formation of an East Asian FTA that could potentially weave East Asia into one unified free trade area, because the aspiration for regional leadership has made the two countries unable to push for a China-Japan FTA, despite its tangible economic benefits. This also has to do with the fact that both China and Japan have different visions for institutionalizing the region. Instead, both countries have competed to court Southeast Asian countries as an FTA partner.

Strategic motivations in FTAs loom large in Chinese FTA strategy (deLisle 2006). Political and security considerations have central importance as the CCP's political dominance and centralized policymaking structure, led by the Ministry of Foreign Affairs (MOFA), greatly aided China in carrying out an inter-institutional balancing strategy in a coherent way, compared to other East Asian countries, which often face political gridlock in achieving domestic consensus on FTA policy (Kwei 2006). It is against this backdrop that China has utilized FTAs as an instrument to gain strategic policy goals.<sup>10</sup> China utilizes FTAs not just to expand its sphere of influence in the international arena, but to launch its charm offensive in East Asia.<sup>11</sup>

In East Asia, China's inter-institutional balancing strategy was essentially spearheaded by Japan's first-move to sign an FTA with Singapore. For China, this action was seen as Japan's initial attempt to encircle China and establish regional leadership in East Asia. It was imperative for China to prevent Japan from encircling it by concluding FTAs with its neighboring countries (Yang 2009). Furthermore, China believed it of paramount importance to prevent Southeast Asian countries from aligning with U.S. efforts to contain China (Wesley 2008). With this backdrop, China has made tremendous efforts to assure Southeast Asian countries of its peaceful rise, seeking to demonstrate that China's rise would not conflict with the interests of Southeast Asian countries, both in economic and in security terms.

To allay Southeast Asian countries' security fears, in 2002 China signed the ASEAN Code of Conduct on Disputes in the South China Sea as a token of its willingness to achieve a peaceful settlement of territorial disputes over the South China Sea. China accelerated its charm offensive further in 2003 when it signed the Treaty of Amity and Coop-



eration (TAC) of Southeast Asia, signifying that China would abide by long-standing dispute settlement practices firmly established by Southeast Asian countries (Chin and Stubbs 2010). A series of China's strategic moves succeeded in weakening Southeast Asian countries' concerns about China's security threat. The Joint Declaration on Strategic Partnership for Peace and Prosperity signed between China and ASEAN confirms this: the signing of the TAC "demonstrated that the political trust between the two sides [was] notably enhanced."<sup>12</sup> In economic terms as well, China went to a great deal of effort to ensure that although the current economic structures of China and ASEAN are competitive, their economic interdependence could transform into a complementary relationship in the long run.

The China-ASEAN FTA was a Chinese attempt to deepen diplomatic and political ties as well as to secure deep economic integration with Southeast Asian countries. China proposed the China-ASEAN FTA at the ASEAN-China Summit in 2000 under Premier Zhu Rongji's initiative, which aimed to allay Southeast Asian countries' fears about the potential impact of China's WTO accession on their economies. It is against this backdrop that China made a preemptive move to conclude an FTA with ASEAN as a whole, which is in stark contrast to Japan, which attempted to sign multiple bilateral FTAs with individual Southeast Asian countries. The Chinese government believed that with this preemptive move, China would be placed in a better position in competing with Japan as well as the United States for regional leadership (Cai 2004).

In the course of FTA negotiations, China attempted to accommodate Southeast Asian countries' interests as much as possible to effectively execute an inter-institutional balancing strategy. First, the Chinese government took advantage of its developing country status at the WTO. Because China could form an FTA based on the enabling clause of the GATT, it could use lax rules to exclude some sensitive sectors from liberalization rather than pushing for the liberalization of "substantially all trade." In reality, the China's scope is quite limited, ruling out the liberalization of the banking and telecommunication sectors. This put China in a better position to embrace Southeast Asia, compared to Japan, which had to abide by GATT Article XXIV to sign FTAs (Solis 2009). In terms of the sequence of trade liberalization as well, China took a gradual approach, liberalizing trade in goods first, and services and investment later.

Second, the Early Harvest Plan (EHP) is another centerpiece of China's inter-institutional balancing strategy. The EHP is slated to liberalize agricultural imports from Southeast Asian countries before the China-ASEAN FTA officially goes into effect. The provisions about the EHP were later included in the Framework Agreement, despite expected sufferings of farmers in southern provinces in China. This action was an attempt to court Southeast Asian coun-



tries ahead of Japan. It vindicates the belief that political and strategic considerations are of great importance in China's inter-institutional balancing strategy.

China's centralized FTA policymaking made this inter-institutional balancing possible. China's political leadership, deeply involved in FTA policymaking, often puts a higher priority on overall national interests over narrow economic interests. In terms of FTA policymaking structure, the MOFA is the lead agency within the bureaucracy, minimizing bureaucratic wrangling among government ministries. This institutional feature has allowed China to give unilateral concessions to Southeast Asian countries, despite the Ministry of Agriculture (MOA)'s concern about economic loss in the agricultural sector (Yang 2009).<sup>13</sup>

Japan also engaged in its own inter-institutional balancing strategy, although it was essentially reactive to China's preemptive and strategic move. Until the late 1990s, unable to dispel neighboring countries' suspicion of its strategic intentions rooted in historical memories, Japan was restrained in formally institutionalizing East Asia. In the 1990s, Japan seemed content to wield "network power" stemming from its widespread production networks in East Asia and did not seek explicit leadership in formally institutionalizing the region. However, Japan suddenly departed from its traditional policy stance to undertake FTA policies in the new millennium. China was at the core of this change. In the 2000s, the rise of China profoundly changed Japan's strategic calculus. China's economic engagement with Southeast Asian countries after its accession to the WTO spurred Japan to re-think its traditional policy posture. In contrast to China's strategic and coherent inter-institutional balancing strategy, Japan's inter-institutional balancing strategy is inherently reactive and defensive, because the Japanese government is domestically constrained in linking the economy and security (Terada 2003).

Japan initially preferred bilateral FTAs with individual ASEAN countries as demonstrated in the fact that Japan had concluded bilateral FTAs with seven individual countries in ASEAN as of 2009.<sup>14</sup> Alarmed by China's preemptive move, Japan was under pressure to court Southeast Asian countries to its side. To compete for regional leadership, it was deemed absolutely necessary to sign an FTA with ASEAN, in addition to existing FTAs. Nevertheless, Japan's negotiations with ASEAN were riddled with conflicts and delays. Although in November 2002, Japan and ASEAN initially agreed to launch negotiations and started preliminary talks in 2004, formal negotiations did not start until April 2005. The two parties could not agree on the coverage and the schedule for tariff reductions or removals. Diversified FTA policymaking structure and strong agricultural opposition limited the Japanese government ability to design coherent inter-institutional balancing strategy. The four-ministry system, where MOFA, METI, MOF, and MOA are involved in FTA policymaking, requires time-consuming consultations and discussions among them, because



each ministry is capable of being a veto power (George-Mulgan 2005).<sup>15</sup>

In order to revamp this institutional setback, Prime Minister Koizumi intervened in FTA policymaking to enhance political control over ministries. Jolted by the China-ASEAN FTA, in 2008, the Koizumi government modified this individualistic FTA strategy to seek a Japan-ASEAN FTA, demonstrating that Japan's FTAs are not purely driven by economic factors but reflect its desire to rejuvenate its regional leadership (METI 2008).<sup>16</sup> This strategic concern facilitated the Koizumi government's ability to overcome domestic constraints and pursue an inter-institutional balancing strategy by kicking off negotiations for a Japan-ASEAN FTA, although it was somewhat belated (Yoshimatsu 2006).

Japan's inter-institutional balancing strategy is also found in its efforts to engage with extra-regional powers. The Japan-Australia FTA was an outgrowth of Japan's inter-institutional balancing strategy (Capling 2008). Strengthening economic ties between China and Australia clearly prompted Japan to embark on FTA negotiations with Australia. Otherwise, it would have been inconceivable to launch FTA negotiations with Australia, because the Japanese government faced staunch agricultural protectionism in the domestic political arena. Negotiations for the Japan-Australia FTA were made possible because the Japanese government thought it crucial that it be regarded as engaging with extra-regional powers.

Singapore is also explicit in implementing an inter-institutional balancing strategy. Singapore's interest in FTAs has grown not just out of economic interests but also from strategic considerations. Singapore does not have great economic motivations to push for FTAs because Singapore, with near zero tariffs, expects limited economic gains from trade liberalization. Instead, strategic considerations are highly incorporated into the FTA strategy of Singapore, for which survival has been its foremost preoccupation since independence and "has been its credo in its foreign policy (Leifer 2000, 68)." Singapore has attempted to link security needs to economic interdependence, hoping that increases in economic interdependence with many countries will substantially reduce its insecurity (Pang 2007).

Singapore's inter-institutional balancing strategy unfolded in two ways. First, surrounded by big Islamic countries such as Malaysia and Indonesia that occasionally aligned to pose antagonistic security threats, Singapore tried to court other regional great powers. China and Japan were natural candidates in this regard. Singapore concluded an FTA with Japan in 2002, which was the first FTA between East Asian countries. Singapore also pushed for the China-Singapore FTA that was signed in October 2008 after eight rounds of negotiations. Despite the opposition of neighboring countries in Southeast Asia, which argued that Singapore's FTA with these great powers would hurt ASEAN's unity, Singapore concluded FTAs with two regional powers individually because it believed



FTAs with the two respective powers would reduce its strategic vulnerability.

Second, Singapore also actively pursued an inter-institutional balancing strategy by attracting extra-regional powers. Although China repeatedly made clear that its peaceful rise would not be detrimental to the core interests of Southeast Asian countries, Singapore was not certain about China's intentions in the region. To reduce this strategic uncertainty, Singapore chose to attract extra-regional great powers. As expressed in the remarks of Raymond Lim, minister of state for trade and industry and foreign affairs, Singapore has to attract bigger extra-regional powers to anchor its presence in the region and ensure that it remains a stakeholder in Southeast Asia (*The Strait Times* 2003). It is against this backdrop that Singapore sought a U.S.-Singapore FTA even if it had to make concessions in key industries such as finance. With the commencement of the USSFTA, both countries agreed to sign a strategic partnership agreement. This was made possible because Singapore's goal was commensurate with the core interests of the United States. Throughout the post-Cold War period, the key U.S. policy objective was to derail any power's attempt at dominating the region to exclude the United States (Shirk 2010, 31). The United States has consistently attempted to establish a military presence and strengthen its bilateral alliances in the region (Green 2010, 36). In short, Singapore and the United States shared a common view that it is in their interests to coordinate security policies under the rapidly changing security environment in Southeast Asia (Terada 2009).

## 2. Financial Cooperation: The Case of Intra-Institutional Balancing

East Asian countries have demonstrated intra-institutional balancing behaviors in creating regional financial mechanisms. The nature and scope of financial cooperation in East Asia were profoundly facilitated by unexpected incidents such as the Asian financial crisis and the global financial crisis. The Asian financial crisis revealed fundamental flaws of existing institutions such as ASEAN and APEC in garnering collective responses to such crises. The revelation paved the way to the establishment of a regional financial arrangement of which geographic boundary was confined to East Asia.

The first proposal for regional financial cooperation was made immediately after the Asian financial crisis in September 1997 when the IMF was carrying out the rescue package for Thailand. The Japanese government proposed to establish the Asian Monetary Fund (AMF). However, the AMF proposal was quickly hijacked by the United States and China. The United States opposed this proposal because it feared the creation of exclusive regional financial governance, while China rejected the Japanese proposal because it did not want Japan to exercise greater leadership in East Asia

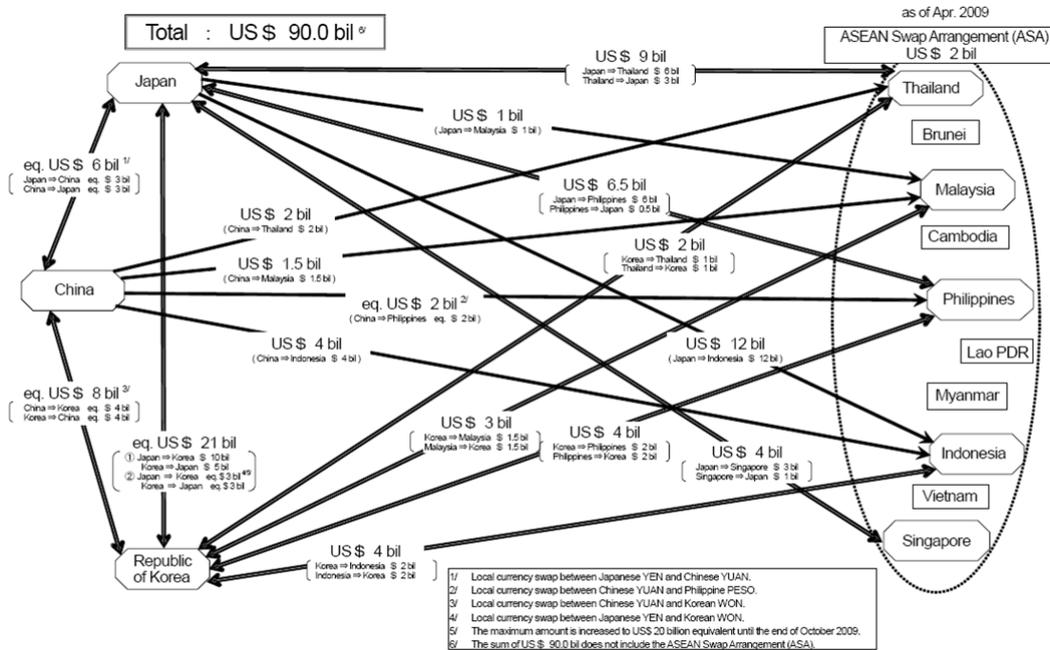


Although the initial idea of the IMF evaporated, major countries in the region did not quit their efforts to realize ideas of regional financial cooperation. The APT emerged in 1997, in which China, Japan, Korea, and ASEAN members participated (Stubbs 2002). Interestingly, in contrast to FTAs where inter-institutional balancing behavior is dominant, all major countries in the region cooperated to create the APT. Furthermore, the members of the APT agreed to take advantage of the APT as a primary institutional platform to stimulate regional financial cooperation. Under these circumstances, in November 1997, Asian finance ministers and central bankers developed the “Manila Framework,” which was later renamed “A New Framework for Enhanced Asian Regional Cooperation to Promote Financial Stability.” With the participation of the United States and the IMF, in December 1997, East Asian countries were able to endorse the Manila Framework only after they acquiesced to the central role of the IMF in launching it. Major ideas of financial stability included in the framework were as follows: (1) a mechanism for regional surveillance to complement global surveillance by the IMF; (2) enhanced economic and technical cooperation, particularly in strengthening domestic financial systems and regulatory capacities; (3) measures to strengthen the IMF’s capacity to respond to financial crises; and (4) a cooperative financing arrangement that would supplement IMF resources (Sussangkarn 2010).

The APT played a pivotal role in creating and consolidating regional financial governance. In 1999, the Asian finance ministers once again confirmed at the APT Summit that East Asia should strengthen self-help and support mechanisms. The APT’s monumental achievement was the creation of the Chiang Mai Initiative of May 6, 2000. The CMI is a network of bilateral swap arrangements in which member countries can swap U.S. dollars with their domestic currencies in the event of a future liquidity crisis (Grimes 2006). In May 2000, after going through a series of discussions and debates, East Asian countries at the finance ministers’ meeting agreed to launch the CMI to expand the ASEAN Swap Arrangement to include Korea, China, and Japan (Chey 2009). The gist of the CMI was to provide foreign exchange short-term liquidity for the recipient countries suffering from rapid foreign capital exit even without macroeconomic mismanagement (Amyx 2008). Member countries agreed to increase the swap line from US\$200 million to US\$1 billion. Since its inception, the CMI has increasingly expanded its web of agreements as well as the amounts involved. The total swap line of the CMI increased to US\$90 billion by 2009 (see <Figure 2>).



<Figure 2> Network of Bilateral Swap Agreements under the CMI



Source: MOF, Japan (2009).

The creation of the CMI was indicative of intra-institutional balancing behavior by East Asian countries. First, East Asian countries clearly understood the public good nature of financial stability in the region. Since the 1990s, economic interdependence has increased with the deepening of production networks and increasing capital flows across the region. The Asian financial crisis revealed financial uncertainty and instability in the region, which dramatically heightened the risk of spillover and contagion. East Asian countries were willing to relegate some elements of their sovereignty in creating the CMI. This sense of urgency facilitated East Asian countries' efforts to draw up cooperative devices to prevent future financial crises in East Asia. These efforts explain why East Asian countries focused on financial cooperation, rather than developing cooperation in trade where they were less damaged by the crisis (Pempel 2010). Concerns about financial insecurity also facilitated East Asian countries' efforts to confine the membership of the CMI exclusively to East Asia, departing from the APEC's open regionalism. The limited membership enabled East Asian countries to take an integrated approach to the creation of the CMI (MacIntyre, Pempel and Ravenhill 2008).

Second, in the wake of the crisis, East Asian countries had to undergo stringent eco-



conomic policies attached to the IMF bailout programs. The U.S. and the IMF's (mis)handling of the crisis and harsh conditions aroused East Asian countries' anger. The "politics of resentment" were widespread in East Asia because East Asian countries had to undergo stringent economic policies attached to the IMF bailout programs. This common sense was shared even between China and Japan, which were not directly hit by the crisis (Higgott 1999). Tokyo understood the IMF programs as a challenge to the Japanese economic developmental model (Lee 2006), whereas Beijing showed its institutional preference that excluded the United States in order to acquire greater influence and flexibility (Higgott 1999).

East Asian countries were involved in intra-institutional balancing in which they were able to agree to create a regional financial body. Japan and China showed bilateral dynamics in creating and developing the CMI that were profoundly different from the AMF proposal. Japan could take the initiative with the support of China in a way that altered its previous opposition to the AMF. Based on shared concerns and woes, Japan and China agreed to create an institutional measure to hedge against the volatility of global finance.

After the initial start of the CMI, however, China and Japan engaged in a mixture of cooperation and competition. On the one hand, Japan and China continued to cooperate in expanding the size of the bilateral swap agreements. On the other hand, they competed to increase their respective influence within the CMI. Japan and China competed to provide generous conditions for currency swaps to CMI members. Although the CMI was designed to swap U.S. dollars with domestic currencies of members in liquidity crisis, China offered a unilateral liquidity provision to such countries as Thailand, Indonesia, Malaysia, and the Philippines.<sup>17</sup> The unilateral swap line to these countries was US\$9.5 billion. The Chinese move was seen as an attempt to establish its regional financial leadership by aggressively embracing Southeast Asian countries' needs. Japan also made a corresponding move by offering unilateral liquidity provisions to Indonesia and Malaysia that were designed to receive US\$12 billion and US\$1 billion, respectively. These competing moves show that both China and Japan are involved in intra-institutional balancing behaviors within the institutional framework of the CMI.

East Asian countries continued intra-institutional balancing behaviors in finance in the second half of the first decade of the 2000s, which is vividly demonstrated in the launch of the CMIM. At the 2005 APT financial ministers meeting, East Asian countries began to float the idea of developing the CMI further into more substantive institutional arrangements. From May 2006, East Asian countries' efforts to create the CMIM cruised as they began to discuss key issues such as the total size of the fund, each country's dividends, voting shares, and the legal modality (Chey 2009). At the 2007 ASEAN+3 Finance Ministers Meeting in Kyoto, East Asian countries contemplated transforming the network



of bilateral swap agreements into a reserve pooling mechanism (Sussangkarn 2009). Finally, in May 2009, East Asian countries agreed to launch the CMIM at the APT finance ministers meeting in Bali, Indonesia. In this meeting, the APT members agreed to make US\$120 billion available for the CMIM, which would serve as a collective centralized reserve fund, with a single contractual agreement, allowing “one stop shopping” for needed funds (Pempel 2010). At the Asian Development Bank (ADB) annual conference in Istanbul, Masahiro Kawai, special adviser to the ADB president, floated an idea that the multilateralization of the CMI would be a step toward a “de facto Asian Monetary Fund.”<sup>18</sup>

Major countries clearly showed intra-institutional balancing behaviors in the transformative process of the CMI into the CMIM. First, they agreed to develop financial stability mechanisms within the contour of the APT, rather than starting from scratch. The CMIM consolidated financial cooperation by expanding its membership to include Brunei, Cambodia, Laos, and Vietnam (Lee 2011). It was in stark contrast to previous experiences of East Asian institutional building in which East Asian countries often created a new institutional framework whenever they faced a crisis. Second, East Asian countries also agreed to increase the size of contributions to US\$120 billion. It was a potentially sensitive issue, because the size of contributions was inevitably linked to the size of each country’s dividends. East Asian countries could agree to develop the CMI into the CMIM after going through a series of prior consultations and discussion.

Again, Japan took the lead with the support of China in the transformation of the CMI into the CMIM. The cooperative behavior between China and Japan laid the ground for the CMIM. China and Japan successfully compromised on the details of the CMIM mechanisms. First, both countries agreed on the size of their contribution. China and Japan will contribute US\$38.4 billion each; Korea will contribute US\$19.4 billion, and ASEAN countries will contribute the rest of the fund. Each country’s voting shares were linked to its contribution: China and Japan will have a 36 percent of voting share, while Korea and ASEAN will have 16 percent and 20 percent, respectively (see <Table 1>). Second, East Asian countries agreed to initiate a regional surveillance mechanism called the Economic Review and Policy Dialogue (Henning 2009). Third, the provision of the fund is a legally binding singly contractual agreement. In the course of these cooperative consultations, the CMIM has become more institutionalized than its predecessor, the CMI (Lee 2009).



<Table 1> CMIM: Contributions, Borrowing Multipliers, and Voting Share

Country	Contribution (US\$ billion)	Borrowing Multiplier	Voting Share (%)
Korea	192 (16)	1	14.77
PRC	384 (32)	0.5	28.41
Japan	384 (32)	0.5	28.41
Indonesia	47.7 (3.97)	2.5	4.52
Thailand	47.7 (3.97)	2.5	4.52
Malaysia	47.7(3.97)	2.5	4.52
Singapore	47.7 (3.97)	2.5	4.52
Philippines	36.8 (3.07)	2.5	3.75
Vietnam	10 (0.83)	5	1.85
Cambodia	1.2 (0.1)	5	1.22
Myanmar	0.6(0.05)	5	1.18
Brunei	0.3 (0.02)	5	1.16
Lao PDR	0.3 (0.02)	5	1.16
TOTAL	1,200 (100)		100

Source: The Joint Media Statement of the 12<sup>th</sup> ASEAN+3 Finance Ministers' Meeting (2009).

Meanwhile, China and Japan displayed dissenting views and conflicts. The conflicts were particularly acute in negotiating the size of each country's contribution. Both countries waged serious debates concerning criteria favorable to themselves. China argued that the size of contribution should be decided based on each country's foreign exchange reserves, while Japan argued that it should be linked to the GDP. The debate and conflict were intense because a bigger contribution meant a bigger voting share in the CMIM. This way, China and Japan demonstrated both aspects of cooperation and conflict in their intra-institutional balancing strategies.



### III. Conclusions and Implications

I have examined newly emerging features of East Asian regionalism. I in particular attempted to explore the proliferation of regional institutions in East Asia. I employed the logic of institutional balancing to properly capture the institutional dynamics. The logic of institutional balancing in particular makes sense given that East Asian countries do not display hard balancing behaviors despite the rapidly shifting structural environments in the region, which is contradictory to the realist predictions. While existing studies tend to focus on institutional dynamics at the regional level, I attempted to explain state behaviors and strategies underpinning institutional evolution in East Asia. For this, I delineated the way in which two distinctive institutional balancing behaviors play out in trade and finance. In trade, inter-institutional balancing that is defined as a state's behavior to create overlapping or separate institutions to balance against a target state is dominant, as demonstrated by the fact that China, Japan, and South Korea all concluded an FTA with ASEAN, respectively. The primary cause for inter-institutional balancing is the Sino-Japanese rivalry, because the two countries, with different visions of the regional order, could not seek a China-Japan FTA or a region-wide FTA.

By contrast, in finance, intra-institutional balancing is prevalent, which is represented by the creation of the CMI and its subsequent transformation into the CMIM. The public good's nature of financial stability and disappointment of the IMF programs combined to prompt East Asian countries to prefer intra-institutional balancing in finance. As a consequence, East Asian countries effectively cooperated to establish the CMI. However, this event does not necessarily mean that East Asian countries, including China and Japan, are involved in cooperative behaviors only when they execute intra-institutional balancing. China and Japan displayed a mixture of cooperation and competition. That is, China and Japan cooperated in the initial stage of institutional creation. But once the institution was created, they quickly competed and conflicted to increase their influence within the institution.

A couple of implications arise from this study. First, I demonstrated that although East Asian countries have commonly pursued a greater degree of institutionalization of regionalism, the specific dynamics of institutional balancing unfolded quite differently in trade and finance. While inter-institutional balancing is dominant in FTAs, intra-institutional balancing is prevalent in financial cooperation. Why are different dynamics of institutional balancing at work simultaneously in East Asia? It seems that the nature of these issues is closely related to two separate dynamics of institutional balancing, although it requires further study. FTAs are an expedient means to execute inter-institutional balancing, because FTAs are by definition discriminatory against non-



signatories. A country in the face of imminent strategic challenge from the target state is likely to prefer bilateral or minilateral FTAs to inclusive region-wide FTAs. In addition, FTAs are inherently a divisive issue in domestic politics because gains and costs from FTAs are clearly recognized by domestic groups. Furthermore, it is extremely difficult to design FTAs where gains are well balanced. In terms of the policymaking structure, multiple government agencies are involved in FTA negotiations, representing their clients, which are expected to either gain or suffer from FTAs. Furthermore, FTAs with big economies or countries in rivalry tend to dramatically increase this uncertainty, as the majority of domestic groups are more sensitive about the expected gains or costs. By contrast, because the public good's nature is more palpable in finance, intra-institutional balancing is more prevalent. Countries with similar concerns and challenges are more likely to cooperate with each other, rather than trying to identify the target state. However, once an institutional arrangement is made, countries are also involved in balancing behaviors within institutions such as bargaining, struggle, and confrontation.

Second, the United States has been a pivotal player in East Asian regionalism, although it is an offshore power. While the United States disliked the institutionalization of economic regionalism in East Asia in the Cold War period, it has engaged in inter- and intra-institutional balancing behavior in the post-Cold War period. The U.S. attempt to conclude the TPP with a few East Asian countries is a good case for inter-institutional balancing behavior. It is generally conceived as a U.S. scheme to balance against China's vision for organizing the East Asian economic order, although it claims that the TPP will be inclusive and transparent. Countering China's preference on the APT as a primary institutional arrangement for economic cooperation, the United States envisions an economic order with different group of countries in the Asia Pacific. That is, the United States tries to prevent China from dominating East Asia by hampering the Chinese vision of regional economic institutionalization. By contrast, U.S. participation in the EAS demonstrates intra-institutional balancing. After joining the EAS in 2010, the United States took advantage of it to check the rising influence of China in the region. The United States skillfully incorporated Southeast Asian countries' concern over the South China Sea as it attempted to turn this issue into a formal agenda, despite China's strong opposition. Whether the United States will prefer inter- or intra-institutional balancing strategy will determine the basic contours of institutional evolution in East Asia. ■

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## Endnotes

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<sup>1</sup> Acharya pays attention to the positive consequences of the hub-and-spoke system in East Asia. He argues that an interlocking “spider-web” form of bilateral security system effectively complemented the absence of multilateral security institutions in the region.

<sup>2</sup> The United States became an official member of the EAS in 2010.

<sup>3</sup> For the concise discussion of soft balancing, see Paul (2004); Brooks and Wohlforth(2005); Pape (2005).

<sup>4</sup> Inclusive balancing is a state behavior to bind the target states within the institution, whereas exclusive balancing is a state behavior to exclude target states from an institution.

<sup>5</sup> Yomiuri Online. <http://www.yomiuri.co.jp>.

<sup>6</sup> “China Criticizes U.S. Agenda for APEC Summit.” 2011. *Wall Street Journal*. November 7.

<sup>7</sup> See Baldwin (1993) on domino effects.

<sup>8</sup> For the various types of trade governance, see Aggarwal (2006).

<sup>9</sup> Instead, Japan made a strategic move by signing an investment treaty with Taiwan, which can be considered as stepping stone to a Japan-Taiwan FTA in coming years. <http://www.bloomberg.com/news/2011-09-22/taiwan-japan-sign-investment-accord-in-stepping-stone-to-fta.html>.

<sup>10</sup> In addition, viewing securing access to natural resources as in its security interests, China aggressively embarked on FTA negotiations with resource-abundant countries in the Middle East and Africa.

<sup>11</sup> For China’s charm offensive, see Kurlantzick (2008).

<sup>12</sup> ASEAN Homepage. <http://www.asean.org/15265.htm>.



<sup>13</sup> Yang argues that recently, China's FTA policymaking has become less strategic and coherent. Since the MOFCOM with expertise on trade negotiations took over the MOFA's position as a lead agency, economic considerations have become more important.

<sup>14</sup> Seven ASEAN members have implemented an ASEAN-Japan FTA: Singapore, Malaysia, Brunei, Vietnam, Laos, Myanmar, and Thailand.

[http://www.fta.gov.sg/fta\\_ajcep.asp?hl=38](http://www.fta.gov.sg/fta_ajcep.asp?hl=38).

<sup>15</sup> It is well documented that Japan's policymaking is saddled with bureaucratic infighting as well as sturdy political pressure from the agricultural sector.

<sup>16</sup> Japan clearly had economic motivations for this change. Because Japanese firms operate production networks in Southeast Asia, the Japanese government found it crucial to harmonize rules of origins across Southeast Asian countries to manage intra-firm trade in the region.

<sup>17</sup> By contrast, China concluded a bilateral swap agreement with South Korea and Japan, respectively.

<sup>18</sup> China, Japan, South Korea, ASEAN Makes Moves for Asian Monetary Fund. 05/06/2005. <http://www.aseansec.org/afp/115.htm>.



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