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Ishiguro, Kaoru

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KOBE UNIVERSITY

RETHINKING THEORY OF HEGEMONIC STABILITY: TOWARD A THEORY OF HEGEMONIC COOPERATION

By KAORU ISHIGURO

The purpose of this paper is to critically reexamine how the theory of hegemonic stability understands the stabilization of international economic order, with a focus on the power of the hegemon, or the strategy of reciprocity. This paper also reviews a structure of a theory of hegemonic cooperation, and the possibility of international cooperation after hegemony.

1. Introduction

A hegemonic system is an international system in which the stability of international economic order is maintained by a hegemon. The theory of hegemonic stability, argued by Kindleberger and others, emphasizes the importance of the will and ability of a hegemon in the stabilization of international economic order, but does not provide sufficient analysis of the roles played by the power of the hegemon and by non-hegemons. The power of the hegemon, along with the hegemonic international regime, plays an important role in the stabilization of international economic order. Non-hegemons, which are major actors in a hegemonic system, also play a significant role in the stabilization of international economic order.

We aim to critically reexamine how the theory of hegemonic stability understands the stabilization of international economic order, with a focus on the power of the hegemon, or the strategy of reciprocity. We will also review a structure of a theory of hegemonic cooperation, and the possibility of post-hegemonic international cooperation. It will be shown how the power of a hegemon, which is not clear in the theory of hegemonic stabilization, plays a primary role in the theory of hegemonic cooperation, and also how countries' reciprocal strategies play an important role in international cooperation in the post-hegemonic era.

During the process of the stabilization of international economic order, countries may fall into the dilemma of cooperation. For example, regarding the formation of the free trade system, it is necessary to consider not only the economic benefits that free trade will bring, which are emphasized in standard trade theories, but also the cost of the political and economic transactions to organize and operate the free trade system. Where such transaction costs, transaction-specific investment for trade, or the danger of opportunism exists, countries may fall into the dilemma of cooperation during the period in which the free trade system is formed. Yarbrough and Yarbrough indicated this point using the economics of transaction cost (Yarbrough and Yarbrough, 1986, 1987, 1992).

Where the dilemma of international cooperation exists, the governance system to avoid such a dilemma is necessary to promote the stabilization of international economic order. Theories of hegemony argue that the hegemon plays the role of the governance system. The theory of hegemonic stability by Kindleberger (1973, 1981), Gilpin (1975, 1987), and Krasner (1976) emphasizes the importance of the will and ability of the hegemon in the organization and operation of the free trade system, but does not give a clear explanation on the roles played by the power of the hegemon, or by non-hegemons. A theory of strategic organization in hegemonic cooperation by Yarbrough and Yarbrough (1987, 1992) offers a clear analysis of incentives for the hegemon and non-hegemons to liberalize trade, but does not clarify the role of the hegemon's power. Alt, Calvert, and Humes (1988) give a clear analysis of the role of the hegemon's power, but their interest lies more in securities issue, than in the stabilization of international economic order.

The power relationship between countries (i.e. reciprocity) plays an important role also in the stabilization of international economic order in the post-hegemonic era. A way to promote the stabilization of international economic order in the post-hegemonic international economic community is the conclusion of a self-binding international economic agreement. Where there is such an international economic agreement, a strategy of reciprocity (i.e. trigger or tit for tat) is adopted between countries under the influence of hidden power.

This paper is organized as follows. Section 2 reviews transaction cost, transaction-specific investment, and danger of opportunism, and clarifies the possibility of countries falling into the dilemma of cooperation during the process of the stabilization of international economic order. Section 3 examines how the theory of hegemonic stability understands the stabilization of international economic order, and indicates that the theory lacks the analysis of the roles played by the power of the hegemon and by non-hegemons. Section 4 deals with other problems concerning the theory of hegemonic stability. Section 5 reviews how the theory of hegemonic cooperation understands the stabilization of international economic order, with a focus on the power of the hegemon, and examines the U.S. strategy of reciprocity. Section 6 examines self-binding international economic agreements, which promote the stabilization of international economic order in the post-hegemonic international community. Section 7 provides a summary of the discussion in this paper.

2. Dilemma of International Cooperation

Countries may fall into the dilemma of cooperation during the process of the stabilization of international economic order, due to transaction cost, transaction-specific investment, or danger of opportunism. In this section, the formation and the maintenance of the free trade system, which are major analytic subjects in the theory of hegemonic stability, are discussed to indicate the necessity of the governance system to avoid the dilemma of international cooperation (Yarbrough and Yarbrough, 1986, 1987, 1992).

2.1 Transaction cost and transaction-specific investment

(1) Transaction cost: Trade liberalization brings trade benefits to countries as a result of improved efficiency of resource allocation among industries as standard trade theories indicate. On the other hand, however, it breeds transaction costs (e.g. expense for search and information, negotiation and contracts, and supervision and execution) to compensate for those who suffer loss due to such inter-industry resources allocation and trade.[1)] That transaction cost is the political and economic cost along with economic benefits that the trade liberalization produces. Trade liberalization is promoted if the transaction cost is kept sufficiently low by well established market and compensation mechanisms, and is hampered if the transaction cost is sufficiently high due to underdeveloped mechanisms.

The presence of transaction costs explains two problems related to the formation and maintenance of the free trade system. First, the presence of transaction costs obstructs trade liberalization agreements between countries. Sufficiently high transaction costs make it difficult for a trade beneficiary to compensate those who suffer loss due to trade. As a result, those who suffer loss in trade liberalization will call for trade restrictions. Such a demand, if it becomes a sufficiently strong political pressure, results in protected trade. Because benefits produced by trade restriction tend to be concentrated in certain sectors or regions, it is relatively easy for countries to avoid the issue of collective action (Olson, 1965) in materializing trade restrictions.

Second, the presence of transaction costs provides incentive to countries to seek opportunism and undermines the feasibility of a trade liberalization agreement. Opportunistic behaviors include intentional distortion of information, false promises, and breaking of promises, to seek self-interest. A country committing such a breach can gain by escaping transaction costs of trade liberalization as long as the other party observes the trade agreement. Opportunistic protectionism means adopting trade restrictions by violating trade agreements in the said manner.

Trade liberalization is hampered if the presence of transaction costs provides countries an incentive to seek opportunism, and opportunistic protectionism prevails as a result.[2)] Opportunistic protectionism is difficult to identify and can be practiced extensively. First, a perception gap concerning the substance of the agreement that may arise between

1) North argues that transaction cost mainly consists of cost to measure goods or services under incomplete information, and cost for contracts and execution (North, 1990). Williamson also has discussed the issues of transaction cost and opportunism (Williamson, 1975, 1983, 1986). Yarbrough and Yarbrough used these issues to support their theory of international trade (Yarbrough and Yarbrough, 1986, 1987, 1992).

2) Fukushima pointed out five conditions for the U.S.-Japan economic talks to succeed (Fukushima, 1992, p.182). First, the agreement should truly meet the way of thinking on both sides. Second, the Japanese government should implement the agreement as it promises. Third, the Japanese industry should not obstruct the true intention of the agreement. Fourth, the American government should monitor the implementation of the agreement. Fifth, the American industry should use the new market created by the agreement to the full extent. It is not easy to satisfy all these conditions. More importantly, he also indicated that if problems occur, they always occur after negotiations are settled in the form of the conclusion of an agreement.

signatories can be intentionally used for opportunistic protectionism.[3] Second, trade liberalization agreements, having escape clauses for unpredictable accidents (e.g. the safeguard provision in Article 19 of GATT), are not always binding. Conflict of opinions may occur concerning the applicability of escape clauses to specific situations, allowing escape clauses to be used for opportunistic protectionism. Third, it is not always possible to definitively judge whether a specific conduct is permissible under a trade liberalization agreement. For example, when a country has a domestic industry promotion policy that also has influence on trade, it may not be clear whether that really is an industrial policy, or a trade policy that has a specific intention for trade effect.

(2) Transaction-specific investment: Trade liberalization is significantly influenced also by the presence of investment specifically for transactions that are related to trade (Yarbrough and Yarbrough, 1987). International trade tends to change a country's production and distribution systems, and to result in the formation of assets for trade-related transactions. Growth of manufactured-goods trade, especially of intermediate goods trade or intra-industry trade, is accompanied by a increase in investment for trade-related transactions. For a trade liberalization agreement, the presence of production and distribution capacity and intangible assets for trade is significant because, where such capacity or assets exist, opportunistic protectionism would result in grossly excessive capacity and economic loss. An example of transaction-specific investment is the investment by aircraft component manufacturers outside of the United States to supply special components to the American aircraft industry.

Costs to produce goods specifically for trade are often sunk costs. Therefore, if the transaction is terminated, companies cannot divert their production and distribution systems and intangible assets for other purposes. Transaction-specific investment is vulnerable to opportunistic protectionism. The presence of transaction-specific assets exposes a party to the risk of losing more than what those assets are worth to them when the assets are used for alternative applications, to the other party. The insurance, which countries need when participating in trade liberalization, increases with the potential loss that opportunism may bring.[4]

2.2 Dilemma of trade liberalization

The presence of transaction costs, trade-related transaction-specific investment, and opportunism creates possibility for countries to fall into the dilemma of trade liberalization. Consider trade liberalization between Countries A and J. Assume that their

3) Regarding the figure of 20% market share of foreign products in the Japanese market, agreed to in the 1991 U.S.-Japan semiconductor trade agreement, there was a perception gap between the two countries: the United States regarded it as a guarantee and Japan regarded it as a target. From the American point of view, it was opportunistic protectionism that Japan did not guarantee the market share.

4) Krugman (1989) makes a similar argument on the relationship between exchange rate fluctuation and international trade, using the sunk cost model.

strategy set, X_A and X_J, consist of two strategies, namely, free trade strategy (f) and protected trade strategy (p) ($X_A = X_J = \{f, p\}$). Then, four types of social situations are possible as a result of different combinations of their strategies: $x = (f, f), y = (f, p), z = (p, f)$, and $w = (p, p)$. Utility indicator functions u_A and u_J are chosen as appropriate to indicate that R_A and R_J are the preferred orders for $X = \{x, y, z, w\}$ of respective country. Utility indicator value (i.e. payoff) is set as follows. $u_A(x) = F_A, u_A(z) = T_A, u_A(y) = S_A, u_A(w) = P_A, u_J(x) = F_J, u_J(y) = T_J, u_J(z) = S_J, u_J(w) = P_J$.

TABLE 2.1 Trade liberalization payoff matrix

A \ J	free trade	protected trade
free trade	(F_A, F_J)	(S_A, T_J)
protected trade	(T_A, S_J)	(P_A, P_J)

Table 2.1 shows the strategies and the payoff matrix of this trade liberalization game. The left column shows payoff for Country A; the right column, for Country J. When Country J agrees to liberalize trade, and makes investment for trade-related transaction, Country J expects to gain F_J (payoff under free trade system (x)). The decision by Country J to participate in the free trade system is probably based on the expectation that F_J will be larger than P_J (its payoff under protected trade system (w)) ($F_J > P_J$). Assume that Country A, on the other hand, needs to pay transaction costs for trade liberalization, and is under the influence of incentives for opportunistic protectionism. If Country A adopts opportunistic protectionism, nullifying the value of Country J's transaction-specific investment, the payoff for Country $J(S_J)$ may become smaller than the payoff (P_J) it enjoyed before participating in the free trade ($P_J > S_J$). Incentives for Country J to participate in trade liberalization process are dampened when Country A's adoption of opportunistic protectionism may make Country J's payoff (S_J) smaller than its payoff before trade liberalization (P_J), as in this case.

TABLE 2.2 Dilemma of trade liberalization

A \ J	free trade	protected trade
free trade	(4, 3)	(1, 4)
protected trade	(3, 1)	(2, 2)*

Next, consider each country's payoff matrix in the case shown in Table 2.2. The countries' preferred orders R_{A} and R_{J} are as follows; $R_{\mathrm{A}} : x, z, w, y, R_{\mathrm{J}} : y, x, w, z$. Here, assume a game under the following rules: neither country can change any action it has taken; the countries choose strategies simultaneously, or each country chooses its strategy without knowing the other's strategy; and the game is played only once. Under these rules, vulnerability of transaction-specific investment against opportunistic protectionism makes protected trade Country J's dominant strategy. In this game, notwithstanding that both countries prefer free trade system (x) to protected trade system (w), the protected trade system will result, and the trade liberalization game will fall into the cooperation dilemma. The nature of the dilemma of trade liberalization depends on the structure of the game.

Where trade-related transaction-specific investment does not exist, the influence of opportunistic protectionism is limited. In such a situation, unilateral trade liberalization can be done, as in the case of 19$^{\mathrm{th}}$ century Britain. If, however, conditions necessitate large scale trade-related transaction-specific investment, creating a possibility for the trade liberalization game to fall into the cooperation dilemma, some kind of governance system to avoid such a dilemma is necessary to allow for the formation of a free trade system. However, the completion of the trade liberalization process does not automatically promise stable international economic order because uneven development among countries may destabilize international economic order. An international governance system is necessary to maintain stable international economic order by eliminating that possibility, too.

The theories of hegemony underline the importance of the role of the hegemon as a system to govern trade liberalization and to maintain stable international economic order. Examples of such a governance system that stabilizes international economic order are the United States or the hegemon, and the IMF-GATT system after World War II.

3. Structure of the Theory of Hegemonic Stability

The theory of hegemonic stability is based on the theory of public goods and the theory of collective action, and understands stable international economic order as international public goods supplied by a hegemon. The theory of hegemonic stability has two models: the benevolent leadership model and the coercive leadership model (Snidal, 1985).

3.1 Benevolent leadership model

The first model is the benevolent leadership model proposed by Kindleberger (1973, 1981). Kindleberger was the first to point out the relationship between a hegemonic system and international public goods, and emphasized the importance of the benevolence of a hegemon to supply international public goods. According to his model, a free trade system has the nature of international public goods, and it requires a "benevolent

monarch" for it to be delivered. Where there are many countries of relatively similar power levels, there is a possibility that these countries fall into the cooperation dilemma. A hegemon, however, prevents the dilemma by changing the payoff matrix to what is shown in Table 2.3, for example, and organizes and operates the Pareto optimum free trade system.

TABLE 2.3 Benevolent leadership model

H \ N	free trade	protected trade
free trade	(4, 3)	(2, 4)*
protected trade	(3, 1)	(1, 2)

In case of the payoff matrix in Table 2.3, the preferred orders for the hegemon (H) and the non-hegemon (N), R_{H} and R_{N}, are as follows; $R_{\mathrm{H}} : x, z, y, w, R_{\mathrm{N}} : y, x, w, z$. The preference of the non-hegemon (N) is the same as that of Country J in the trade liberalization dilemma in Table 2.2. For the hegemon, however, free trade is significant, and constitutes its dominant strategy. Regardless of the action of the non-hegemon, the hegemon prefers free trade: non-hegemons become free-riders of the free trade system, anticipating such preferences of the hegemon.[5] For example, while Pax Americana was being formed after World War II, the United States adopted a unilateral market opening policy toward its western allies under the Cold War regime. In this kind of model, a hegemon plays the same role as the role which Olson argues that a privileged group plays in his theory of collective action (Olson, 1965). A privileged group means a group under the influence of incentives to supply public goods even if one or more members need to bear the whole cost of that supply.

A problem of this model is that a hegemon's actions are not always consistent with its rational self-interest or stable supply of international public goods.[6] If a hegemon unilaterally bears the economic burden for international public goods, this would uplift the relative status of competitive non-hegemons to the hegemon's disadvantage. Also, if economic burdens for the hegemon accumulate, a stable supply of international public goods is hampered unless further economic growth is warranted for the hegemon (Gadzey,

5) Snidal (1985, p.581) argues that the theory of hegemonic stability has two propositions. First, the hegemon leads countries to a stable free trade system. Second, while the hegemon gains benefits from the free trade system, non-hegemons gain more benefits because they free ride the free trade system. In the coercive leadership model, the second proposition is not always true.

6) See Grunberg (1990, pp.439-42)'s argument for a critical review of the benevolent leadership model. Grunberg categorizes Gilpin's argument as that of the benevolent leadership model. We regard Gilpin's argument in 1981 as the realist theory of hegemonic cycle, and that in 1975 and 1987 as the coercive leadership model for the theory of hegemonic stability.

1994).

3.2 Coercive leadership model

The other model in the theory of hegemonic stability is the coercive leadership model, proposed by Gilpin (1975, 1987), Krasner (1976), and others. In this model, the hegemon supplies, for its own interest, the free trade system, which has the nature of international public goods, and as a result benefits are brought to the non-hegemon. Stein (1984) points out the importance of self interest for the hegemon in this model. For example, the United States exhibited leadership in establishing the free trade system when Pax Americana was formed because it believed such an action was in its political, economic, and ideological interest (Gilpin, 1987). Importantly, the hegemon cannot only supply international public goods, but can also demand the non-hegemon to bear its share of the cost.

TABLE 2.4 Coercive leadership model

H \ N	free trade	protected trade
free trade	(4, 4)*	(2, 3)
protected trade	(3, 1)	(1, 2)

A characteristic of the coercive leadership model is that it takes threat power into consideration. In the benevolent leadership model, the hegemon cannot force the non-hegemon to bear the cost, or finds it difficult to exclude the non-hegemon from the use of international public goods. As a result of the non-hegemon's free riding, the hegemon's cost burden accumulates as the game is repeated, which may result in "imperial overstretch" (Kennedy, 1987). In contrast, in the coercive leadership model, the hegemon can impose free trade on the non-hegemon by elevating the cost of protected trade through threatening sanctions against it. Consequently, free riding by the non-hegemon is controlled, and the free trade system is supplied through collective action of the hegemon and the non-hegemon. In Table 2.4, the preference of the hegemon (H) is the same as that of Table 2.3, but the non-hegemon is forced to choose free trade if the hegemon prefers free trade. Therefore, the preference orders of both countries, R_{H} and R_{N}, are as follows; $R_{\mathrm{H}} : x, z, y, w, R_{\mathrm{N}} : x, y, w, z$.

Another characteristic of the coercive leadership model is its emphasis on the importance of the relative ability of the hegemon. In the benevolent leadership model, the absolute ability of the hegemon is focused: the greater the hegemon's economic ability is, the more free riding by the non-hegemon the hegemon can allow while maintaining the

free trade system. On the other hand, in the coercive leadership model, the relative ability of the hegemon is important. The ability to impose cost burdens on the non-hegemon is important for a centralized supply of international public goods. That ability derives from the power relationship between states. Because of this difference, the two models have different explanations on why the decline of hegemony destabilizes the free trade system. According to the benevolent leadership model, the decline of the economic ability of the hegemon that supplies international public goods destabilizes the free trade system while, according to the coercive leadership model, the decline of the threat power that controls non-hegemons brings a crisis to the free trade system.

The theory of hegemonic stability clarifies the issue of free-riding non-hegemons by analyzing the stability of international economic order, using the theory of public goods. It is quite natural that this approach has developed in the United States when its hegemony is declining. The theory of hegemonic stability, however, does not offer a clear analysis of the role of the hegemon's power in the stabilization of international economic order. The power of a hegemon is obscured due to the use of the theory of public goods. The benevolent leadership model substitutes a "benevolent monarch" for the power of a hegemon, while the coercive leadership model focuses only on the threat power. Also, the theory of hegemonic stability considers very little the roles that non-hegemons or hegemonic international regime play in the stabilization of international economic order.

4. Evaluation of the Theory of Hegemonic Stability

Besides the above issues concerning the power of a hegemon and the roles of non-hegemons and hegemonic international regime, some other points need to be considered about the theory of hegemonic stability. Discussion here will concern a hegemon's free trade policy, free trade and security policy, the free trade system and international public goods, and possibility of international cooperation under a non-hegemonic system.[7)]

4.1 Free trade policy of a hegemon

First, we consider the free trade policy of a hegemon (Gowa, 1989; Grunberg, 1990). The theory of hegemonic stability assumes that a hegemon prefers free trade, and exhibits leadership in the organization and operation of the free trade system. However, a hegemon does not always prefer the free trade policy.

7) McKeown (1983) points following general questions about the theory of hegemonic stability. First, when is a hegemon established, and what is the indicator of the establishment? Second, the will and ability of non-hegemons are left unclear. Third, what is meant by "power," or "economic power"? How does a hegemon maintain its hegemony? Fourth, the issue of collective actions does not seem to apply to certain international systems that are oligopolistic, controlled by a small number of countries. Fifth, neither theoretical prediction nor empirical analysis of the development of a hegemonic system is given. For more discussion on the theory of hegemonic stability, see arguments by Keohane (1984), Gilpin (1987), Lake (1988), Webb and Krasner (1989), Gowa (1994), Mansfield (1994).

According to typical trade theories, a great power which has influence over terms of trade can maximize its economic welfare by the optimal tariff. That means that the free trade policy is not always an optimal policy for a hegemon.[8] The use of an optimal tariff by a hegemon, however, may be problematic in two ways. First, an optimal tariff may reduce the real income of the non-hegemon more than it increases the real income of the hegemon, and therefore is not always a superior method for international redistribution of income (i.e. exploitation of the non-hegemon) (Caves and Jones, 1981, p.208). If the hegemon is concerned about its long-term interest, it may be better off, for example, accepting bribes from the non-hegemon and imposing taxes on the non-hegemon under the free trade system. In some cases, however, the transaction cost which this approach accompanies is greater than the economic loss the tariff would produce, and the hegemon chooses the optimal tariff rather than free trade. Second, a hegemon sometimes chooses not to use an optimal tariff to maintain its monopoly power even when using it is possible. This can be compared to a domestic monopoly setting a price lower than the short-run optimal price to prevent new market entry. In such a case, the hegemon sets a tariff rate lower than the optimal level although it does not mean that the hegemon always chooses the free trade policy, under which the tariff rate is zero.

When the hegemon determines its trade policy, it probably considers the domestic economic situation and political pressure, and possible retaliation from its trade partner. If domestic economic aggravation gives rise to strong political pressure to seek protected trade, it becomes difficult for the hegemon to adopt the free trade policy. On the other hand, if its trade partner can take retaliatory measures against its protected trade policy, a hegemon may not have any alternative but to adopt the free trade policy although the non-hegemon can retaliate only when the hegemonic system has come to an end.

Those who are involved in empirical studies on a hegemon's free trade policy are critical of the theory of hegemonic stability. Regarding the formation of free trade system, Krasner (1976) asserts the theory of hegemonic stability and emphasizes the role of the hegemon, while Stein (1984) stresses the significance of the non-hegemon who follows the hegemon. Also, McKeown (1983) indicates that the change in European countries' tariff rates in the 19th century had a stronger relationship with domestic business cycle than with the leadership of the hegemon. Furthermore, Cowhey and Long (1983) explain that the transformation of the international regime in the automobile trade was caused not by the decline of the hegemon but by excessive capacity, and argue that the decline of the hegemon is a necessary but not sufficient condition of the collapse of an international

8) According to the theory of optimal tariff, a hegemon would face the asymmetrical chicken-stag hunt game (Conybeare, 1984, pp.14-15). If the offer curve of the hegemon is infinitely elastic and if that of the non-hegemon is elastic, the game has the structure of a chicken game for the hegemon, and of a stag hunt game for the non-hegemon. As a result, the dominant strategy of the non-hegemon will be a cooperative one, but the hegemon will take a non-cooperative strategy as long as it thinks that the non-hegemon will not retaliate.

regime.[9)]

4.2 Free trade and security policy

Next, we consider the relationship between the hegemon's free trade and security policy (Gowa, 1989). Sometimes, a hegemon needs to sustain the free trade system for its security or its commitment to the ideology of liberalism more than for its economic gains (Gilpin, 1987). The free trade under the Pax Americana during the Cold War regime played the role of uniting western allies ideologically. In some cases, free trade is sacrificed for the sake of the hegemon's security policy.

A hegemon chooses protected trade when trade liberalization would threaten its security. A country's participation in the free trade system will have external effects on its security. The abolition of trade restrictions influences not only the country's real income, but also its security. The source of trade benefit which trade liberalization brings is the efficient use of domestic resources. Such efficient resource allocation releases military-purpose economic resources. Thus, trade liberalization may strengthen potential military powers, destabilizing the existing balance of power between countries. When trade liberalization would lead to the expansion of the military capability of the non-hegemon, which then would threaten the hegemon's security, the hegemon chooses the protected trade.

Sometimes, the hegemon chooses a more direct method, that is, to impose export restrictions on some strategic commodities to guard against countries which may threaten its security, or to ensure the domestic supply of those commodities. The protected trade is also chosen if commodities in which a country has a comparative disadvantage is strategically important for its security: under the free trade system, the country would depend on imports for the supply of those commodities. For example, the United States has "techno-nationalism," that asserts that it is necessary for its security to keep its high tech industry at the top of the world. In 1983, when the market share of imported machine tools surpassed 17.5%, the U.S. Machine Tool Manufacturers Association demanded the committee for trade restriction according to Article 232 of the 1962 Trade Expansion Act (National Security Act).

Furthermore, the hegemon sometimes sacrifices free trade by linking trade liberalization

9) Those involved in empirical studies of other topics than international trade are also critical of the theory of hegemonic stability. Keohane (1980, 1984) studied the relationship between the American hegemony and the change in international regime concerning crude oil production and distribution, international currency, and industrial products trade in the postwar period. Accepting the validity of the theory of hegemonic stability as a first approach, he pointed out its limitation. Gowa (1984) argues that the discussion of international currency system reform in the late 1970's cannot be explained only by the decline of the American hegemony, and that the trends in the U.S. Congress and the world economy should also be considered. Eichengreen (1989) argues that the stability of the international currency system takes more than the existence of a hegemony, and that the international cooperation of non-hegemons is important.

and security issues, and using the former to draw out concessions from the non-hegemon on the latter. Gadzey (1994) stresses the validity of the embedded hegemony model rather than that of the theory of hegemonic stability in understanding the post-World War II trade liberalization (1954-65).[10] According to the model, the hegemon poses different trade liberalization requests to non-hegemons depending on the importance of security issues. The United States, in dealing with militarily important regions such as Europe and Far East, opened its domestic market unilaterally to gain their cooperation on security issues, and tolerated delay of trade liberalization by its allies such as the U.K. and France while it demanded trade liberalization from other countries quite strongly.

4.3 Free trade system and international public goods

The theory of hegemonic stability regards the free trade system as international public goods.[11] In general, international public goods are characterized by non-rival and non-excludable consumption. The benevolent leadership model regards the free trade system as pure international public goods, which satisfy both criteria of non-rivalness and non-excludability. The coercive leadership model, although based on the assumption that the hegemon is capable of exclusion, basically regards the free trade system as non-rival international public goods. A question remains, however, as to whether the free trade

10) Gadzey (1984) proposes four models for the relationship between free trade and a hegemon. His ① benevolent leadership model and ② coercive leadership model are the same as those of Snidal (1985). In his ③ mercantilist hegemony model, a hegemon practices free trade for its own interest as in the case of the coercive leadership model, but it uses free trade as a political instrument to exploit non-hegemons. The relationship between the hegemon and the non-hegemon in this model is zero-sum. In his ④ embedded hegemony model, the power of a hegemon is weaker than in other models, and non-hegemons are assumed to have enough power to make political or economical negotiations with the hegemon. Such a vulnerable hegemon uses free trade as a political instrument to draw concessions on security issues out of non-hegemons. In the case of the theory of hegemonic stability, the development and maintenance of free trade system is the goal for the hegemon whereas in models ③ and ④, free trade is merely an instrument to achieve other political or economic objectives.

11) Conybeare (1984, pp.7-8, 20) indicates the following relationship among trade liberalization, international public goods, and the Prisoners' Dilemma. The trade liberalization game can fall into the Prisoners' Dilemma, but that is different from the problem for the supply of international public goods. The game of international public goods supply can also fall into the Prisoners' Dilemma, but the Prisoners' Dilemma need not have the nature of international public goods. The difference between the game of international public goods supply and the Prisoners' Dilemma is as follows. First, difference in non-optimality: the level of non-optimality depends on how public the goods are and how many beneficiaries there are in case of international public goods. It depends on the game structure and the institutional agreements, regardless of the public nature of goods or the number of participants, in the case of the Prisoners' Dilemma. Second, difference in externality: externality in case of international public goods concerns collective actions in supplying non-excludable goods. In the Prisoners' Dilemma, externality concerns changing the decision by respective countries. Third, difference in policy: to resolve the Prisoners' Dilemma, a deterrence mechanism to prevent, for example, unilateral imposition of tariff is necessary. To ensure the supply of international public goods, an enforcing mechanism to make potential free riders participate in the supply is necessary. Enforcement is more difficult to do than deterrence.

system really meets the criteria of international public goods (Conybeare, 1984; Stein, 1984; Snidal, 1985; Gowa, 1989; Grunberg, 1990).

It is hard not to assume rivalry in consumption where it is difficult to allocate benefits among actors. In particular, non-rivalness within a specific trade sector is hard to expect. Also, it is difficult to accurately estimate how much benefit is gained using the free trade system, and then it is difficult to evaluate the level of non-rivalness. According to the benevolent leadership model, non-hegemons become free-riders, and therefore, do not declare the right preference regarding free trade. Even in the case of the coercive leadership model, which assumes that non-hegemons are forced to bear costs, it is questionable to regard such a burden as the proof of benefits gained from free trade.

Also, the hegemon can exclude others from the use of the free trade system if transaction costs are sufficiently low. Excludability is tied to the ability of a country to impose trade restrictions to prevent others from gaining benefit from the free trade system. The hegemon, according to the coercive leadership model, is assumed to have the excludability and the ability to force burden on non-hegemons. Even in the benevolent leadership model, the hegemon is assumed to have minimum excludability. If, however, transaction costs to punish free riders and to organize and operate the free trade system are sufficiently high, the free trade system may be non-excludable.

Furthermore, the possibility of the shared consumption of the free trade system does not necessarily contradict the free trade system as private goods. According to the mercantilist hegemony model, the free trade system is not something that is supplied as international public goods like international trade order, but is a means for a hegemon to pursue its economic gains and to exploit non-hegemons. The free trade practiced by a hegemon under such condition is "free trade imperialism" (Gallagher and Robinson, 1953). Also, according to the embedded hegemony model, free trade is a means for political dealings used by a hegemon to draw concessions out of non-hegemons on security issues (Gadzey, 1994). In these models, the free trade system is a private means to achieve political and economic objectives.

Thus, the free trade system does not satisfy the criteria of non-rivalness or non-excludability in consumption, and has limited significance in terms of its "use" as international public goods. The free trade system, however, has an aspect of international club goods, whose "existence" as a system is significant.[12)]

4.4 Possibility of international cooperation under a non-hegemonic system

Finally, reviewed here is the possibility to organize and operate governance mechanism by international cooperation among countries under a non-hegemonic system (Snidal, 1985; Gowa 1989). Can governance mechanisms alternative to a hegemon, such as Pax

12) If the free trade system maintains stable trade order, and promotes economic development of club participants, the "existence" of free trade system itself is significant. Free trade rules, however, are neither necessary nor sufficient conditions for stable international trade order.

Consortis or Pax Diplomatica, conceived in post-hegemonic system theory organize and operate a stable international economic order?

While the theory of public goods assumes that a small group can be an effective substitute for a privileged group (i.e. hegemon), the theory of hegemonic stability is skeptical of collective actions by countries. According to the theory of hegemonic stability, it is not always easy for countries to make collective actions because a sovereign state is a self-interested and rational actor, and also because the authority with centralized power that forces cooperation among countries does not exist in the international community. A small group of voluntary states faces political and economic challenges that a hegemon would not face in the development of a stable international economic order. For example, how to develop a small group in the world where transaction costs exists, and how to monitor actions of each country; even if the solution of these problems is theoretically possible, the question of whether a required transaction cost is realistic remains. The existence of a hegemon is a way to internalize these external issues that accompany collective actions (Eichengreen, 1989, p.255).

Collective actions, however, are not impossible (Caporaso, 1993), if a mechanism in which selective incentives and compelling power (Olson, 1965), or reciprocity and confidence between countries are incorporated, even if actors are assumed to be self-interested and rational as the theory of hegemonic stability argues. The possibility of collective actions depends on the nature of the strategic mutual dependence between countries. If collective actions are possible, the organization and operation of a stable international economic system can be done through international cooperation between countries, without a hegemon. Under such circumstances, the theory of hegemonic stability has less validity. Snidal (1985) presents, in the form of a characteristic function game, a model in which problems concerning collective actions are solved by a small group which substitutes for a hegemon. One must remember, however, that his model describes a cooperative game, and has a limitation in that transaction cost is not considered.

The theory of post-hegemonic system is conceived on the assumption that such collective actions are possible and that transaction cost is sufficiently low. The system of the economic summit meetings of industrialized nations stands on this expectation, but it should be remembered that the system is a mere facade of what is really a hegemonic system called Pax Americana II.

5. Structure of the Theory of Hegemonic Cooperation

5.1 Commercial power and trade liberalization

While the theory of hegemonic cooperation emphasizes the power of a hegemon and the role of non-hegemons in the development and maintenance of a stable international economic order, the theory of hegemonic stability does not provide a clear analysis of them. The theory of strategic organization in hegemonic cooperation by Yarbrough and

Yarbrough (1992) explicitly considers incentives for a hegemon and non-hegemons, but is not clear about the power of a hegemon. In this section, the commercial power of a hegemon and the role of non-hegemons in trade liberalization will be clarified.

(1) Three faces of the commercial power: the commercial power of a hegemon is its ability to achieve its commercial objectives by influencing the non-hegemons' trade policy decisions. The commercial power in this sense has three faces; the integral power, the threat power, and the compensate power.

The integral power is a hegemon's ability to affect the trade policies of a non-hegemon, through psychological persuasion and agreements, or through politico-cultural influence (Cox, 1981, 1983, 1987, 1993; Gill, 1990, 1993). The most desirable situation for a hegemon is where non-hegemons liberalize trade while liberal ideology and the free trade philosophy function effectively. The integral power might be analyzed from the perspective of the credibility and reputation of a hegemon's trade liberalization policies. Under the Cold War regime, the integral power functioned effectively under the GATT system, which is a hegemonic international regime of Pax Americana. When this integral power is not effective, a hegemon tries to promote trade liberalization by compensatory power or threats.

In the negotiation stage of trade liberalization, a hegemon coordinates interests of countries and provides rewards to them. Here, a hegemon is acting as the compensatory power. For trade liberalization to be supported by countries, acceptable allocation of its benefit and cost needs to be made in advance.[13] In the negotiation stage, the hegemon offers incentives for liberalization to non-hegemons. Incentives need to be large enough to make non-hegemons abandon protected trade that is based on transaction costs and opportunism. In other words, the hegemon needs at least to compensate for the adjustment cost and transaction cost that are incurred by countries due to their consent to liberalize trade. The hegemon provides countries with side payments or political convenience which absorbs those costs to ensure their consent. For example, the United States provided assistance to the western allies based on the Lend-Lease Act (1941) to gain their support for the development of free trade system after World War II. Also, during the period in which GATT was developed, many of the western allies were excused from GATT obligations. The incentive for consent increases with the side payment or political convenience.

In the monitoring stage of a free trade system, the hegemon exercises compelling power to non-hegemons. There, the hegemon is acting as the threat power. The hegemon monitors non-hegemons which have agreed to liberalize trade, and punishes their opportunistic actions. It takes sanctions against non-conforming countries by changing its security or external economic policies. The threat and the compensatory power of a

13) A country which intends to change trade rules, needs to device a "lump sum transaction" to offset disadvantages any specific group would suffer in distribution as the result of the change (Brennan and Buchanan, 1985).

hegemon stand on its overwhelming advantage in power bases, which includes military and economic ability. The decline of hegemony means that the hegemon's power and its bases are weakened, and makes it difficult for the hegemon to organize and operate the free trade system.

(2) Trade liberalization under hegemonic cooperation: we explain the commercial power of a hegemon and trade liberalization using a simple power game. The hegemon holds the commercial power over the non-hegemon when the following conditions exist. First, the non-hegemon makes a political decision to liberalize trade or not. Next, after confirming the non-hegemon's decision, the hegemon determines its trade policy (i.e. strategy of reciprocity). The optimal realistic situation for the non-hegemon is the economic situation that is chosen with highest preference among possible, realistic economic situations assuming that the hegemon takes the optimal trade policy. Under such a condition, if there is among all the economic situations that can be chosen by the non-hegemon at least one ideal economic situation which is, first, preferred by the non-hegemon to the optimal realistic situation and, second, achieved by any other choice than by the choice of that optimal realistic situation, then, the hegemon holds the commercial power over the non-hegemon.

The hegemon's commercial power in the power game in trade liberalization can be divided into the threat power and the compensatory one. Assuming that the non-hegemon can choose a trade policy which can realize an ideal economic situation, the economic situation that is expected to emerge in the non-hegemon as the result of the hegemon's optimal policy decision that is made after the non-hegemon's adoption of the said policy is called the avoided realization situation. If this avoided realization situation is worse than the present situation for the non-hegemon, and if the optimal realistic situation is equal to the present situation, the hegemon has the threat power over the non-hegemon. If the avoided realization situation is equal to the present situation, and if the optimal realistic situation is better than the present situation, the hegemon has the compensatory power over the non-hegemon.

Fig. 2.1 shows trade liberalization under hegemonic cooperation in the form of a power game. The payoff of the two countries is the same as that of the dilemma of trade liberalization of Table 2.2. The right side shows the payoff of the hegemon (H), and the left side shows that of the non-hegemon (N). In the previous example, under the symmetrical power, both countries chose strategies simultaneously, or without knowing each other's choice. In this game, the non-hegemon is forced to choose a strategy first. The hegemon can take the strategy of reciprocity, that is, to offer a reward (i.e. the opening of its market) if the non-hegemon chooses free trade, and take sanctions (i.e. import restriction) if it chooses protected trade. Under such conditions, basically, the hegemon's strategy of reciprocity constitutes its commercial power. The strategy of reciprocity can be expressed using the trigger or tit for tat strategy in the game theory (Friedman, 1990). The ideal economic situation for the non-hegemon is where it chooses protected trade and has the

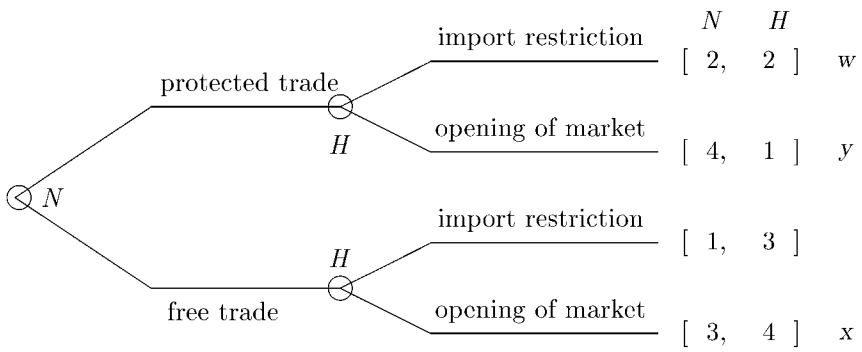


FIGURE 2.1 Trade liberalization under hegemonic cooperation

hegemon open its market. The trade policy optimal for the hegemon, however, is to close its market if the non-hegemon chooses protected trade. The non-hegemon cannot prevent the hegemon from making this choice. Therefore, the optimal, realistic situation for the non-hegemon is where it chooses free trade and has the hegemon open its market. Thus, the non-hegemon accepts trade liberalization at the game's equilibrium, which is the subgame perfect Nash equilibrium in this game.

This game represents the most typical, extensive-form power game. The commercial power of the hegemon is expressed by the hegemon's ability to force the trade partner to lay down its hand first, and to adopt the strategy of reciprocity (i.e. trigger or tit for tat). The non-hegemon, being under the power control of the hegemon, cannot act likewise. An important characteristic of the stabilization of international economic order under hegemonic system is this reciprocity through the hegemon's power.[14] The conventional theories of hegemony do not offer a clear perception of such power. An exception is the argument made by Alt, Calvert and Humes (1988) although their interest is in security issues, and not issues concerning the stabilization of international economic order. Also, they do not offer a clear description of the integral or the compensatory power.

While the theory of hegemonic stability understands the hegemon as a necessary and sufficient condition for stable international economic order, the theory of hegemonic cooperation regards it as no more than a means to avoid the dilemma of international cooperation, arguing that international cooperation is not impossible even if there is no hegemon as long as a reciprocal relationship exists among countries.

5.2 Reciprocal strategy of the United States

We will examine the reciprocal strategy of the United States, using the theory of hegemonic cooperation. Both Article 301 of the Trade Act, and Super 301 of the 1988

14) The reciprocity by power, as discussed here, is different from the multilateral, multi-sector, non-enforcing reciprocity under the GATT: it is bilateral, sector-specific, and enforcing (with retaliatory measures). See arguments by Keohane (1986) for reciprocity.

Omnibus Trade Act of the United States are intended to promote trade liberalization by reestablishing America's commercial power by the reciprocal (trigger or tit for tat) strategy in the hegemonic declining age, the period in which the economic superiority of the United States shows a relative decline.

The United States has always positioned reciprocity as one of its basic strategies in its external trade policy. Yet, the content of the reciprocity is now swaying widely between the to-give-to-be-given and the an-eye-for-an-eye approach. The reciprocity practiced by the United States under the GATT system was of the to-give-to-be-given type but as America's relative economic superiority diminishes, the nature of its reciprocity is tilting toward the an-eye-for-an-eye type. The shift in the reciprocity was materialized in Article 301 of the 1974 Trade Act. In the 1980s, the Reagan Administration positioned this article at the center of the U.S. trade policy, and eventually established Super 301 in the 1988 Omnibus Trade Act.

The reciprocity represented by Article 301 of the Trade Act and Super 301 can take different forms depending on the emphasis. First, there is reciprocity which emphasizes the use of retaliatory measures. The emphasis is on the use of retaliatory measures to stop exclusive or unfair trade practices by a trading partner. Second, there is reciprocity which emphasizes equal opportunity. The goal here is to ensure that the same rules as used in one's own market are applied in the trading partner's market. Third, there is reciprocity which emphasizes equal outcomes. The focus is on the outcome rather than the rules of competition. Examples of such outcomes include the equalizing of market access or trade balance.

Super 301 performs the following points for the U.S. government: it investigates unfair trade practices of other various countries and reports the investigation in the U.S. Congress and adopts retaliation steps for the unfair trade practices. The article has the following problem: the U.S. government judges the fairness or unfairness for one about the trade practices of the other countries. This article also turns over multilateralism, non-discrimination and a neutral dispute solution in the GATT=WTO system, and adopts bilateralism, discrimination and solution for one (Bhagwati, 1988; Bhagwati and Patric, 1990; Krueger, 1995).[15] However, this article opens one possibility only for a point of trade liberalization.

The role of Super 301 in the trade liberalization game is to make the trading partner accept America's demand, by either changing the payoff matrix of the U.S. government, or forcing the trading partner to make the first move.[16] The fundamental mechanism of trade liberalization here is the reciprocal (trigger or tit for tat) strategy. If this is to be indicated using Fig. 2.1, the United States (H) forces the non-hegemon (N) to accept free trade, by demanding that the non-hegemon make the first move. Super 301 is the strategy where the United States will practice free trade if the non-hegemon chooses free (i.e. fair) trade, but will impose import restrictions (i.e. retaliatory measures) if the

15) See also Bayard and Elliot (1994) for Super 301.

16) See also McMillan (1992) for the role of Super 301 in the trade liberalization game.

non-hegemon chooses protected (i.e. unfair) trade. In the game shown in Fig. 2.1, the free trade system is achieved as the game's equilibrium, as the result of the non-hegemon choosing free (i.e. fair) trade, and then the United States also choosing it. Only the United States, the hegemon, can unilaterally exercise such reciprocal (trigger or tit for tat) strategy.

Article 301 of Trade Act and Super 301 extend power games in the explicit form of a reciprocal (trigger or tit for tat) strategy. Those power games were previously hidden in the U.S. trade policy. It seems that, as its hegemony weakens, the United States is trying to revive its commercial power by those laws. The hegemonic decline is evident, however, from the fact that the United States now needs to deal with each country separately according to these laws, instead of dealing with countries collectively in multilateral negotiations as it had done previously.

As its hegemony declines, the United States needs to use multilateralism under the GATT=WTO system, regionalism such as NAFTA and APEC, or reciprocity or bilateralism based on Article 301 of the Trade Act or Super 301, depending on the situation (i.e. multi-track approach) to sustain the free trade system for political and ideological objectives although it is not always economically optimal for it to do so. It needs to sustain the system because liberalism or free trade, along with democracy, is the fundamental philosophy of Pax Americana (Nau, 1990).

6. International Cooperation after Hegemony

The theory of hegemonic cooperation emphasizes the roles of the hegemon's power and hegemonic international regime in the stabilization of international economic order. Power (i.e. reciprocity) and international regime play important roles in the international economic community after hegemony. We clarify how a self-binding international economic agreement promotes the stabilization of international economic order in the international economic community after hegemony, and how that is made possible by economic hostage and issue linkage.

6.1 Self-binding trade liberalization

Realizing stable international economic order in the international economic community after hegemony requires some kind of governance mechanism which replaces hegemony. A way to restrain opportunism and to avoid the dilemma of international cooperation is to design self-binding international economic cooperation, which uses future benefits to be gained from the continuous trading relationship[17] as an incentive for present cooperation.

17) Continuous transaction relationship is significant for trade liberalization because of two factors (Yarbrough and Yarbrough, 1986, 1987; Gowa, 1989). First, the existence of investment for trade-related transactions adds premium to a continuous trading relationship. Second, where a continuous trading relationship is possible, linkage created between different points in time allows future benefits to work as incentives for cooperation. Due to these factors, a continuous transaction relationship can

In a self-binding trade liberalization agreement, no third party intervenes in processes such as the enforcement of the agreement, the confirmation of breach, the evaluation of damage, or the execution of punishment. The only available retaliatory measure against opportunistic breach of the agreement is the revocation of the agreement. Each country will exercise the strategy of reciprocity (i.e. trigger or tit for tat) that is to follow the trade agreement as long as the opponent practices free trade, and to suspend it if the opponent practices protected trade. A self-binding trade liberalization agreement has a tacit, built-in component, which is the reciprocity that a country would change its policy attitude depending on the trading partner's policy decisions. A characteristic of a non-hegemonic system is that each country can take such reciprocal (i.e. trigger or tit for tat) strategies.

Reciprocity constitutes a compelling mechanism, which replaces third-party intervention in promoting trade liberalization, and is an important characteristic of a self-binding trade liberalization agreement (Yarbrough and Yarbrough, 1986, p.15). The explicit embodiment of retaliation threat makes a trade agreement self-binding, and reduces the need for third-party intervention to punish opportunism. A major reason why self-binding trade agreements are preferred is the high arbitration cost of third-party intervention. For example, the dispute settlement procedure provided in Article XXIII of GATT was not necessarily effective. When the transaction cost of institutional enforcement method is sufficiently high, an informal system is used. It is also difficult for a third party to take effective sanctions against a sovereign state. In such a case, the use of a self-binding trade liberalization agreement is effective.

Consider the trade liberalization game between countries J and A, as indicated in Table 2.1. Under a self-binding trade liberalization agreement, each country decides whether to keep a promise or not, only according to its own payoff. Assume country A adopts a reciprocal (i.e. trigger) strategy to continue the trade agreement if country J practices trade liberalization, and to abandon it if country J practices protected trade. Under such conditions, country J observes the trade agreement only when the discounted present value of the payoff expected to be gained by free trade is greater than that by protected trade. The condition for the trade liberalization agreement to be self-binding for country J at date t can be expressed as the equation below (Axelrod, 1984).

$$\sum_{t=1}^{\infty} \delta_J^{t-1} F_J \;\geq\; T_J + \sum_{t=2}^{\infty} \delta_J^{t-1} P_J. \tag{1}$$

If δ_{J} expresses the discount factor for country J, α_{J2}, the termination probability of the game, and α_{J1}, the subjective time preference rate of the country J, then, $\delta_{\mathrm{J}} =$

promote or obstruct trade liberalization. The need to continue transactions, which arise from the existence of transaction-specific investment, is the source of the trade liberalization dilemma, and can obstruct trade liberalization. A continuous transaction relationship, however, can also curb opportunism by linking present cooperation and future benefits.

$[1-\alpha_{J2}]/[1+\alpha_{J1}]$. Therefore,

$$[1/(1-\delta_J)]F_J \geqq T_J + [\delta_J/(1-\delta_J)]P_J. \tag{2}$$

The left side of the equation is the discounted present value of the payoff expected to be gained by free trade, and the right side is that by protected trade. The discounted present value of the expected payoff in case of protected trade can be divided into two components: T_J and $[\delta_J/(1-\delta_J)]P_J$. T_J is the payoff which country J would gain by committing opportunistic violation of the trade agreement. $[\delta_J/(1-\delta_J)]P_J$ is the discounted present value of country J's expected payoff starting from the next date.

Eq. (2) can be rewritten as eq. (3).

$$\delta_J \geqq [T_J - F_J]/[T_J - P_J]. \tag{3}$$

If country J's discount factor δ_J is large enough, the trade liberalization agreement becomes self-binding. According to eq. (3), the probability that the trade liberalization agreement be self-binding is greater, if the countries have longer term perspectives and attach greater importance to their future payoff, and if the benefits of protected trade are smaller (or their opportunity cost is greater). The existence of an international regime for trade liberalization will promote trade liberalization, by reducing the probability of game's termination and countries' subjective time preference rate, and increasing countries' discount factors.

A self-binding trade liberalization agreement can grow from bilateralism or regionalism (which is formed by a small number of countries) into a multilateral relationship. For example, by-country negotiations joined Mexico to the U.S.-Canada Free Trade Agreement to form NAFTA, and are now going on to include Latin American countries into that agreement. These country-by-country negotiations constitute a way to realize a multilateral relationship even if they are not a post-hegemonic trade liberalization agreement. This type of trade liberalization method, however, differs from the multilateral method exercised under the GATT system established by the U.S. hegemony.

6.2 Economic hostage and issue linkage

Ways to satisfy conditions of self-binding trade liberalization as expressed in eq. (3) include the use of an economic hostage or issue linkage (Yarbrough and Yarbrough, 1986, 1987).

(1) Economic hostage: an economic hostage is a binding advanced commitment made by each country. Depending on its value, an economic hostage reduces the benefit of opportunism (e.g. T_J), or increases the cost of protectionism. Also, it conveys to the opponent the message that the country has no intention to act on opportunism. When the trade liberalization agreement lacks a reliable legal enforcing mechanism, things such as transaction-specific assets, unilateral economic dependence, reputation, and side payment

can take the form of an economic hostage to satisfy the condition for self-binding trade liberalization.[18)]

For example, the use of technical trade barriers, such as those related to safety, pollution, and health, is a way for the importing country to draw an economic hostage from the exporting country. The requirements or barriers posed by the importing country necessitate investment by the exporting countries in transaction-specific assets. If the exporting countries act on opportunism, it may lose the economic hostage (i.e. the transaction-specific assets) due to sanctions by the importing country. This apprehension works as an enforcing mechanism to ensure that the exporting country observes existing trade agreements. Also, if the importing country has invested in transaction-specific assets for import, or depends unilaterally on an exporting country for specific goods or services, such investment or unilateral dependence works as the economic hostage which deters opportunistic actions by the importing country.

(2) Issue linkage: issue linkage is an act that links different goods and services that are subject of trade liberalization, or links trade liberalization and other issue areas when negotiating trade liberalization issues (Mcginnis, 1986). For example, in NAFTA negotiations, a large number of areas are combined into a target package for trade liberalization effort. Another example is linking trade liberalization and security issues. In some cases, this linkage can satisfy the condition for self-binding trade liberalization, which may be unachievable by working only on trade liberalization. There, a trade liberalization game may be played, with national security held in hostage, and an intense international political situation can promote trade liberalization.[19)] Under such a situation, the benefits of trade liberalization (F_J) include not only economic but also security benefits, and also the cost of protected trade (i.e. decrease of P_J) includes security costs. This was a factor for the promotion of trade liberalization under GATT during the Cold War regime (Eckes, 1992).

Increases in multiple interdependence (Keohane and Nye, 1977, pp. 23-29) the type of interdependence which includes not only an international division of labor and other economic interdependence, but also mutual dependence in terms of politics, security, aid, etc. can turn each country's weaker areas, or the areas in which a country depends heavily on others, into hostages, thereby promoting trade liberalization. This can happen because, where there is multiple interdependence, the issue linkage satisfies the condition for self-binding trade liberalization even if the condition is not met within each issue area. The satisfaction of the condition can be made possible by expanding

18) A background to the U.S.-Japan economic friction having been handled more in favor of the United States is the unbalanced mutual dependence between the two countries.

19) Another reason why U.S.-Japan economic friction has been handled more in favor of the United States is that the Japanese national security has been held hostage under the U.S.-Japan Security Treaty. Taking the FSX issue in 1987 for example, although it was not of course a purely economic friction issue, Japan abandoned the domestic development of the fighter for fear of aggravating the security relation of the two countries.

the range of transactions that may be terminated as punishment for the violation of the agreement, thereby increasing the cost of opportunism. While the issue linkage helps trade liberalization in some cases, one should not think, however, that it always helps the process because it can also allow the process to be influenced by disputes in other issue areas.

7. Conclusion

In this paper, a critical review has been made of the theory of hegemonic stability with a focus on the hegemon's power (i.e. reciprocity), and the structure of the theory of hegemonic cooperation, and the possibility of international economic cooperation in the international economic community after hegemony has been clarified. We summarize the discussion in this paper.

First, transaction cost and transaction-specific investment, or the danger of opportunism can put the stabilization process of international economic order into the dilemma of international cooperation. A governance mechanism which stabilizes international economic order is necessary to avoid such a dilemma.

Second, theories of hegemony emphasize the role of a hegemon as the governance mechanism to stabilize international economic order. The theory of hegemonic stability is based on the theory of public goods and emphasizes the importance of a hegemon's will and ability for the development and maintenance of the free trade system. Although the theory clarifies the issue of free-riding non-hegemons in the stabilization process of international economic order, it does not clarify the role of the hegemon's power.

Third, the theory of hegemonic stability has other problems that need to be addressed in addition to the issue of a hegemon's power. According to the theory of hegemonic stability, a hegemon prefers free trade, and exhibits leadership in the development and maintenance of the free trade system as international public goods. A hegemon's economic preference, however, is not always free trade. A hegemon may sacrifice free trade for security policy in some cases. Furthermore, seen from the perspective of the significance of its "use," the free trade system cannot be regarded purely as international public goods. Also, theories of hegemony reduce their validity where international cooperation among countries is possible with affordable transaction cost under a non-hegemonic system.

Fourth, the theory of hegemonic cooperation emphasizes the role of a hegemon's commercial power in the formation and maintenance of stable international economic order. The commercial power of a hegemon is the hegemon's ability to achieve its trade objectives by influencing non-hegemons' trade policy decisions. The commercial power has three faces: the integral, the threat, and the compensatory power. In the trade liberalization game under hegemonic cooperation, the commercial power of a hegemon allows the hegemon to force the trading partner to make a first move, and to adopt the strategy

of reciprocity. Non-hegemons accept trade liberalization in the game's equilibrium.

Finally, a way to stabilize international economic order in the international economic community after hegemony is to design a self-binding international economic agreement. Reciprocal strategies of countries are built in such an agreement. The uses of economic hostages or issue linkage are ways to make such an agreement work.

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