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**Competitive Regionalism**  
**Explaining the Diffusion and Implications of FTAs in Asia Pacific**

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**Introduction**

In the past fifteen years, the world trading system has experienced a major transformation with the rapid proliferation of free trade agreements (FTAs)<sup>1</sup> whereby members establish special exemptions to the most favored nation principle of the WTO and exchange preferential market access commitments. The increase in FTAs has indeed been phenomenal: from 25 such agreements reported to the WTO in the late 1980s to more than 200 by the 2000s. This rapid proliferation has, hence, been described as the “rise of regionalism” (as FTA members agree to deeper economic integration) and has raised concerns as to how these arrangements might undermine the multilateral trading system. We argue in this book, however, that this conventional wisdom yields only a partial understanding of the drivers of the FTA frenzy and its most important consequences. We posit that in order to understand the rapid expansion of FTAs, it is essential to factor in how these different sets of preferential trade agreements are *interconnected* (either because they generate externalities on non-members or because they disseminate novel policy paradigms). Next, we argue that understanding the causes of the FTA frenzy is essential not only because of its impact on the WTO, but also because of its influence on the nature of regional integration- remarkably enough, a very important topic that has remained under the radar. FTAs can work for or *against* the emergence of coherent regional blocs and we must explore which conditions favor one outcome over the other.

In order to analyze the FTA explosion, then, it is essential to explore diffusion dynamics arising from the interconnectedness of preferential trade negotiations, including but going beyond, traditional economic considerations. For these purposes, we anchor our analysis of FTA proliferation in diffusion models which have already demonstrated their

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<sup>1</sup> Although FTA is the most widely used term, these trade agreements represent the exchange of trade/investment preferences to selected members and PTA (preferential trade agreements) may be a more accurate acronym. We have decided to use FTA, however, given that it is the more familiar term.

usefulness in explaining the spread of economic and political liberalism (Elkins and Simmons, 2005, Simmons et al. 2006). We argue that the waves of regionalism in the world economy approximate well the condition of “uncoordinated interdependence,” as developed by diffusion theorists. In other words, the policy choices of governments are influenced by the actions of their peers, either because they alter the material payoffs or because they disseminate new information about the impact of these policies (Elkins and Simmons, 2005). In the process of analyzing FTA proliferation, we focus on two of the most powerful diffusion mechanisms, emulation and competition, to explore the extent to which policy paradigms propagated by like-minded elites or competitive goals articulated by business and government officials have contributed to the dissemination of FTAs. Furthermore, we do offer a much broader conceptualization of competition than the one articulated by the diffusion literature as we take into account not only economic rivalry, but also competitive pressures arising from security and legal objectives as fueling interest in FTA negotiations.

The extent to which the competitive hypothesis is confirmed over the emulation hypothesis in the country case chapters has significant implications for a bedrock expectation in the FTA literature: that these preferential trade agreements promote regional integration.<sup>2</sup> Instead, if the competitive incentives behind FTA proliferation predominate, these preferential trade agreements may weaken the emergence of coherent trade blocs in different ways: through preference erosion of earlier FTAs; by diluting regional solidarity as individual members of existing trade groupings negotiate separate trade deals with larger nations;<sup>3</sup> and by encouraging cross-regionalism or the development of competing FTA networks within the same region. An FTA competition that erodes, rather than strengthens, the emergence of a regionally coherent trade area is a powerful proposition assessed by this book.<sup>4</sup>

In sum, this collective volume investigates central questions regarding the nature of the international trading system and the future of regional integration: What is driving

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<sup>2</sup> Indeed, they are typically characterized as the first step in the path towards regional integration that will later on include creation of a customs union, common market and monetary union (Balassa, 1961).

<sup>3</sup> The numerous instances of individual ASEAN nations negotiating separate bilateral FTAs are illustrative examples.

<sup>4</sup> Our thinking on this issue was greatly influenced by the comments of Richard Stubbs and T.J. Pempel at a 2007 ISA panel.

the worldwide explosion of FTAs? Why is it more likely for states to establish a new bilateral FTA than to join in existing ones?<sup>5</sup> Can FTA networks represent the foundation for much more ambitious projects of regional integration and collaboration? We examine these important questions through a novel analytical approach that highlights the sources of policy diffusion.

The FTA strategies of important trading nations located at both sides of the Pacific Rim offer an ideal venue to test these arguments. Western Hemisphere countries, such as the United States, Mexico and Chile have been at the forefront of the FTA wave as they have already negotiated multiple preferential deals at the bilateral and subregional level, while a region-wide FTA has remained an elusive goal. Moreover, these active preferential traders have also signed FTAs with East Asian counterparts which only recently launched an FTA track in their trade strategies. In fact, as the APEC (Asia Pacific Economic Cooperation) project, which sought to voluntarily liberalize trade among the Pacific Rim member countries, lost steam in the late 1990s, these cross-regional FTAs have acquired a much more central role in structuring trans-Pacific economic relations. The policy shift is especially remarkable for East Asian countries such as Japan, Korea, China, and ASEAN, who are now putting aside their previous reluctance towards formal integration, are rapidly signing FTAs (both regionally and cross-regionally) that award preferential market access, impose binding commitments, and embrace some WTO-plus commitments.

In view of these developments, we argue that it is important to assess the extent to which the FTA policies of Pacific Rim countries are influenced by the externalities generated by prior actions of their peers; whether FTA diffusion in both the Western Hemisphere and East Asia approximates better the expectations of ideational emulation or economic competition; and within competitive dynamics, the extent to which governments' FTA policy is affected by the need to respond to multiple competitive

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<sup>5</sup> Mattli (1999: 61-64) for instance argues that governments have two choices when confronted with losses due to FTA externalities: to join existing trading blocs (first integrative response) or to form new and separate ones (second integrative response). In his view, the reason why a government is forced to opt for the more costly option of creating a new group is due to high membership costs or rejection by the original group. Our project adds to such logic and investigates the possibility that the excluded government might choose to create its own group due to various competitive pressures.

pressures (economic, security, or legal) that may or may not be compatible at different points in time.

This framework chapter is organized in the following ways. First, we review the general literature on FTA negotiation and the more specialized scholarship on the policy shift in favor of preferential trading in the Pacific Rim in order to highlight the contribution that our focus on the diffusion dynamics of FTA proliferation can make to the field. Second, we offer an empirical overview of the rapid spread of FTAs with an emphasis on the following dimensions: the temporal clustering of FTAs, the actual volume of trade covered under these preferential trade agreements, and the proliferation of North-South and South-South FTAs. Third, we develop a model of FTA diffusion that contemplates two alternative hypotheses –emulation and competition- and discuss the operationalization of the relevant variables that guide the process tracing methodology employed in the country chapters. Fourth, we discuss the implications of endorsing a multidimensional concept of competition that factors in economic, security, and legal pressures that trigger preferential trade talks. The final section presents a synopsis of the individual chapters in this volume on competitive regionalism, and discusses the value added of explaining FTA proliferation through the diffusion model developed here.

## **1. Literature Review:**

### **Towards an understanding of FTA triggers and proliferation**

So what then motivate governments to negotiate preferential trade agreements? How has the traditional literature on regionalism explained the growth of FTAs? And what are the most influential views regarding the very visible policy shift among Pacific Rim nations in favor of preferential trade accords? These are some of the questions that this section will explore.

#### Traditional explanations of FTA negotiation and proliferation

The study of regional integration has a long pedigree. Three schools of thought in particular have largely influenced our understanding of the central driving forces of preferential trading, and in some instances they also reflect upon the likely factors behind FTA proliferation.

### *Economic Interdependence*

The first such school of thought –neofunctionalism- focuses on economic interdependence and argues that trade concentration is the most important spark for regional integration. According to this view, governments will initially agree to pool sovereignty in order to manage the technical issues created by expanding economic transactions. But integration will quickly acquire a life of its own due to the dynamics of functional spillover, i.e., integration in one sector will increase pressure to integrate other related industries. Supranational and subnational actors are, therefore, the main engines of the integration locomotive (Haas, 1964). In a more recent formulation, Mattli (1999) uses neofunctionalist logic to explain the demand side of regional integration. In his view, as flows of intra-regional trade and investment increase, the private actors will call for the creation of supranational institutions that allow them both to reduce the uncertainty and transaction costs surrounding these cross-border economic transactions, and to reap the benefits of economies of scale.

While neofunctionalism identifies a powerful force for regional integration (private sector demand for an integrated trade governance structure to maximize economic opportunities), it has in fact serious difficulties in explaining the timing of regional integration initiatives or the more specific choices countries are making in selecting their trading partners. For starters, economic interdependence is a poor indicator of shifts in favor of regionalism. For instance, intra-regional trade has consistently been higher for East Asia than for North America (as of 2003, 54% in East Asia and 46% in North America), and yet the United States, Canada, and Mexico moved much faster to negotiate a regional trade agreement (NAFTA) than the nations of East Asia.<sup>6</sup> Moreover, contradicting the expectations of neofunctionalism, industrialized nations are currently selecting mostly minor economic partners for FTA negotiations that are expected to generate modest aggregate economic gains (Pekkanen, Solís, Katada, 2007). In the case of East Asia, the absence of a bilateral Sino-Japanese FTA initiative despite extensive

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<sup>6</sup> Figures are from Kawai 2005, 31-32.

trade and investment links illustrates how political obstacles and strategic considerations weigh heavily on the decision whether or not to seek preferential trading ties.

### *Domestic lobbying and rent-seeking*

The role of domestic lobbies in pushing for trade diverting agreements that yield rents for specific producer groups constitutes another line of analysis. In this regard, Grossman and Helpman (1995: 680, 687) have led the way in developing formal models to explain when FTAs will be politically viable, and what the likely characteristics are of these preferential trading agreements after clearing the political market. These authors deem possible the successful negotiation of an FTA only under three scenarios: a) the benefits from trade creation win the support of consumer groups while import competing industries fail to coordinate their opposition to the accord, b) gains to exporters far surpass losses of disadvantaged industries, or c) liberalization exemptions are carved to protect sensitive sectors. These authors consider the latter two options far more likely since protection for most sectors is the political recipe to muster domestic support for unilateral trade agreements. On the one hand, exporters protected by stiff rules of origin and hefty external tariffs will endorse an agreement that guarantees them access to higher priced regional markets. On the other, import competing industries will not mount an opposition campaign if they are “bought out” with promises of sectoral protection.

Baldwin’s (1997) powerful model of the “domino effect” describes how the negotiation of trade diverting trade agreements will trigger a chain reaction of subsequent FTA enlargement or negotiation of alternative trade blocs as disadvantaged non-member producers will seek to minimize the trade and investment diversion resulting from the original regional preferences. Baldwin makes the persuasive point that producer groups will lobby harder for FTA membership than to rescue troubled multilateral talks, since failure at the multilateral level results in a missed opportunity for everyone; whereas uncorrected regional discrimination weighs heavily on non-member producers (Baldwin, 1997: 879).

Models of domestic lobbying for (and to counter) trade diverting FTAs offer a powerful account of the importance of sectoral rent seeking in the search for preferential market access. However, the trade diversion motive can only explain a subset of such

FTAs, and is quite clearly irrelevant in other instances. For example, Japan's first ever preferential trade agreement with Singapore (in force since 2002) was not informed by the desire to counter trade diversion since Singapore is already one of the most open economies in the world. More generally, domestic lobby arguments are hard pressed to explain the construction of regional institutions to satisfy proactive state agendas at the political level, such as to ameliorate regional tensions, favor allies, partake in trade and investment rule-making, and fend off against domestic lobby groups through the familiar "tying of hands" in international agreements.

### *State autonomy*

A third model of regionalism –intergovernmentalism- focuses less on economic gains or private lobbies, and more on the autonomous objectives of states in embarking on official trade negotiations. In this view, states consent to pool sovereignty via regional integration to achieve joint gains that could not be realized with purely national measures, or to gain leverage over domestic interest groups (Moravcsik, 1993). Alliance and security concerns are also a part of the state calculation in engaging in more intense trade relations (Gowa, 1984). Dominated by the state agenda, regional integration proceeds as a series of 'celebrated bargains' between heads of state. Preference convergence between political leaders is therefore an important precondition for regional integration to make strides. Power asymmetries are important in that the largest states in the bloc dominate negotiations. Policies adopted represent the lowest common denominator, i.e., the minimalist position on integration by one of the largest members. Small states will be persuaded to support the integration package through side payments; whereas recalcitrant larger states will be brought in through the fear of exclusion. Finally, states will do their utmost effort to preserve sovereignty. States will grant any loss of discretionary power only after carefully weighing in the benefits of integration, and they will consistently adopt safeguards (consensus voting rules for instance) to make sure national interests are not overridden by regional institutions (Moravcsik, 1991).

Intergovernmentalism has not been without its critics. Mattli (1999: 29) for instance, points to the shortcomings of depicting regionalism as a series of discreet summitry events. Intergovernmentalism's narrow focus, therefore, leaves out on-going



processes (market exchange) affecting the prospects of regional integration, assumes away problems of implementation of high-level official bargains, and leaves unexplained the reasons behind the convergence of regional integration preferences among key members. In our own view, it is not necessary to circumscribe the intergovernmentalism hypothesis to a series of high-profile deals between heads of state. Autonomous state preferences can have a powerful impact on the path of preferential trade negotiations in many other ways. In addition to head of state summitry, state preferences mold integration efforts through inter-bureaucratic politics. Indeed, FTA negotiations can become important matches for competing bureaucracies that seek control over the foreign economic policy agenda either to push for a specific policy orientation, or to gain bureaucratic turf and protect special client groups.<sup>7</sup>

Similarly, state goals to be achieved through preferential trading negotiations are not limited to the supply of an integrated governance structure to lower risk and transaction costs (although an important goal in its own right); but can include other economic and security diplomatic goals. Economic integration negotiations can serve as a confidence building measure that ameliorates the security dilemma among nation-states. States may embark on FTA diplomacy in order to bid for regional leadership through economic cooperative endeavors. Preferential trading blocs can also help states accomplish their foreign policy objectives in other forums, such as pushing for new rules on trade and investment that can later on be incorporated at the multilateral level (WTO) (World Bank, 2000).

As this brief overview has shown, theories of regional integration have yielded a number of propositions regarding the incentives to negotiate FTAs. From neo-functionalism, we should expect high levels of economic interdependence to energize the private sector in demanding a regional economic governance structure that reduces transaction costs. From domestic lobbying models, we should expect industries to lobby for FTAs that offer rents through preferential market access or that aim to dissipate these rents by negotiating countervailing FTAs. And from intergovernmentalism, we should anticipate governments to be firmly in control of the integration agenda and to use these

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<sup>7</sup> For an example of inter-bureaucratic politics affecting foreign economic policy (Japan's regime on capital flows) see Solís (2005).

agreements to gain leverage over domestic interest groups. Within the regionalism literature, we believe that Baldwin's domino effect has addressed most directly and with greatest success the issue of FTA proliferation by highlighting how trade and investment diversion effects from initial FTAs can generate a chain reaction of subsequent preferential trade agreements. Yet, we believe that diffusion models can shed new light on the dissemination of FTAs in at least three important ways. First, we can factor in the interplay of multiple competitive objectives in FTA negotiation that go beyond the defensive economic interests of the domino theory, and include regional leadership contests and dissemination of alternative standards in regional integration. Second, our project posits an alternative hypothesis on FTA proliferation that focuses on the role of ideas or policy paradigms as countries emulate successful FTA strategies of leading reference nations. In this way, our study entertains an alternative explanation for FTA diffusion with markedly different expectation on the nature of regional integration. And third, this project looks more directly into how domestic policy formulation processes influence the manner in which governments respond to external diffusion pressures.

Next, we discuss the budding literature on FTAs and regionalism in the Pacific Rim area, with a particular emphasis on East Asia, to highlight the promise of diffusion models in explaining the on-going FTA rush.

### Current understanding of FTA proliferation in the Pacific Rim

#### *First movers: FTA strategies of Western Hemisphere nations*

Although Latin American countries had one of the longest histories of regional integration efforts in the world dating back the time of Simón Bolívar (in the early nineteenth century),<sup>8</sup> this "old regionalism" for the most part did not produce substantive integration. The predominant developmental model in the region during the 1960s and 1970s—import substitution industrialization—implied that the goal of creating a preferential regional market would be achieved by maintaining external protective barriers, restricting foreign direct investment, allowing extensive national industrial

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<sup>8</sup> See Barbara Stallings (2008) for a brief history of regional integration endeavors in Latin America. The most notable initiatives were the Central American Common Market (1960), the Latin American Free Trade Area (1961, transformed in 1980 into the Latin American Integration Association or ALADI), and the Andean Group (1969).

planning, and exempting multiple sectors from liberalization (Devlin and Giordan, 2004). The staunch US support for the multilateral liberal economic system, and its suspicion of “parochial and local regionalism” further limited the chances of far-reaching hemispheric integration (Feinberg, 2002: 127).

In the second half of the 1980s and early 1990s, a window of opportunity opened for the emergence of the “new regionalism” in the Western Hemisphere. The 1989 Canada-US FTA –spurred by Canadian concerns over U.S. protectionism- was the first step (Baldwin, 1997). But it was Mexico’s subsequent request in 1990 to negotiate a free trade agreement with the United States (which became the trilateral NAFTA) that marked the turning point in the spread southward of the new type of FTA: a North-South trade agreement that endorses a hard law approach to the preferential liberalization of goods, services, and capital flows. Mexico’s initiative reflected a much broader shift among Latin American countries. Most of them underwent neoliberal policy reforms and trade liberalization as a result of the 1980s debt crisis, and they have made promotion of exports and FDI inflows major policy priorities towards economic recovery and growth.

The broad desire to create more outward looking economic integration agreements was noticeable in the 1991 formation of the four country (Brazil, Argentina, Paraguay and Uruguay) regional bloc in the South Cone. The resultant Mercosur (Mercado Común del Sur) endorsed the notion of open regionalism, projected the creation of a customs union with a common external tariff, and attempted intra-regional tariff liberalization and FDI promotion. Moreover, spurred by the desire to replicate Mexico’s preferential access to the U.S. market, Chile began to explore NAFTA membership and launched a very active FTA strategy (as Mexico did) in order to diversify its market access. The most ambitious project for region-wide integration, the Free Trade Area of the Americas (FTAA) launched in the 1994 Miami summit, was mostly due to the desire among Latin American countries to pursue integration with the United States to secure market access and FDI inflows, lock in macroeconomic reforms and consolidate democratic rule (Feinberg, 2002).

At the turn of the century, the prospects for sub-regional and regional integration began to falter, however. The 1999 Brazilian devaluation and the 2001 financial turbulence in Argentina triggered bitter competition among Brazil and Argentina, as both

reverted to protectionist measures. Mercosur also began to exhibit other fundamental weaknesses such lack of institutionalization and meager macroeconomic coordination (Preusse, 2004: 131). The FTAA negotiations did not make the 2005 deadline and are currently in limbo. Oliveira (2007: 125) argues that the fundamental reason for this breakdown in the negotiation process is that Latin American countries are not willing to forego their development status (as Mexico did in NAFTA), and want the concession package to reflect the huge North-South asymmetries in the region. Brazil, in particular, has been suspicious of the US willingness to open its agricultural markets and impose stricter disciplines on antidumping , while it considers that the new trade agenda items such as intellectual property protection could hinder its development strategy (Zabludovsky and Gómez Lora, 2007: 101).

But the 2001 shift in US trade policy in favor of “competitive liberalization”<sup>9</sup> (the negotiation of bilateral FTAs with ‘can-do’ nations in order to stimulate negotiations in other trade fronts) also drastically decreased the incentives for Latin American countries to pursue the FTAA. As explained by Zabludovsky and Gómez Lora (2007: 99), instead of perceiving the FTAA as the only way to secure preferential access to the US, many of them opted for the faster bilateral route. With competitive liberalization, FTAs has become a cornerstone of US trade strategy and not a mere *ad hoc* deviation from multilateralism. Consequently, in a five year period the Bush administration launched 16 FTA initiatives (in addition to enacting the FTAs with Singapore and Chile initiated in the previous Clinton administration). The active FTA policies of the United States, Mexico, and Chile have generated a veritable boom of preferential trade agreements in the region, and more recently these Western Hemisphere countries have set their sights in East Asia, the most recent theater for the dramatic proliferation of preferential trade agreements.

### *The latest bandwagon: East Asia joins the FTA frenzy*

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<sup>9</sup> The competitive liberalization strategy reflected the concern with falling behind in the FTA race given the difficulties in obtaining fast track authority after NAFTA; the desire to obtain market access concessions from countries competing for preferential treatment in the US market; and the attempt to maximize leverage by pursuing concurrent trade negotiations bilaterally, regionally and multilaterally Evenett and Meier (2008).

Not so long ago, champions of multilateralism (Panagariya, 1999, Bhagwati, 1993), who worried about the deleterious effects of regional trading blocs on the GATT/WTO system, could take comfort in the fact that one of the world's fastest growing regions remained immune to the spread of preferential trading. East Asia, prior to the 1997 financial crisis, was commonly praised as a highly performing region where webs of trade and investment had been established not through formal inter-governmental agreements, but rather through the private sector, and more specifically, through Japanese multinational corporations or by business networks of overseas Chinese (Peng 2002, Ravenhill, 1995, Hatch and Yamamura, 1996). Even the region's most ambitious project of trade liberalization –the Asia Pacific Economic Cooperation or APEC- seemed to confirm this regional distaste for formal and preferential integration. Japan in particular consistently resisted U.S. attempts to turn APEC into a binding trade-liberalizing organization. Instead, APEC promised to deliver trade and investment liberalization by the year 2020 based on voluntarism, non-binding commitments, and most importantly, non-discrimination (Higgott and Stubbs, 1995).

Since the late 1990s, East Asian countries have negotiated multiple FTAs that award preferential market access, impose binding commitments, and embrace numerous WTO-plus commitments. The key issue is why? In answering this question, the growing literature on East Asian regionalism has focused on three main aspects: the triggers for policy change, the drivers of the FTA policy track, and the likely consequences of FTA proliferation for the construction of broader regional institutions and the multilateral trading system. Regarding the origins of regional institution building in East Asia, Pempel (2005: 9-11) argues that the region is ripe for cooperation today due to long-term changes that include growing economic interdependence in East Asia, China's reintegration into the region (by normalizing relations with the United States and Japan, and focusing on economic reforms), and growing cooperation among ASEAN nations. The combined result of these trends has been to lower the obstacles to regional cooperation. On the other hand, other accounts of FTA proliferation in the region focus on a number of recent external shocks that raised serious concerns about the performance of international trade institutions –WTO, APEC, AFTA (Aggarwal, 2005, Krauss, 2003a: 317-318, Dent, 2003) and/or challenged the wisdom of exclusively pursuing *de facto*

market integration in a world characterized by growing trade blocs and financial instability (Aggarwal, 2005, Lincoln, 2004).

A heated debate has also ensued among scholars regarding the essential drivers of East Asia's FTA frenzy. On the one hand, some analysts emphasize the fact that FTA diplomacy is by no means a repeal of statist policies. Bowles (2002: 259-260), for example, explains Japan's recent economic bilateralism as the use of a new mechanism to achieve goals long sought after by a developmental state: promotion of a division of labor in East Asia where Japan plays a key role as supplier of technology and capital, where intra-regional exports provide new stimulus to economic growth, and where Japanese subsidiaries in the region capture a sizable portion of the intra-regional trade. Through a broader examination of bilateral FTAs among Asia-Pacific nations, Aggarwal and Koo (2005) reach the conclusion that interest group politics has not been a very powerful driver of these initiatives, thereby reinforcing the conclusion that the strong state is at the center of these bilateral trade negotiations.

And yet, other scholars (including us) have portrayed interest group lobbying and non-state actors as powerful agents influencing the actual content of FTAs. For instance, Katzenstein (2006) argues that the porous region of East Asia is experiencing a process of hybrid regionalism where new and mostly non-state actors heavily influence this process. Similarly, Munakata (2006) concludes that East Asian governments have finally started to engage in FTAs to "catch up with the market." In the specific case of Japan, the industrial sector through its umbrella organization –Keidanren- has been pivotal in launching an FTA track in Japanese trade policy (Solís 2003, Manger, 2005, Yoshimatsu, 2005); while the agricultural lobby has very skillfully defined the upper ceiling for farm liberalization (Mulgan, 2005, Solís and Katada, 2007). Ravenhill's (2005) analysis of the essential features of Asia-Pacific bilateralism reaches similar conclusions in that these agreements are plagued with sectoral exemptions for sensitive sectors, so much so that they might not be compatible with article 24 of the WTO.

Finally, recent scholarship on East Asian regionalism has explored the impact of bilateral FTAs on broader regional trade initiatives and the multilateral trading system. As Aggarwal (2005: 20) deftly puts it, it is important to analyze whether these FTAs are nested on broader agreements or whether they overlap by endorsing different principles

of trade liberalization. The compatibility of these bilateral trade agreements with existing trade governance frameworks is the essential issue at stake. Dent (2003) offers an optimistic account of how crisscrossing bilaterals (what he labels “lattice regionalism”) will create momentum for broader regional integration: because there is convergence on the trade liberalization mode (preferential agreements based on specific reciprocity), and because there is strong pressure to streamline the “noodle bowl.” Ravenhill (2005), however, reaches the opposite conclusion in that trade diverting bilateral agreements have weakened the domestic coalition in favor of liberalization (by creating vested interest that endorse preferential export access and protection of weak sectors), thereby undermining as well the momentum for multilateral liberalization. On the other hand, Aggarwal and Koo (2005: 296) believe that a combination of a weak WTO and APEC, as well as a potential Sino-Japanese alliance could likely produce a strong Northeast Asia FTA. Yet, the chances of a Sino-Japanese partnership for regional trade integration cannot be adequately assessed unless we address systematically the competitive dynamics of their trade diplomacy in the region.

In sum, existing literature on regional integration in the Western Hemisphere has clarified the importance of the shift in developmental model among Latin American countries towards outward-looking FTAs; as well as the causes and impact of the emergence of “competitive liberalization” in U.S. trade policy. On the other hand, the recent surge of scholarship on East Asian regionalism has helped clarify the external triggers behind the policy change, the importance of domestic politics in each country’s FTA approach (the interplay of demand and supply factors discussed above), and the ways in which emerging FTAs mesh or do not mesh with already existing trade governance frameworks. We seek to build upon these insights, but we argue that the scholarship to date has neglected a fundamental aspect of FTA proliferation in the Pacific Rim. That is the interconnection among different sets of FTA negotiations both within regions (Western Hemisphere and East Asia) and across them. In other words, it is important to assess the extent to which the FTA policies of Pacific Rim countries are influenced by the externalities generated by prior actions of their peers; whether FTA diffusion in the region approximates better the expectations of ideational policy diffusion or economic competition; and within competitive dynamics, the extent to which

governments' FTA policy is affected by the need to respond to multiple competitive pressures (economic, security, or legal) that may or may not be compatible at different points in time. .

## **2. The State of Play in FTA Proliferation**

After assessing the existing literatures of regional integration theories and regionalism in the Western Hemisphere and East Asia, we now offer a brief overview of the empirical evidence on FTA proliferation that constitutes a baseline for the chapters throughout the book. Our first concern is with ascertaining whether there is in fact temporal clustering of FTA negotiations. Chart 1 shows that indeed the cumulative number of preferential trade agreements has increased very rapidly since the early 1990s.<sup>10</sup> There were only 25 such agreements notified to the GATT by the end of the 1980s, but that number jumped to over 200 by the late 2000s. This rate of FTA dissemination has yielded the traditional S-shaped curve found in studies innovation diffusion in diverse settings (Gray, 1994, Simmons et al, 2006).

[Chart 1 comes here]

Another parameter by which to assess the diffusion of FTA policies is to look at the types of countries partaking in preferential trading. Up to the late 1980s, the most common type of FTA involved industrialized nations, but since then North-North FTAs' share of total trade agreements has contracted sharply. Instead, what we find is more diversity in the types of partnerships established through FTAs: North-South and South-South trade agreements. For instance, in the 2000s (as of March 2007), out of 113 RTAs notified to the WTO, 50 (44 percent) were between developed and developing countries, and 34 (30 percent) were among developing countries (see Chart 2).<sup>11</sup> These figures then corroborate a widening acceptance of free trade agreements in the Third world (of the

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<sup>10</sup> The WTO uses a different nomenclature, Regional Trade Agreements or RTAs to refer to the preferential trade agreements of interest to this project: customs unions and FTAs . The contracting parties, which are the WTO members, have the obligation to notify the organization

<sup>11</sup> As per the WTO, developed economies include: Canada, U.S., EU, EFTA, Japan, Australia, New Zealand. Transition economies are former USSR, Easter and Central Europe, Baltic States and Balkans. The remaining are considered developing economies.



developing country WTO members, only Mongolia is not part of at least one FTA); and the growing interest of industrialized nations to negotiate preferential market access with countries at very different income levels.

[Chart 2 comes here]

If more countries are willing to negotiate market access on preferential terms, is FTA diffusion the result of the expansion of existing free trade agreements as new members join in, or on the contrary, is it mostly fueled by the proliferation of separate FTAs? Chart 3 shows that throughout the postwar period, and certainly during the latest wave of free trade agreements, the vast majority of the new FTAs are “greenfield” FTAs established among new sets of countries, and do not represent expansion of the old ones (see Chart 3). In fact, most of the accessions notified, involved rounds of enlargement in the European integration process, whereas elsewhere in the world the dominant trend by far was the negotiation of alternative FTAs.<sup>12</sup> Geographically speaking, the majority of the recent FTAs are so-called cross-regional FTAs. In the first half of the 2000s for example, 58 (51 percent) out of 113 FTAs were cross-regional, and East Asian governments have demonstrated cross-regional inclinations from the early stage of the region’s FTA boom in the late 1990s (Solís and Katada, 2007). These two observations do not bode well for the expectation that FTAs will yield region-wide coherent integration blocs, and again underscore the importance of assessing whether this clustered and fragmented pattern of FTA diffusion results from competitive dynamics to be explored in more detail shortly.

[Chart 3 comes here]

Finally, a striking fact of the recent wave of FTAs is that they only cover a modest volume of trade. As illustrated in Table 1, only a few FTAs such as NAFTA cover a large proportion of trade for contracting parties. Therefore, standard arguments

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<sup>12</sup> In other words and as discussed earlier, the new FTAs emerge mostly due to the “second integrative response” by the government than the first in Mattli (1999)’s terms.

on the desire to maximize aggregate welfare gains by negotiating with large economic partners as the main motivation for preferential trade agreements cannot explain adequately FTA negotiation or diffusion. Instead, we propose to tease out alternative mechanisms for FTA proliferation that include the dissemination of policy paradigms through cross-country policy networks, or the multiplier effect of strategic interaction among states and interest groups as they maneuver for competitive advantage.

[Table 1 comes here]

### 3. The analytics of FTA diffusion

Our central objective is to explain the dissemination of FTA policies by using diffusion models. Diffusion occurs when “the prior adoption of a trait or practice in a population alters the probability of adoption for remaining non-adopters” (Strang, 1991: 325). And as Garrett et al (2008: 344) have argued, diffusion models challenge the conventional *modus operandi* in political science of explaining policy outcomes as domestic responses to common external shocks.<sup>13</sup> Instead, the diffusion literature takes “Galton’s problem” (the interdependence of government choices)<sup>14</sup> very seriously, and makes it the central analytical concern (Braun and Gilardi, 2007). Therefore, in developing a diffusion argument to explain FTA proliferation, we posit here that a government’s decision to pursue this policy innovation is influenced by the actions of other countries and is not purely determined by domestic factors.

The next analytical task is of course to ascertain in which ways the prior actions of governments affect the likelihood that other countries will follow suit with similar policies. The literature recognizes four main mechanisms of diffusion: 1) “competition” as an economic and horizontal process whereby countries adopt policies to enhance their differential attractiveness vis-à-vis competitors, 2) “coercion” as strong countries pressure or manipulate incentives to force weaker countries to adopt a practice, 3) “rational learning” as countries adopt a policy after they assess it objectively and learn

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<sup>13</sup> Peter Gourevitch’s (1978) “second image reversed” has been one of the most influential arguments on the impact of international factors in domestic policy-making.

<sup>14</sup> In statistical analyses, this is usually identified as a problem of spatial dependency or autocorrelation.

that it produces benefits, and 4) “emulation” as countries adopt policies that they deem appropriate and frequently they follow the lead of strong countries or socio-cultural peers<sup>15</sup> (Simmons et al, 2006. Dobbin et al, 2007).

The diffusion literature has already made significant contributions to our understanding of the cross-border dissemination of economic and political liberalism (Elkins and Simmons, 2005, Simmons et al, 2006). However, this literature is still confronted with the challenge of clearly demarcating among the alternative mechanisms that increase the likelihood of policy convergence. For instance, soft coercion or emulation are hard to distinguish given that in both cases powerful countries emerge as the key focal point of policy convergence; rational learning and competition may be difficult to separate since countries may pursue a policy that has proven successful in order to keep up with competitors; and epistemic communities are considered important vehicles for the dissemination of policy paradigms both in the rational learning and emulation mechanisms.

For these reasons, we propose to conflate these mechanisms into two distinct possibilities: emulation and competition. As Dobbin et al (2007) argue, emulation offers a constructivist understanding of policy diffusion since it focuses on the role of ideas and the importance of social acceptance to the dissemination process. Policies diffuse not because of an objective examination of their effectiveness, but rather because of the meaning they hold for policy makers and by notions of their appropriateness. Policy paradigms offer cognitive maps that greatly influence policymakers since they provide “a framework of ideas and standards that specifies not only the goals of policy and the kind of instruments that can be used to attain them, but also the very nature of the problems they are meant to be addressing” (Hall, 1993: 279). Simmons et al (2006: 801) distinguish three main emulation processes: 1) powerful countries that are used as examples; 2) epistemic communities advocating a policy; and 3) influence from socio-cultural peer groups. In the first instance, leading countries become the key reference point as policymakers will copy from “the largest, richest, or fastest-growing countries”

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<sup>15</sup> These are not the only mechanisms for policy convergence discussed in the literature, but certainly the most prevalent. For alternative specifications of diffusion mechanisms see Bennett (1991: 220) who identifies emulation, elite networking, harmonization and penetration; or Braun and Gilardi (2007: 299) who focus on competitive and cooperative interdependence, coercion, learning, common norms, taken-for-grantedness, and symbolic imitation.

(Dobbin et al, 2007: 452). In the second case, as professional economists endorse new policy paradigms they influence the adoption of policies in areas as diverse as privatization strategies in Latin America and Europe (Meseguer, 2004) or European monetary integration (McNamara, 1999). Swank's (2006: 859-60) work on the dissemination of tax reform views emulation along the lines of the third mechanism, in that shared cultures and political histories pave the way for dissemination in a manner he portrays as akin to what the sociologist Castles described on his work about "families of nations."

Furthermore, the role of ideas in promoting regional integration or the spread of FTAs is receiving growing attention. Acharya (2000) for instance focuses on the importance of regionalist discourses to the process of region building. Oyane (2003: 107-108) describes the recent wave of FTAs in East Asia as one more example of policy bandwagoning, and the World Bank (2000) concurs that policy mimicry seems to be an important factor behind the spread of regionalism (World Bank 2000). Just as in the past Keynesianism or trade liberalism became entrenched concepts influencing policy-making, the idea of preferential trade liberalization is regarded as shaping how policy makers define their interests and plot their foreign economic strategies. Policy networks and communication among experts and policy makers become, then, critical channels through which emulation and dissemination of ideas take place. These channels are expected to aid the rapid diffusion of ideas regarding regional preferential trading arrangements among like-minded countries with social, cultural, and historical ties.

On the other hand, the competitive diffusion of policies takes place when a country's actions generate externalities for others, thereby creating an incentive to respond in kind (Braun and Gilardi, 2007). Therefore, when a competitor adopts a policy, the other country follows suit to remain attractive to foreign capital or to avoid loss of market share. More than national efficiency gains, competition arguments "stress the differential attractiveness of certain policies to investors and buyers in international markets" (Simmons et al, 2006: 792). So for instance, it is a concern with investment diversion that encourages developing nations to use bilateral investment treaties (BITs) to generate credible commitments on the fair treatment of foreign capital in order to outbid other potential hosts (Elkins et al, 2006: 825). Competitive diffusion models share

several assumptions: a) the policy innovation has the potential to influence material outcomes (FDI inflows, market share), b) these effects can be felt in the short to medium term so it makes sense for elected officials to adopt the new policies and claim credit, c) countries know which nations they are competing against and how intense the competition is,<sup>16</sup> and d) competition is a horizontal process amongst one's peers (Simmons et al, 2006: 792-793).

The diffusion literature, therefore, defines competition **exclusively** as an economic phenomenon that affects mostly countries lacking credibility or capital (i.e. mostly developing nations). In our view, however, competition -understood as the quest for *relative* advantage- is a multi-dimensional phenomenon comprising economic, political, and legal elements, which affects both large/industrialized nations and small/less advanced countries competing among their peers to secure preferential access abroad for their internationalized business sectors, to gain regional status, or to become more influential in defining the direction of the multilateral trading system.<sup>17</sup> In short, the process involves complex strategic calculations on the part of states as they engage in FTA negotiations. Therefore there is no guarantee that governments in the region will pursue coherent region-wide FTAs, as each country is influenced by a particular set of competitive pressures.

After clarifying the concepts of emulation and competition, we proceed to flesh out three testable hypotheses:

*Null hypothesis:* The chances that a country will launch an active FTA policy are not affected by the prior decision of other countries to negotiate preferential trade agreements (this is the null hypothesis for a diffusion model: independent decision making).

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<sup>16</sup> The intensity of a rivalry is measured by competitive distance among countries: a) how similar are their export patterns in terms of market destination and b) in terms of product profile, c) similarity in educational and infrastructural resources (Elkins et al, 2006).

<sup>17</sup> Simmons, Dobbin and Garrett (2006) discuss the actions of powerful countries in the promotion of liberalism as top-down diffusion in the form of hard or soft coercion. While we agree that industrialized nations reap the benefits of asymmetrical bargaining in North-South FTAs (see Pekkanen, Solís, Katada, 2007), we are reluctant to equate this with outright coercion since large countries frequently derive their bargaining leverage from the fact that the costs of no-agreement are higher for the smaller party, and not because of explicit threats of retaliation.

Emulation hypothesis: Countries will copy the FTA policies of their socio-cultural peers (identified by ‘psychological distance’: common language, religion, history) or of leading nations, as cross-national policy networks or epistemic communities play a pivotal role in the embrace of an FTA track. FTA policies that disseminate through emulation should be “omnidirectional” (i.e. once preferential trade agreements are deemed an appropriate international trade instrument, governments should be interested in negotiating as many FTAs as possible with little concern about sequencing) and “homogeneous” (FTAs should comprise standard rules that mirror closely those of reference nations).

Competition hypothesis: Countries will counteract the FTA policies of their competitors (identified by “competitive distance”: competition over markets and capital, status/leadership contests, and articulation of alternative models of economic integration). Business and economic bureaucrats concerned with trade and investment diversion and/or politicians and foreign affairs officials focused on the foreign policy implications of FTAs should be the main agents behind the country’s trade policy shift. FTA policies that spread through competition should be more “selective” (i.e. the pattern of counterpart choice, market access commitments, and rule-making in FTAs should reflect the desire to create or restore competitive advantage) and “heterogeneous” (FTAs should comprise a distinct package of trade and investment rules).

These hypotheses, therefore, generate clearly distinct expectations as to when countries will be sensitive to the actions of others (either reference nations or competitors); which domestic constituencies will champion the policy shift; and what are the observable implications of either emulation or competition in FTA outcomes. Moreover, these competing hypotheses also hold diametrically opposed views on the prospects of regional integration. While emulation should lead to a more coherent regional free trade area as countries imitate their cultural peers in adopting more homogeneous trade agreements; competition should produce fragmented and inconsistent FTAs within the same region (see Table 2).

[Table 2 around here]

In order to start operationalizing these variables, we have constructed aggregate measurements of competitive distance. Table 3 offers a first cut by comparing the export profile (by market of destination) of selected countries. Countries with very similar export profiles (measured by the weighted sum of a country's exports across all trading partners -averaged from 1995 to 2005) will report higher ratios. The weights represent each partner's total imports expressed as a ratio of world imports. In a nutshell, this indicator shows the extent to which countries have similar concentration of trading partners, thus, how a pair (appearing on the matrix) compete in third markets. Table 3 demonstrates that there is very intense competition (colored in red) between Japan and China, Mexico and the United States, as well as Thailand with Singapore and Indonesia. While a country with the least competition with the countries on the list is Chile.

Tables on export and import concentration are also useful in understanding the types of trade competition and in which countries they occur. Table 4 indicates how much the countries in our list capture the markets of large importers with their exports. For example, Japan, China and Mexico all capture a sizable share of the US market (each with 10-11 percent of US imports). In the case of the Chinese market, Japan, Korea, and the United States have a large presence. Finally, the United States and China alone supply close to one third of Japanese imports. Table 5 captures how large importers such as the United States and Germany (sorted by the country's share of world imports) are major markets of destination for the exporters listed. For example, the United States captures 26 percent of China's exports to the world, while 82 percent of Mexico's exports go to the United States. It is important to note, however, that the purpose of these tables is merely to provide a baseline since the trade competition measured here does not capture rivalry on specific products or the role of MNCs and intra-firm trade, both of which influence trade patterns.

[Tables 3, 4 and 5 around here]

The diffusion literature offers sophisticated quantitative tests for large-N studies of BITs dissemination (Elkins et al, 2006), the spread of market-oriented tax reform

(Swank, 2006), and public sector downsizing (Lee and Strang, 2006).<sup>18</sup> We opt, however, for process tracing methodology in assessing the extent to which a country's FTA policy is influenced by emulative or competitive diffusion forces. We argue that this qualitative methodology is better able to capture the less easily quantifiable signs of emulation and competition such as the emergence of policy paradigms, intense industry rivalries that are not captured by aggregate levels of economic exchange, diplomatic contests to enhance regional influence or security, and attempts to disseminate new rules on trade and investment. Our qualitative methodology informs the structure of all country chapters, as they test the alternative hypotheses outlined above. In so doing, all chapters ask a few basic questions: a) what triggered the policy change (purely domestic factors or actions of sociocultural peers or competitors)? b) how were the international pressures for diffusion channeled through the domestic policymaking process (who mobilized in favor of FTAs –epistemic communities, business, or bureaucrats- and/or is the decision making process top-down or bottom up?) c) To what extent do FTA outcomes (in terms of the timing and selection of countries, market access and rules commitments) approximate better the expectations of emulation or competition mechanisms?

#### **4. Competition as a Multi-Dimensional Concept**

A distinct trait of the diffusion model developed here is that it treats competition as a multi-dimensional process comprising economic, security, and legal motivations. In order to understand more fully how FTAs can be used to advance competitive goals along these issue-areas, three thematic chapters in this volume explore in depth the different logics of FTA competition. We summarize briefly these logics below, in order to discuss the implications of adopting a more expansive view of the range of competitive pressures and goals at stake in FTA proliferation

##### *Economic Competition*

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<sup>18</sup> Yet, these statistical analyses are sometimes confronted with the problem of finding adequate proxies for the variables they are testing. For instance, Weyland (2006: 14) objects to the frequent use in the diffusion literature of an IMF loan as evidence of coercion, since local elites may have sought the deal with the IMF to enhance their leverage over domestic reforms. For that reason, Weyland also opts for a qualitative methodology in his diffusion work on pension privatization.



Contrary to the most-favored nation principle of the WTO, the essence of FTAs is the exchange of trade and investment preferences that are not made available to third parties. Preferential liberalization, therefore, creates new incentives for private sector lobbies and governments to achieve competitive goals through these agreements. On the economic front, these objectives include improved market access through tariff and investment liberalization, the harmonization of product standards, policy coordination in areas such as competition and anti-dumping, or the elimination of non-tariff barriers (NTBs). Because these concessions are only extended to FTA parties, they enable member companies to out-compete their rivals through preferential treatment. FTAs also offer a potent form of non-transparent protectionism through rules of origin (ROOs) that can be manipulated to disadvantage non-member producers. Excluded parties, therefore, have a strong incentive to negotiate countervailing FTAs to minimize the effects of trade and investment diversion.<sup>19</sup>

These series of moves and countermoves of FTA negotiations create another competitive element that has received less scholarly attention: “concession linkage.” With the rapid multiplication of FTAs, preference erosion has become a real problem since the initial advantages secured by members of the first FTA are undermined as similar benefits are extended to other countries through subsequent preferential trade negotiations. Governments have adjusted to this possibility by introducing renegotiation clauses and periodic updating of preferences. FTA concessions are, therefore, not fixed, but can be adjusted over time. Further reflecting the interconnectedness of FTA negotiations, concession linkage also has signaling effects that influence a country’s bargaining behavior. FTA negotiators are keenly aware of the fact that tariff concessions in current FTA talks will become the minimum baseline for future FTA negotiations. This “shadow of the future” frequently persuades governments to adopt more defensive positions in on-going FTA talks, lest they lose bargaining power in subsequent FTAs.

Summing up, FTAs offer interest groups and governments the ability to get ahead in international economic competition in several different ways: preferential trade and investment access, onerous rules of origin for nonmembers, targeting of rents for

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<sup>19</sup> Along these lines, Manger (book manuscript) explains the proliferation of defensive North-South FTAs by highlighting the role of MNCs seeking preferential investment access in developing countries to reap early-mover advantages and/or to reduce production costs in fragmented production chains.

investors and exporters while maintaining the mantle of protection for uncompetitive sectors, and concession linkage to secure better deals in subsequent trade talks.

### Political/Security Competition

Free trade agreements are also useful in pursuing non-economic foreign policy objectives. Traditionally, this agenda has been discussed in terms of alliance politics. FTAs can be a useful tool in affecting inter-state alignment patterns by establishing closer economic links with security partners, employing them as confidence building measures vis-à-vis rivals, or using them instead to isolate competitors by excluding them from economic cooperation agreements negotiated with other nations. FTAs can also be used to increase a country's political influence or status, and the degree of ambition on this front is heavily influenced by a country's power resources (both hard and soft forms of power). So for instance, for medium-sized countries, FTAs offer the opportunity of acquiring greater visibility in the politics of international trade as they establish themselves as trade hubs (for instance, Chile, Mexico, South Korea and Singapore have emphasized this goal). For large countries, it is about emerging as credible regional leaders capable of acting as focal points in the integration process, thereby defining the membership of the regional bloc, the sequence of the integration movement, and offering if necessary side payments (Mattli, 1999). For example, Japan, China, and the United States are currently vying for this position in East Asia.

### Legal Competition

The difficulty the WTO has experienced in adopting a new set of trade rules on issues such as investment protection, competition policy, and labor or environmental standards, has created an incentive for many countries to compete through their FTAs in the definition and dissemination of new rules in these areas. FTAs are attractive venues for adoption of new rules on trade and investment that have proven unwieldy at the multilateral level for several reasons. First of all, there is the advantage of small numbers of partners, as it is easier to reconcile the preferences. Second, these preferential negotiations allow for the selection of "common view" partners with similar positions on the negotiation agenda. And third, because many of the recent FTAs pair industrialized

with developing nations, the larger party uses its asymmetric market power to gain control over the negotiation agenda (Pekkanen, Solís, and Katada, 2007). Developing nations are prepared to make concessions bilaterally (i.e. incorporation of the new issues in international trade and investment) that they are unwilling to make multilaterally lured by the prospect of preferential access to important export markets and the desire to attract inflows of foreign direct investment (Ethier, 1998). But there is a strategic calculation as well: holding out on multilateral commitments increases the attractiveness of these developing nations as FTA partners since only through preferential trade negotiations will they endorse some WTO plus commitments.

The race to push for the adoption of new rules on trade and investment through FTAs is guided by two fundamental objectives. One, which we label standard setting, seeks the dissemination across several FTAs of a new rule or standard that can later on be incorporated more widely at the multilateral level (for example, intellectual protection, investment protection, or anti-dumping disciplines). The second objective, we describe as a strategy of lock-in whereby nations offer alternative models of economic integration that differ in the degree of legalization, escape clauses, and the scope of WTO plus commitments. For both legal strategies early mover advantages are very strong since the first preferential negotiations usually set important precedents so that the first commitments become default approaches guiding subsequent negotiations. Thus, the term “race” quite literally describes FTA proliferation.

### *Implications*

The decision to adopt a multi-dimensional characterization of competition that goes beyond defensive economic interests has important implications for the analysis of FTA proliferation. First, it raises the possibility that the rapid spread of FTAs is due to their “flexibility benefits.” In other words, governments approve of the fact that they can pursue multiple goals through FTA diplomacy in ways that may not be possible through other instruments. This is clear particularly in contrast to BITs: through FTAs, policymakers can simultaneously push for trade and investment liberalization, and due to their deeper integration agenda including economic cooperation clauses, they can more effectively boost diplomatic relations with selected countries. Consequently, and more

problematic for the analyst, FTAs may frequently be “over-determined” since they may be animated by different competitive pressures. We believe that the task of sorting out the weight of these competitive pressures triggering individual FTAs should begin with a clear demarcation of the competitive goals at stake in each issue-area as the thematic chapters in this volume attempt to do. Furthermore, there could be a marked contrast among governments regarding the type of competitive pressure that triggers FTA frenzy. For example, small trade dependent countries such as Chile might perceive economic competition as a formidable force. Meanwhile, given the historical and geopolitical context, Japan and China may be sensitive to political points that they can score through FTAs with smaller partners. Finally, in our view, the conceptualization of competition as a multi-dimensional process enriches the research agenda in one more way: it underscores the very real tradeoffs among competitive goals and focuses our attention on the ways in which governments may negotiate among contradictory competitive goals.

### **5. Overview of the chapters in this volume**

(To be developed more fully later as we read the second draft of the chapters)

### **6. Final Remarks**

(To be developed more fully later as we read the second draft of the chapters)

*Contributions of this project:*

- 1) In this project, we have attempted to offer a novel analysis of the FTA frenzy that connects the proliferation of FTAs to the burgeoning policy diffusion literature. This allows us to consider whether the forces of emulation or competition, found to be so powerful in the studies of dissemination of market reform and democracy, are responsible for the rapid spread of free trade agreements.
- 2) We expand the notion of competition prevalent in diffusion studies to encompass economic, security and legal motives, and this allows us to also probe into the ways in which governments respond to contradictory competitive goals.

3) We highlight the interconnection among FTAs by going beyond the notions of trade and investment diversion, and noting the significance of concession linkages at the time of negotiation and the incorporation of renegotiation clauses to address the phenomenon of preference erosion.

4) We put on the table an interesting proposition to assess: whether the competitive incentives behind FTA proliferation may weaken the emergence of coherent trade blocs in different ways: through preference erosion of earlier FTAs; by weakening regional solidarity as individual members of existing trade groupings negotiate separate trade deals with larger nations; and by encouraging cross-regionalism or the development of alternative FTA networks within the same region.

The findings of this research project regarding the mix of objectives and specific mechanisms through which some of the most active preferential traders construct their FTA networks, should also be of interest to policy-makers seeking to understand the drivers, direction, and consequences of the ever-expanding number of FTAs in the world economy.

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Table 1

## Partner Trade as % of Country Trade with World (avg.)

Country	Partner	FTA in effect	1980-1989	1990-1999	2000-2005
Chile	Canada	1997	1.56	1.46	1.89
	Mexico	1999	0.70	2.34	3.58
	Costa Rica	2002	0.00	0.07	0.03
	El Salvador	2002	0.00	0.03	0.08
	EC	2003	28.72	24.23	20.32
	United States	2004	21.76	18.51	15.91
	S. Korea	2004	1.65	3.34	3.86
	EFTA*	2004	0.94	0.86	0.71
	LAIA**	1981	19.65	20.97	25.62
China***	ASEAN****	2003	5.30	6.70	8.81
	Bangkok Agreement*****	2002	0.54	5.57	8.59
	Hong Kong	2004	20.45	21.31	10.52
	Macao	2004	0.54	0.35	0.16
Mexico	Japan	2005	5.96	3.18	2.91
	Chile	1999	0.19	0.38	0.45
	NAFTA	1994	64.40	79.20	75.75
	Israel	2000	1.20	0.13	0.11
	EFTA*	2001	0.70	0.59	0.35
	Colombia, Venezuela	Signed	0.50	0.63	1.72
	Nicaragua	1998	0.18	0.03	0.05
	Costa Rica	1995	0.20	0.12	0.24
	EC	2000	16.41	8.73	7.02
	El Salvador	2001	0.20	0.11	0.09
	Honduras	2001	0.09	0.06	0.06
	Guatemala	2001	0.35	0.24	0.21
	Bolivia	Negotiation	0.01	0.02	0.01
	Uruguay	Negotiation	0.16	0.08	0.05
	LAIA**	1981	3.98	2.91	2.85
Japan	Malaysia	2006	1.97	2.93	2.88
	Mexico	2005	0.87	0.79	0.77
	Singapore	2002	2.13	3.22	2.57
Singapore	AFTA****	1992	20.00	23.66	29.27
	EFTA*	2003	0.91	1.03	1.08
	Japan	2002	14.58	13.86	9.82

	Jordan	2005	0.03	0.02	0.01
	New Zealand	2001	0.61	0.27	0.29
	S. Korea	2006	1.75	3.04	3.92
	Australia	2003	2.64	2.00	2.44
	United States	2004	16.78	17.89	14.31
South Korea	Chile	2004	0.33	0.52	0.48
	Singapore	2006	1.41	2.76	2.41
	EFTA*	2006	1.23	1.26	0.70
	Bangkok Agreement*****	1976	4.23	10.81	19.09
	United States	Signed	28.28	21.20	16.78
United States	Central America-DR*****	2006	0.99	1.38	1.51
	Chile	2004	0.33	0.41	0.38
	Jordan	2001	0.08	0.03	0.05
	Australia	2005	1.43	1.17	0.96
	Bahrain	2006	0.05	0.05	0.04
	Israel	1985	0.76	0.86	1.02
	Morocco	2006	0.08	0.06	0.04
	Singapore	2004	1.41	2.25	1.61
	NAFTA	1994	24.42	28.67	31.45
	S. Korea	Signed	3.04	3.26	3.10
	Oman	Signed	0.07	0.04	0.04

\*EFTA is Iceland, Liechtenstein, Norway & Switzerland. Partner data is the sum of DOTS data for Iceland, Norway, & Switzerland. Liechtenstein is not included as a separate entry in DOTS data.

\*\*LAIA is Argentina, Bolivia, Brazil, Chile, Colombia, Cuba, Ecuador, Mexico, Paraguay, Peru, Uruguay, & Venezuela. Partner data is the sum of DOTS data these countries.

\*\*\*In DOTS data, China is divided into Mainland, Hong Kong, and Macao. Because WTO treats the deals with HK and Macao as separate RTAs, the data here labeled as "China" represents only the Mainland.

\*\*\*\*ASEAN is Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, Vietnam. Data here is the DOTS sum for these countries.

\*\*\*\*\*Bangkok Agreement is with Bangladesh, S. Korea, India, Laos, & Sri Lanka. Partner data is the sum of DOTS data for these countries.

\*\*\*\*\*CAFTA-DR is with Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, and Nicaragua

**Table 2**  
**FTA diffusion: Emulation versus Competition**

<b>Diffusion Pressures</b>	<b>Domestic Policy-making Process*</b>	<b>Country FTA Outcomes</b>	<b>Regional Integration Outcomes</b>
<p align="center"><b>Emulation</b></p> <p>Prior actions of socio-cultural peers or leading nations increase information about a policy and pave way for its social acceptance</p>	<p>Epistemic communities play leading role in influencing policymakers</p>	<p><i>Omnidirectional</i> (negotiate with as many partners as possible with little concern about sequencing)  <i>Homogeneous</i> (negotiate FTAs with standard rules that mirror closely those of reference nations)</p>	<p>Coherent regional integration process as shared views on the merits of FTAs and homogenous agreements pave the way for rounds of enlargement</p>
<p align="center"><b>Competition</b></p> <p>Prior actions of competitors that:</p> <ul style="list-style-type: none"> <li>• Create trade and investment diversion, and/or</li> <li>• Increase the relative influence of rival states, and/or</li> <li>• Disseminate alternative models of regional integration</li> </ul>	<p>Business groups, economic bureaucrats, politicians or foreign affairs officials push for FTA policy shift</p>	<p><i>Selective</i> (choice of partners, timing of negotiations and market access commitments reflect strategic calculus to advance competitive advantage)  <i>Heterogeneous</i> (push for distinct packages of trade and investment rules)</p>	<p>Fragmented regional integration process as competitive dynamics produce preference erosion of earlier FTAs; weaken the solidarity of existing regional subgroups as individual members negotiate separate trade deals; encourage cross-regionalism and/or the development of parallel FTA networks</p>

Notes: The model is agnostic on the whether policymaking process is top-down or bottom-up and expects national variation in decision-making patterns

**Table 3. Competitive Distance: Similarity in export profiles by market of destination (average 1995-2005)**

	China, P.R.	Japan	US	Mexico	Korea	Malaysia	Singapore	Thailand	Indonesia	Philippines	Chile
China, P.R.	1										
Japan	0.996	1									
United States	0.751	0.755	1								
Mexico	0.664	0.667	0.884	1							
Korea	0.314	0.316	0.419	0.473	1						
Malaysia	0.210	0.211	0.279	0.316	0.667	1					
Singapore	0.164	0.165	0.219	0.247	0.523	0.784	1				
Thailand	0.140	0.141	0.187	0.211	0.446	0.670	0.854	1			
Indonesia	0.114	0.115	0.152	0.172	0.363	0.544	0.694	0.812	1		
Philippines	0.091	0.091	0.121	0.137	0.289	0.433	0.552	0.647	0.796	1	
Chile	0.039	0.039	0.051	0.058	0.123	0.185	0.235	0.276	0.339	0.426	1

	0.99 - 0.80		0.59 - 0.40		0.19 - 0.00
	0.79 - 0.60		0.39 - 0.20		

**Footnotes: The competitive distance is calculated based on the following method:**

1. The export profile of each country is first estimated through a weighted sum of each of its trading partner's export share multiplied by that partners' share of world imports.
2. Next, the export profiles of pairs of countries are compared as a simple ratio. The higher the ratio, the more similar is their distribution of exports by market of destination.

Source: IMF, Direction of Trade Yearbook

**Table 4: Top exporters in large importing nations (%)**

IMPORTER	EXPORTER										
	China, P.R.	Japan	United States	Mexico	Korea	Malaysia	Singapore	Thailand	Indonesia	Philippines	Chile
<b>United States (17%)</b>	10.37	11.28	-	10.29	2.96	2.05	1.53	1.34	0.90	0.94	0.34
<b>Germany (8%)</b>	4.04	4.32	7.57	0.26	1.08	0.65	0.68	0.45	0.44	0.33	0.17
<b>Japan (5.4%)</b>	16.14	-	18.60	0.51	4.80	3.30	1.62	2.97	4.18	1.63	0.82
<b>France (5.1%)</b>	2.58	2.33	6.79	0.16	0.59	0.41	0.64	0.37	0.27	0.09	0.23
<b>United Kingdom (5%)</b>	2.78	4.29	11.77	0.22	1.24	0.94	1.26	0.70	0.48	0.40	0.20
<b>Italy (3.8%)</b>	3.09	2.09	4.47	0.12	0.90	0.26	0.16	0.37	0.42	0.07	0.37
<b>Canada (3.6%)</b>	4.28	4.39	63.34	3.22	1.35	0.67	0.36	0.49	0.27	0.29	0.22
<b>China,P.R. (3.6%)</b>	-	17.83	9.26	0.30	10.50	2.77	2.50	1.92	1.50	1.20	0.55

**Footnotes:**

1. Each cell in a column shows the market share of an exporter in the total imports of an importer. For example, 10.37% of the US imports come from China.
2. Importers are sorted by their share of total world imports (percentages in parentheses after the name of the country).



**Table 5: Key destination markets for selected exporters (%)**

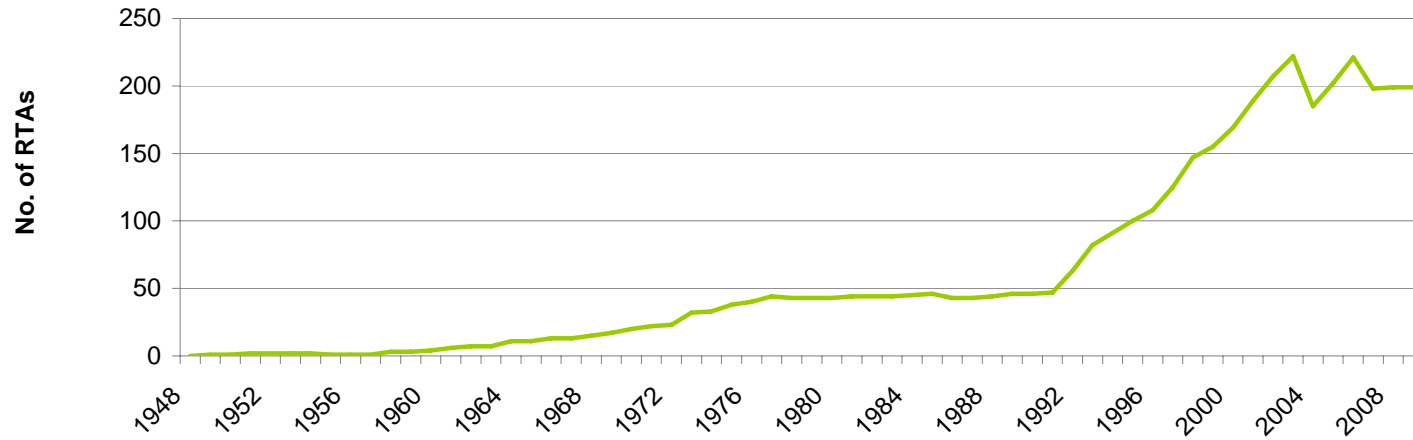
IMPORTER	EXPORTER										
	China, P.R.	Japan	United States	Mexico	Korea	Malaysia	Singapore	Thailand	Indonesia	Philippines	Chile
<b>United States (17%)</b>	25.88	26.23	-	81.83	19.39	20.43	16.41	20.16	16.06	26.25	17.46
<b>Germany (8%)</b>	4.64	4.62	5.10	0.94	3.27	2.98	3.37	3.13	3.61	4.30	4.15
<b>Japan (5.4%)</b>	12.84	-	8.68	1.29	10.03	10.47	5.55	14.24	23.78	14.54	13.53
<b>France (5.1%)</b>	1.92	1.62	2.98	0.38	1.16	1.23	2.05	1.67	1.43	0.79	3.64
<b>United Kingdom (5%)</b>	2.07	2.98	5.16	0.51	2.44	2.79	4.05	3.14	2.54	3.34	3.03
<b>Italy (3.8%)</b>	1.71	1.07	1.45	0.20	1.31	0.58	0.39	1.22	1.65	0.44	4.22
<b>Canada (3.6%)</b>	2.28	2.17	19.73	5.45	1.89	1.42	0.83	1.56	1.04	1.73	2.44
<b>China,P.R. (3.6%)</b>	-	10.21	3.34	0.59	16.94	6.79	6.61	7.09	6.59	8.27	7.06

**Footnotes:**

1. Each cell in a column shows the share of an importer in the total exports of an exporter. For example, 25.88 % of China's exports go to the United States.

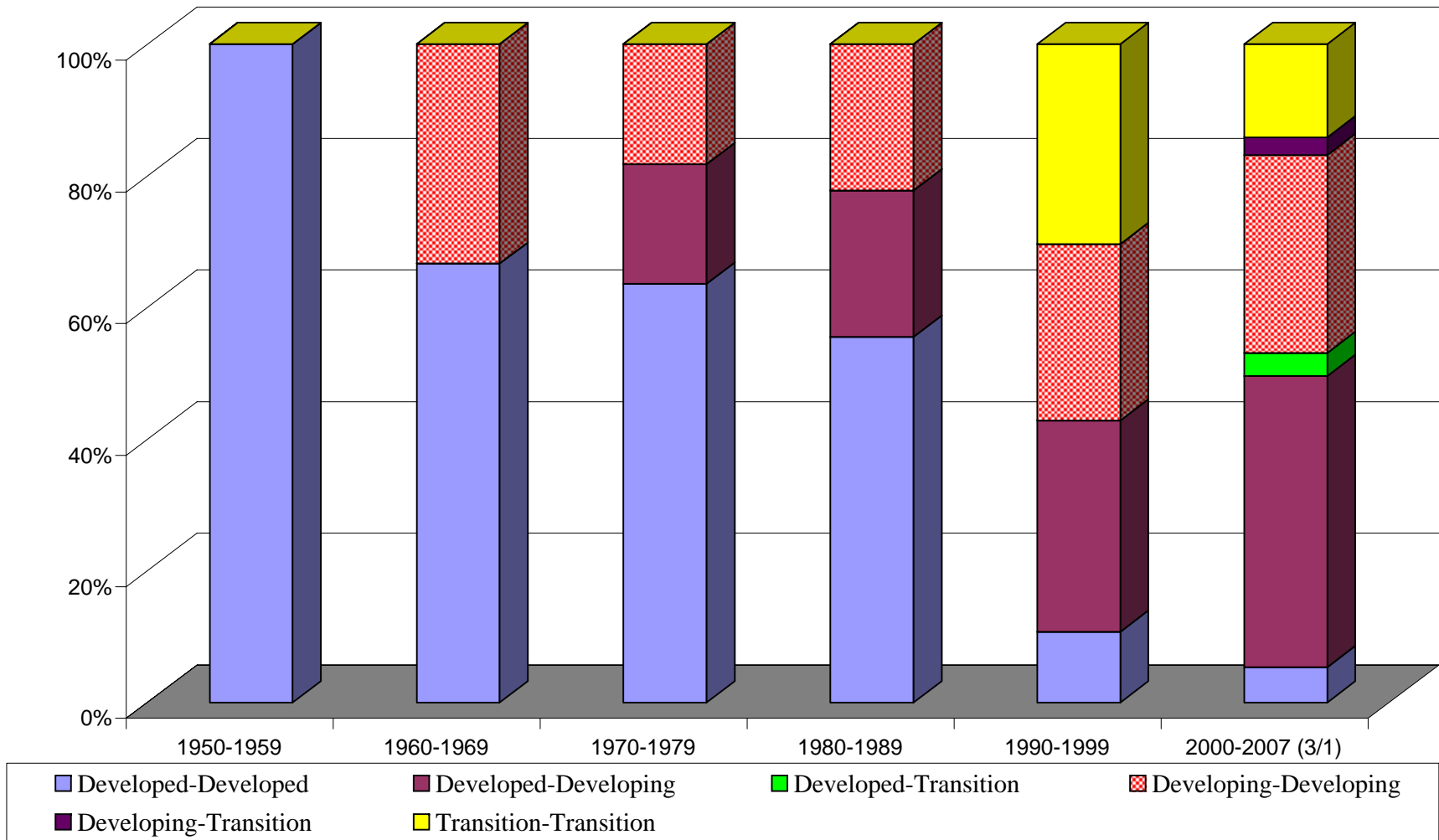
2. Importers are sorted by their share of total world imports (percentages in parentheses after the name of the country) .

**Chart 1: FTA Diffusion in the World Economy**  
(cumulative RTAs by date of entry into force)

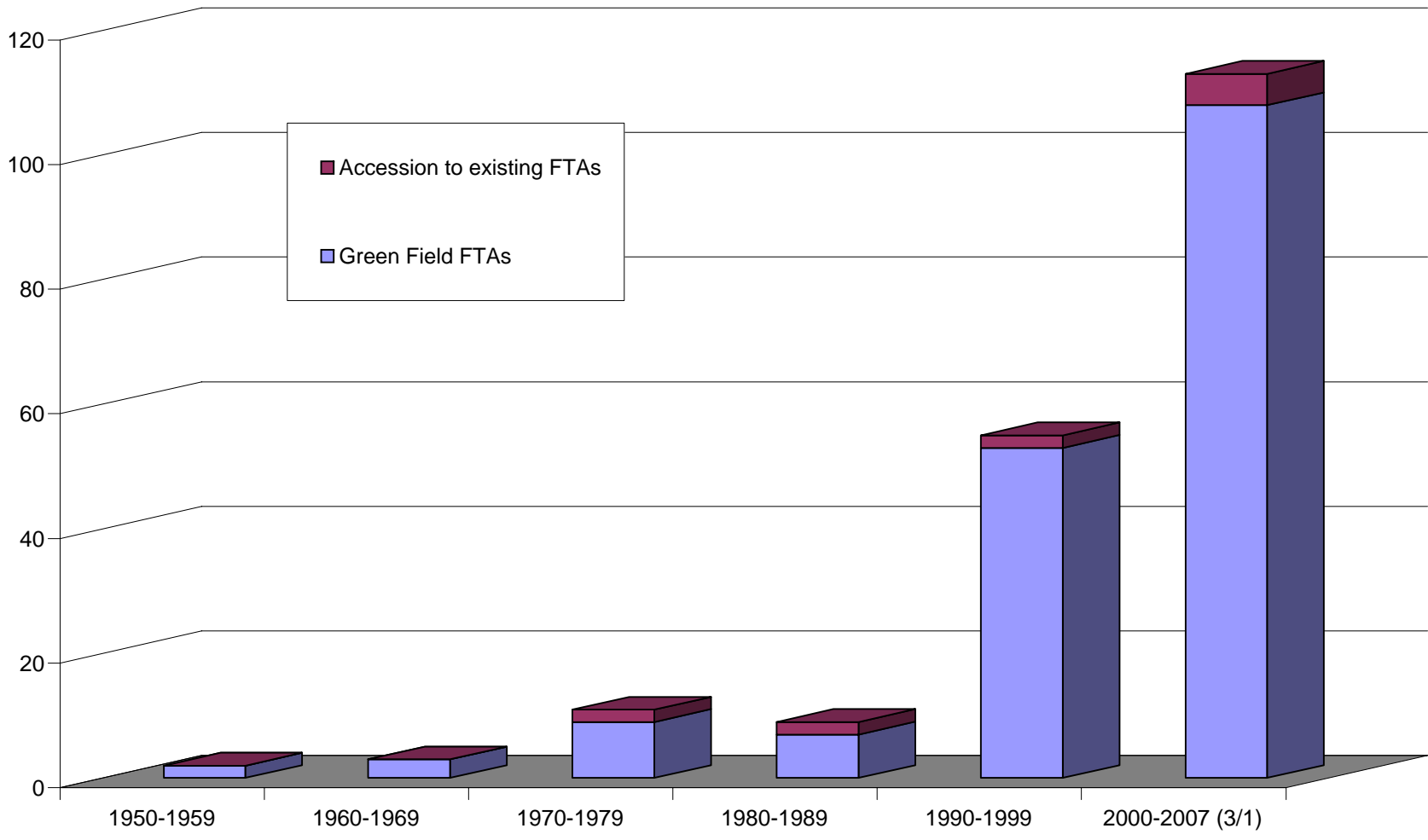


Source: [http://www.wto.org/english/tratop\\_e/region\\_e/regfac\\_e.htm](http://www.wto.org/english/tratop_e/region_e/regfac_e.htm)

**Chart 2: FTA Partnerships among Developed and Developing Countries**



**Chart 3: FTA Diffusion: Enlargement versus Proliferation**  
(number of RTAs reported to the GATT/WTO by decade)



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